

# What Were They Thinking?!!

## 2008 Fall Workshop

Savannah

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## Session Agenda

- Approach to session (or how to cover nine hours of material in just 100 minutes!)
- Audience survey
- Overview of important information
  - Recently issued documents—within past two years—and upcoming effective dates for both GASB and FASB
  - Includes FASB's approach to standard setting for not-for-profit organizations...

## Session Agenda

- Detailed examination of selected standards
  - Alternating between FASB and GASB to (hopefully) avoid excessive boredom
    - FASB Statement No. 157
    - FASB Staff Position FAS 117-1...
    - GASB Statement No. 52
    - GASB Statement No. 53
- Questions—and maybe even some answers—about what I've covered *or* any other accounting topics you're interested in

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# Recently Issued GASB Documents

## GASB Pronouncements

- Statement 48—Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues (9/06)
- Statement 49—Accounting and Financial Reporting for Pollution Remediation Obligations (11/06)...

## GASB Pronouncements

- Statement 50—Pension Disclosures, an amendment of GASB Statements No. 25 and No. 27 (5/07)
- Statement 51—Accounting and Financial Reporting for Intangible Assets (6/07)
- Concepts Statement No. 4—Elements of Financial Statements (6/07)...

## GASB Pronouncements

- Statement 52—Land and Other Real Estate Held as Investments by Endowments (11/07)
- Statement 53—Accounting and Financial Reporting for Derivative Instruments (6/08)
- 2008-09 Comprehensive Implementation Guide (10/08)

## GASB Exposure Documents

- Exposure drafts
  - Fund balance reporting & government fund type definitions (2/08)
  - Service efforts & accomplishments (SEA) amending Concepts Statement No. 2 (4/08)
  - OPEB ARC adjustment (7/08)
  - GAAP hierarchy (8/08)...

## GASB Exposure Documents

- AICPA auditing standards addressing related party transactions, subsequent events, and going concern considerations (8/08)
- Request for response
  - Suggested guidelines for SEA reporting (7/08)

# Upcoming GASB Effective Dates

## GASB Effective Dates

- June 30, 2008
  - Statement 43—Phase II (OPEB plans)
  - Statement 45—Phase I (Employers OPEB)
  - Statement 48—Sales & Pledges of Receivables and Future Revenues
  - Statement 50—Pension Disclosures
- June 30, 2009
  - Statement 43—Phase III (OPEB plans)...

## GASB Effective Dates

- June 30, 2009
  - Statement 45—Phase II (Employers OPEB)
  - Statement 49—Pollution Remediation Obligations
  - Statement 52—Endowment Real Estate
- June 30, 2010
  - Statement 45—Phase III (Employers OPEB)
  - Statement 51—Intangible Assets
  - Statement 53—Derivatives •

## Questions?

# FASB's Approach to NFP Standard Setting

## FASB's Approach

- Actually a closer linkage exists to IASB (international) than to GASB (public)
- FASB adopted a *differences* approach for NFPs
  - Similar transactions accounted for similarly
  - Standards for unique transactions (e.g., contributions in FASB 116, FASB 136)
  - NFP reporting model (e.g., FASB 117)
  - Tailoring other guidance (e.g., FASB 124)

# Recently Issued FASB Documents

## FASB Pronouncements

- Interpretation 48—Accounting for Uncertainty in Income Taxes (6/06)
- Statement 157—Fair Value Measurements (9/06)
- Statement 158—Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (9/06)...

## FASB Pronouncements

- Statement 159—The Fair Value Option for Financial Assets and Financial Liabilities (2/07)
- Statement 160—Noncontrolling Interests in Consolidated Financial Statements (12/07)
- Statement 161—Disclosures About Derivative Instruments and Hedging Activities (3/08)...

## FASB Pronouncements

- Statement 162—Hierarchy of Generally Accepted Accounting Principles (5/08)
- Statement 163—Accounting for Financial Guarantee Insurance Contracts (5/08)
- FSP SOP 94-3-1 and AAG HCO-1—Omnibus Changes to Consolidation and Equity Method Guidance for Not-for-Profit Organizations (5/08)...

## FASB Pronouncements

- FSP FAS 117-1—Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds (8/08)

## FASB Exposure Documents

- NFP mergers and acquisitions (12/07)
- NFP goodwill (12/07)
- Accounting for hedging activities (6/08)
- Disclosure of certain loss contingencies (6/08)
- Amendments to FASB 140—transfers of financial assets *and* Amendments to FASB interpretation 46(R) (9/08)

# Upcoming FASB Effective Dates

## FASB Effective Dates

- To be determined
  - Statement 162—GAAP Hierarchy
- June 30, 2008
  - Statement 155—Certain Hybrid Financial Instruments
  - Statement 156—Servicing Financial Assets
  - FIN 48-1—Uncertainty in Income Taxes
  - EITF 06-2—Sabbaticals...

