FASB Update

EACUBO

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Agenda

- Standard-Setting for Non-Public Entities
- FASB Not-for-Profit Advisory Committee
- FASB/IASB Convergence
- Other FASB Projects
  - Financial Instruments
  - Leases
  - Revenue Recognition
  - Fair Value
  - Additional ongoing projects
- Q & A

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Standard-Setting for Non-Public Companies

Many questions persist:

- Same standards as public companies (?)
- Same standard setter (?)

Recent developments:

- Increased concern about complexity of U.S. GAAP
- Perceived limited relevance of some recent standards in private company reporting (e.g., FIN 48)
- Ongoing simplification efforts in other countries (e.g., IFRS for SMEs, Canadian GAAP for Private Enterprises)

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SCHNEIDER DOWNS

Blue-Ribbon Panel

- Formed in December 2009, met 5 times
- Jointly sponsored by FAF, AICPA and NASBA
- Mission was to address how accounting standards can best meet the needs of users of U.S. private company financial statements (excluded NFPs)
- Comprised 18 members including preparers, users and practitioners
- Reached key decisions on GAAP and Board structure
- Presented recommendations to FAF in January 2011
  - Currently being considered by FAF Trustee Workgroup

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SCHNEIDER DOWNS

Blue Ribbon Panel Recommendations

- Private Company US GAAP
  - One GAAP with private company exceptions?
  - Baseline GAAP with add-ons for public companies?
  - Separate stand-alone GAAP for private companies?
- FASB Board Structure
  - Enhanced board or separate board?
  - Minority view: EITF-type structure
- Differential framework (set of decision criteria) is essential
- Shorter-term structural and process changes need to happen / continue to happen

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SCHNEIDER DOWNS

FAF Trustee Workgroup

- Considering the recommendations of the Blue-Ribbon Panel, especially concerning a separate standard setting board
- Part of strategic initiative on nonpublic entities (private companies and NFPs)
- Looking at the recommendations within the broad context of the U.S. financial reporting system
- Doing outreach to all key stakeholder groups, including those who did not weigh in significantly during the Blue-Ribbon Panel process
- Action Plan expected by late summer, followed by public comment period

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Recent Changes Focused on Nonpublic Entities

- Daryl Buck (private company preparer) added to the FASB Board
- Nonpublics staff team expanded, to help ensure greater outreach and more explicit consideration in each project
- Nonpublics roundtables on major projects
- Semiannual nonpublics FASB Update webcasts being developed
  - Initial webcast planned for June 17, 2011 (for CPE)
- Work towards a differential framework
  - White paper being developed on users / uses and on the definition of 'public'
- Formation of the NAC
- Post implementation review of FAF (publics and nonpublics)

Challenges

- Standard setting – some ways similar to private companies, but a fundamental difference needs to be considered
  - NFPs have a much greater degree of public accountability
  - Much wider distribution of financial statements
- The FAF is considering the standard-setting structure and approach for NFPs
- The FASB Not-for-Profit Advisory Committee (NAC) is examining the NFP financial reporting model to identify areas for possible standard-setting or educational action

FASB Not-for-Profit Advisory Committee (NAC)

- Established in October 2009 to serve as the standing resource for the FASB in obtaining input from the NFP sector on:
  - Existing guidance
  - Current and proposed technical agenda projects
  - Longer-term issues affecting those organizations
- 17 members, plus 3 participating observers
  - NFP financial officers, auditors, foundation and other donors, creditor, watchdog agency, charities regulator, attorney
- NFP Resource Group (> 100 members)

NAC – Marquis Project

- Three subgroups are working to identify potential improvements in NFP financial reporting for discussion at the next NAC meeting (September 2011)
  - Reporting financial performance
    - Statements of activities and cash flows: operating measures, net asset classes, functional and natural expenses, cash flow presentation, etc.
  - "Telling the story"
    - MD&A, functional expense reporting, segment reporting, summary financials
  - Reporting liquidity / financial health
    - Balance sheet and related footnotes
    - Liquidity and other financial health measures

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What will the Future Hold?

- FAF decision on Blue Ribbon recommendations
  - Separate Board?
  - Modified GAAP with exceptions?
- Future of IFRS convergence
  - SEC work plan
  - 2011 decision

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Convergence Overview

- Idea of single set of global accounting standards not a new one
- FASB-IASB convergence commitment since 2002
- Current MOU projects became focus of convergence efforts in 2006
  - **Goal: Convergence AND improvement**

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Joint Projects

- Revenue recognition
- Leases
- Accounting for financial instruments
- Financial statement presentation
- Insurance contracts
- Consolidation (Investment Companies)
- Consolidation (Voting Interest Entities)
- Reporting Discontinued Operations
- Emissions Trading Schemes
- Financial instruments with characteristics of equity

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FASB-Only Projects

- Goodwill impairment assessments
- Disclosure of loss contingencies
- Disclosure of risks and uncertainties and liquidation basis of accounting (going concern)
- Disclosures – participation in multiemployer plan
- Investment properties
- Disclosure framework
- Various EITF issues

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Convergence Timing

- Extended timetable for priority projects – Beyond June 2011

- Three remaining priority projects – Second half of 2011

- Insurance contracts – exposure draft expected during second half of 2011

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Financial Instruments

- Scope: all financial instruments, other than those under certain other standards (e.g. leases, pension obligations, etc.): NFP pledges receivable and payable also scoped out
- Major proposed changes of Note for Higher Ed:
  - Classification and Measurement
    - Most financial instruments on balance sheet at FV, except option to carry short-term trade receivables and payables, and some debt at amortized cost
    - Student loans receivable and much Higher Ed debt would be at FV
    - NAV still practical expedient for many investments in funds
  - Impairment
    - Improvements to the incurrent loss method: loan losses recognized would be those that are expected in foreseeable future, based on current economic conditions and historical data (rather than forecasts of future economic conditions)

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Financial Instruments: Due Process & Redeliberations

- Approximately 2,800 comment letters received
- Roundtables included one that was dedicated exclusively to nonpublic entities (especially community banks and credit unions)
- In middle of redeliberations, trying to converge IASB where possible

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Financial Instruments: Due Process & Redeliberations

- Key classification & measurement decisions made during redeliberations
  - Financial instruments classified first based on characteristics of the instrument and then based on business activity
  - Risky instruments with variable cash flow characteristics are classified and measured at fair value with changes recognized in net income
    - Included derivatives and equity securities
    - Practical expedient expected for nonpublic entities regarding nonmarketable equity securities
    - Board also redeliberating scope of equity method; expected to keep reject relatedness criterion

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Financial Instruments: Due Process & Redeliberations

- Final standard expected in 2011
- Effective date TBD
  - Likely not before 2014 or even 2015 for publics
  - Likely incremental delay beyond that of at least two years for nonpublics

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Financial Instruments

- Some Classification & Measurement developments of note for Higher Ed thus far during redeliberations:
  - Loans held for collection/payment of contractual cash flows at amortized cost
  - Most other (non-derivative) liabilities at amortized cost
  - Nonmarketable equity securities: practicability exception to FV for some or all nonpublic entities
- Joint FASB/IASB supplementary document on impairment issued for public comment

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Leases

- Major proposed changes
  - Lessee obligations recognized on balance sheet with a corresponding "right of use" asset (no "operating leases")
    - Factor in contingent rents, renewal options (if more likely than not)
    - Simplified (undiscounted) method for short-term leases
  - Interest expense on debt, amortization of right-to-use asset instead of rent expense: front-loads expense: increases EBITDA, but front loads expense
  - Lessor records receivable and relieves the leased asset (de-recognition approach) or records deferred revenue (performance obligation) depending on facts
    - The latter would likely be the case in most or all instances which Higher Ed institution is lessor/sublessor

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Leases

- Approximately 800 comment letters received
- Roundtables included one dedicated exclusively to nonpublic entities.
- Some key developments of note for Higher Ed thus far during re-deliberations:
  - Only factor in renewal options if significant economic incentive to exercise
  - Only factor in contingent rents if meet a high threshold (such as "reasonably certain")
  - Accounting policy option not to capitalize short-term leases (maximum of 12 months including any renewal options)
  - Staff exploring a "finance" versus "other-than-finance" distinction, with "lease expense" (similar in pattern to current "rent expense") being recognized for the latter type of lease (in lieu of interest and amortization expense)
- Final standard expected in 2011. Re-exposure?
- Effective date TBD
  - Likely not before 2014 or even 2015 for publics
  - Likely incremental delay beyond that of at least two years for nonpublics

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Revenue Recognition

- Scope: contracts with customers, excludes contributions, collaborative arrangements
- Major proposed changes:
  - Would eliminate over 200 pieces of guidance in U.S. GAAP, many of them industry specific
  - Rights/obligations approach rather than "earnings process" approach: revenue recognized as benefits transferred to customer and performance obligations fulfilled:
    1. Identify the contract(s) with a customer
    2. Identify the separate performance obligations with the contract
    3. Determine the transaction price
    4. Allocate the transaction price to the separate performance obligation
    5. Recognize revenue when the entity satisfies each performance obligation
  - Recognition pattern for some arrangements may change