## FASB Effective Dates

- June 30, 2009
  - Statement 157—Fair Value Measurements
  - Statement 158—Pension and Other Postretirement Plans
  - Statement 159—Fair Value Option
  - FSP SOP 94-3-1 and AAG HCO-1—Consolidations / Equity Method Guidance...

## FASB Effective Dates

- June 30, 2009
  - FASB Staff Position FAS 117-1—Net Asset Classification and Disclosures for Endowments of Not-for-Profit Organizations...

## FASB Effective Dates

- June 30, 2010
  - Statement 161—Derivative Instruments and Hedging Activities Disclosures
  - Statement 163—Financial Guarantee Insurance Contracts •

## Questions?

# FASB 157

## Fair Value Measurements

## Fair Value Measurements

- Broad applicability to all sectors
  - NFPs are included
- Provides guidance on measuring fair value whenever fair value measurements already required under existing GAAP
  - Does not introduce new fair value measurements...

## Fair Value Measurements

- Definition
  - The price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date...

## Fair Value Measurements

- Price
  - Referred to as *exit price*
  - Determined in the *principal market*—the market with greatest volume and level of activity
    - If no principal market exists, then *most advantageous market* is used
  - Price does not include transaction costs

## Fair Value Measurements

- Three primary valuation techniques
  - Market approach relies on prices / other relevant information generated by transactions involving similar or identical assets or liabilities
  - Income approach relies on valuation techniques to convert future amounts (e.g., cash flows) to a single present amount (typically through discounting)

## Fair Value Measurements

- Cost approach utilizes amount required to replace the service capacity of an asset, typically referred to as replacement cost
  - Generally not applicable to investments in funds

## Fair Value Measurements

- Framework for measuring fair value
  - Asset—consider highest and best use
  - Liability—consider credit standing
  - Utilize one of the valuation techniques (i.e., market, income, cost)
  - Hierarchy of inputs
    - Identical market
    - Observable market
    - Unobservable market...

## Fair Value Measurements

- Ignore or adjust entity-specific inputs to reflect perspective of market participants
- Requires enhanced disclosures about fair value measurements...

## Fair Value Measurements

- Specific guidance for NFPs expected soon
  - Multiyear pledges
  - Split-interest gifts
  - Beneficial interests in trusts
  - Noncash contributions
    - Could be covered in Audit Guide revisions or FASB Staff Position

## Fair Value Measurements

- Effective date is June 30, 2009
  - Implementation effort for those affected will be massive
  - Start now by coordinating with treasury staff, investment advisors, and external auditors •

# GASB 52

## Endowment Real Estate Investments

## Endowment Real Estate

- Paragraph 19 of GASB 34 defines land as a capital asset
  - Requires recognition at cost (or fair value at time of donation)
- Many endowments hold land and other real estate for investment purposes
- Standard applies to real estate held as true and term endowments *but not quasi-endowments...*

## Endowment Real Estate

- True and term endowment real estate should be measured at fair value
- Changes in value should be reported in SRECNA as investment income
- Investment disclosures per paragraph 15 of GASB 31 should be presented as appropriate •

## Questions?

# FSP FAS 117-1 Endowments and UPMIFA / UMIFA

## FSP

- Uniform Prudent Management of Institutional Funds Act (UPMIFA)
  - Model act approved by National Conference of Commissioners on Uniform State Laws (07/06)...

## FSP

- Enacted by 24 states and DC so far; under consideration by several others
  - Nine SACUBO states and DC have enacted
- Updates the 1972 act, Uniform Management of Institutional Funds Act (UMIFA), in the area of investment management and endowment spending...

## FSP

- Eliminates concept of historic dollar value
- Enhances guidance on what constitutes prudent endowment spending
- Authorizes spending from “underwater” endowments
- Includes optional rebuttable presumption of imprudence for spending below 2% or above 7% of market value...

# FSP

- FSP's objectives
  - Provide guidance on net asset classification of donor-restricted endowment funds for not-for-profit organizations subject to UPMIFA
  - Improve endowment disclosures *whether subject to UPMIFA, UMIFA, or other state law...*

# FSP

- Key questions
  - Does ability to spend from “underwater” endowments affect net asset classification?
  - Does optional rebuttable presumption of imprudence impose a temporary (time) restriction on a portion of otherwise unrestricted funds?...

## FSP

- UPMIFA specifies that “Unless stated otherwise in the gift instrument, the assets in an endowment fund are donor-restricted assets until appropriated for expenditure by the institution.”
- Does above language impose a time restriction on a portion of otherwise unrestricted funds?...

## FSP

- Conclusions
  - If governing board determines that state law requires a portion of the fund—initial gift or appreciation—to be retained in perpetuity
    - That amount is permanently restricted
      - Other amounts are temporarily restricted or unrestricted...

## FSP

- If subsequent losses result in spending below amount required to be retained
  - Loss must be recognized in temporarily restricted until exhausted, then unrestricted
    - Because overall fund accountability is unchanged under UPMIFA—still accountable for full amount of fund...

## FSP

- Requirement to appropriate earnings for expenditure creates temporary restriction
  - Results in classification of all earnings (i.e., income and appreciation) as temporarily restricted net assets—even for endowments with no purpose restriction

## FSP

- An important caveat!
  - Be sure to read actual language in UPMIFA as adopted by individual state along with other relevant information
  - Might reach a different conclusion if law deviates from model legislation...

## FSP

- New disclosure requirements
  - Apply to all NFPs—not just those in states adopting UPMIFA
  - Must address net asset classification, net asset composition, changes in net asset composition, spending policy(ies), and related investment policy(ies) concerning endowment funds (both donor-restricted and board-designated)...

# FSP

- Minimum information
  - Description of board's interpretation of relevant law guiding net asset classification
  - Description of endowment spending (distribution) policy(ies)...

# FSP

- Description of endowment investment policy(ies)
  - Return objectives and risk parameters
  - How the objectives relate to spending policy(ies)
  - Strategies for achieving objectives...

# FSP

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

# Questions?

# GASB 53 Derivatives

## Derivatives

- Examples
  - Interest rate swaps
    - Variable rate to fixed rate
    - Fixed rate to variable rate
  - Swaption gives the purchaser the right to enter into an interest rate swap
  - Commodity swap reduces exposure to a commodity's price risk

## Derivatives

- Basic approach
  - Fair value with hedge accounting
    - Derivatives reported on statement of net assets at fair value
    - Fair value changes reported on SRECNA as investment income
    - Exception for *effective* hedges
      - Changes in fair value reported on statement of net assets using deferrals (i.e., charges or credits)

## Derivatives

- Measuring effectiveness
  - Effectiveness determined by using specified methods
  - Qualitative method
    - Consistent critical terms
  - Quantitative methods
    - Synthetic instrument
    - Linear regression
    - Dollar offset
    - Other comparable method at your option

## Derivatives

- Note disclosures—voluminous
  - Summary of *derivative instrument activity* sorted by
    - Fair value hedges
    - Cash flow hedges
    - Investment derivatives...

## Derivatives

- Within the three categories, segregate by type providing
  - Notional amount
  - Fair values and changes in fair value and where reported (i.e., statement of net assets or SRECNA)
  - Identify fair values of amounts reclassified from hedge to investment...

## Derivatives

- Disclosures for *hedging* derivatives
  - Extensive disclosures carried forward from Technical Bulletin 2003-1
  - Significant terms
  - Risks including credit, interest rate, basis, termination, rollover, market access, and foreign currency
  - Identification of “other” effectiveness assessment method if applicable, including its critical values...

## Derivatives

- Disclosures for *investment* derivatives
  - Risks including credit, interest rate, and foreign currency
- Disclosures of contingent features
  - Description of features
  - Aggregate fair value of instruments containing the features
  - Aggregate fair value of assets to be posted or transferred
  - Amounts posted or transferred

## Derivatives

- Disclosures for synthetic guaranteed investment contracts
  - Description and nature
  - Fair values of
    - Wrap contract
    - Underlying investments

## Derivatives

- Four key points
  1. Derivative instruments are reported on the statement of net assets and measured at fair value
  2. Changes in fair value are reported on the SRECNA, unless instrument is a hedging derivative

## Derivatives

3. Change in fair value of derivatives qualifying for hedge accounting are deferred and reported on the statement of net assets until termination (i.e., the hedged transaction occurs)
4. Massive disclosures are required for derivatives!!!

## Derivatives

- Effective date is June 30, 2010
  - Implementation effort for those affected will be substantial
  - Start now by coordinating with treasury staff, investment advisors, and external auditors •

# Accounting Update

## Questions, Comments, and Reactions

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