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Revenue Recognition

- Major proposed changes (Continued)
  - Collectability factored into initial measurement of revenue (no longer a recognition threshold issue)
- Approximately 1,000 comment letters received
- Roundtables and a great deal of outreach, especially to industries with greatest potential impact (e.g., construction, technology, real estate, etc.)
  - U.S. roundtables had a heavy non-publics presence (e.g. construction, health care, etc.)
- Final standard expected in 2011. Re-exposure?
- Effective date TBD
  - Likely not before 2014 or even 2015 for publics
  - Likely incremental delay beyond that of at least two years for nonpublics

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Revenue Recognition

- Primary issues being re-deliberated:
  - Determining when goods/services are transferred and performance obligations fulfilled (crucial for construction and service entities such as Higher Ed institutions)
  - Identifying separate performance obligations
  - Service vs. lease arrangements
  - Onerous performance obligations
  - Contract modifications
  - Variable consideration
  - Effect of credit risk (collectability)
  - Warranties
  - Contract costs
  - Disclosures

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Revenue Recognition

- A couple noteworthy developments thus far during redeliberations:
  - Potential guidance for determining the (more continuous) transfer of a service (or a non-distinct bundle of goods or services) as opposed to a good
  - Potential display on a separate line, directly below revenue, of amounts not deemed collectible because of credit risk, rather than as either a direct reduction of revenue recognized (the proposal in the ED) or down in bad debt expense (Current GAAP)
- Important issue for Higher Ed and NFPs still to be deliberated: How to determine whether performance obligations are "onerous" in the context of a non-public driven mission

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Fair Value Measurements

- IASB is putting into place an equivalent of FAS 157 (Topic 820); we have been trying to converge where possible
- Primarily will affect U.S. GAAP disclosure rather than measurement
- Most significant change to U.S. GAAP
  - Adds qualitative sensitivity disclosures for measurement uncertainty for level three FV measurements
    - Requires (1) identification of key inputs for which material changes in fair value would result if another feasible value for the input were used (2) quantitative information indicating the numerical input used and (3) discussion of the nature of the change in fair value if another feasible input amount was used
    - Nonpublics exempt from part (3)

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Fair Value Measurements

- Other key changes to disclosures for public entities only:
  - Level tables for FV used in "FAS 107" disclosures
  - All transfers between Levels 1 and 2 (not just significant transfers)
    - Nonpublics will no longer have to disclose **any** such transfers
- Final standard (ASU 2011-4, IFRS 13) issued
  - Effective for public companies at the beginning of 2012;
  - For nonpublics at end of 2012

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Some Recent ASUs of Note

- ASU 2010-20 (Credit Quality Disclosures)
  - Better insight into loss recognition and nature of impairments of loans and other financing receivables
    - Includes both greater disaggregation in existing disclosures (e.g., loans in nonaccrual status) as well as new disclosures about credit quality indicators, aging of past-due receivables, etc.
    - IMPORTANT for NPOs: excludes pledges receivable
  - Public Entities:
    - Balance sheet disclosures: CY 2010
    - Activity disclosures: CY 2011
  - Nonpublic Entities:
    - All disclosures: CY 2011

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Some Recent ASUs of Note

- ASU 2010-25 (Reporting Loans to Participants by Defined Contribution Pension Plans)
  - Notes receivable (at unpaid balance and accrued interest), separate from plan investments
  - Effective for years ending after 12-15-2010; retrospective

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Ongoing FASB-only Projects of Note

- Assessing goodwill for impairment
  - To reduce costs, especially for nonpublic entities, proposing that Step 1 of the impairment test (comparing carrying value of reporting unit to fair value) is not required if an elective qualitative assessment indicates that it is more likely than not that goodwill is not impaired
  - Comments on ED due June 6; piloting Electronic Feedback Form; final standard expected in 3Q 2011
- Disclosure of certain loss contingencies
  - Investors complain that they often have no idea about litigation settlements until after the check has been written
  - FASB issued two ED's to attempt to rectify this concern but it is not clear this is a standard setting rather than a compliance issue
  - SEC letter has placed increased focus on compliance with FAS 5
  - Will consider approach forward after assessing quality of 2010 YE disclosures

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Ongoing FASB-only Projects of Note

- Risks and uncertainties (going concern)
  - Coordinating with SEC and PCAOB before proposing disclosures requiring earlier identification of circumstances that might lead to going concern issues
- Disclosures about an employer's participation in a multiemployer plan
  - Re-deliberating now; key issue is identification of quantitative measure of potential exposure

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Questions?

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