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100 Introduction

100.1 Nonprofit organizations range in size from small local organizations to large national and inter-national entities. Their scope covers almost every activity imaginable—health and welfare, religion, education, research, social organizations, and professional associations. It is estimated that there are more than one million nonprofit organizations in the United States.

What Is a Nonprofit Organization?

100.2 GAAP defines *not-for-profit entities* by contrasting them with *for-profit entities*. Specifically, FASB ASC 958-10-20[1] defines a *not-for-profit entity*[2] as an entity that possess the following characteristics not typically found in business entities:

a. They receive contributions of significant resources from resource providers who do not expect a commensurate or proportionate monetary return.

b. They operate for purposes other than to make a profit.

c. There is an absence of ownership interests like those of business enterprises.

100.3 In some cases, it may be difficult to determine whether an entity is a nonprofit organization since they may have the preceding characteristics in varying degrees. (For example, an organization may receive significant revenue from exchange transactions rather than contributions but still meet the nonprofit definition.) In other cases, it is fairly obvious that an entity does not have the characteristics of a nonprofit organization. The glossary definition of a *not-for-profit entity* in FASB ASC 958-10-20 notes that such entities do not include investor-owed enterprises and “entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans.”

100.4 FASB ASC 958-10-15-3 explains that nonprofit organizations include the following:

- Cemetery organizations.
- Civic and community organizations.
- Colleges and universities.
- Elementary and secondary schools.
- Federated fund-raising organizations.
- Fraternal organizations.
- Health care entities. [3]
- Labor unions.
- Libraries.
- Museums.
- Other cultural organizations.
- Performing arts organizations.
- Political parties.

- Political action committees.
- Private and community foundations.
- Professional associations.
- Public broadcasting stations.
- Religious organizations.
- Research and scientific organizations.
- Social and country clubs.
- Trade associations.
- Voluntary health and welfare organizations.
- Zoological and botanical societies.

100.5 **IRS Definition**

The Internal Revenue Service (IRS) defines a tax-exempt entity as an entity exempt from income taxes, primarily under Section 501 of the Internal Revenue Code (IRC). Section 501 includes specified types of exempt entities, such as charitable, religious, and educational institutions; civic leagues; social clubs; etc. Most nonprofit entities must apply for and receive recognition of tax-exempt status from the IRS. Churches, however, do not need to apply for tax-exempt status, but automatically qualify under IRC Section 501(c)(3). [4]

Oftentimes, the only attribute shared by nonprofit entities is their tax-exempt status; their missions and primary activities may be very diverse.

Types of Nonprofit Entities

100.6 **IRS Classification**

There are more than 20 categories of tax-exempt entities classified under Section 501(c) of the Internal Revenue Code as well as additional types of entities under other sections of the Code. Some of the major IRC Section 501(c) classifications include the following:

- *501(c)(3)*. Entities that are religious, educational, charitable, scientific, or literary, or that test for public safety or foster national or international amateur sports competitions, or organizations for the prevention of cruelty to children or animals, the nature of whose activities is implied by the description of the class of entity.

- *501(c)(4)*. Civic leagues, social welfare organizations, and local associations of employees, whose activities include promotion of community welfare along charitable, educational, or recreational lines.

- *501(c)(5)*. Labor, agricultural, and horticultural entities, whose activities are educational or instructive, with the purpose of improving conditions of work or improving products and efficiency.

- *501(c)(6)*. Business leagues, chambers of commerce, real estate boards, etc., not organized for profit and whose activities are intended to improve business conditions of one or more lines of business.

- *501(c)(7)*. Social and recreation clubs, the purpose of whose activities are pleasure, recreation, and social.

Voluntary Health and Welfare Organizations

100.7 **Definition**

GAAP differentiates between voluntary health and welfare organizations and other nonprofit organizations. Because voluntary health and welfare organizations are required to present a statement of functional expenses as a basic financial statement, it is important for the accountant to decide whether an organization is a voluntary health and welfare organization or another nonprofit organization. Sometimes the distinction may not be obvious, and the accountant will need to decide whether the organization meets the following definition of a *voluntary health and welfare entity* found in FASB ASC 958-205-20:

> A not-for-profit entity (NFP) that is formed for the purpose of performing voluntary services for various segments of society and that is tax-exempt (organized for the benefit of the public), supported by the public, and operated on a not-for-profit basis. Most voluntary health and welfare entities concentrate their efforts and expend their resources in an attempt to solve health and welfare problems of our society and, in many cases, those of specific individuals. *As a group, voluntary health and welfare entities include those NFPs that derive their revenue primarily from voluntary contributions from the general public to be used for general or specific purposes connected with health, welfare, or community services.* [Emphasis added.]

100.8 This definition includes two pieces. First, the organization primarily obtains its revenue from contributions from the “general public.” “General public” does not include governmental entities. Thus, organizations that primarily receive their support either from membership fees or dues (exchange transactions) or from government grants (not the general public) would not meet the first piece of the definition. The second piece of the definition is that the organization's purpose is to provide health, welfare, or community services. Thus, organizations that have purposes besides health, welfare, or community service would not meet the second piece of the definition. For example, a school has an educational purpose and thus would not be considered a voluntary health and welfare organization.

100.9 **Nonauthoritative Guidance in the Black Book**

Additional guidance on the definition of a voluntary health and welfare organization is provided in a book entitled *Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations*, Fourth Edition, 1998 (the “Black Book”).[5] The Black Book includes the same definition of a voluntary health and welfare organization as that discussed in paragraph 100.7. The Black Book also states that membership in, or affiliation with, the National Health Council, Inc., the National Assembly of Health and Human Service Organizations, Inc., or the United Way of America is usually an indicator that an organization is a voluntary health and welfare organization.

100.10 The objective of the Black Book is to attain uniform accounting and external financial reporting in compliance with GAAP by all voluntary health and welfare organizations. The Black Book gives additional explanations of existing authoritative literature and illustrations particularly relevant to voluntary health and welfare organizations.

100.11 **Examples of Voluntary Health and Welfare Organizations**

Examples of voluntary health and welfare organizations include the following:

- Salvation Army.

- Red Cross.

• CARE.

• Goodwill Industries (local chapters—see paragraph 100.13).

• United Way.

• Boy Scouts.

• Girl Scouts.

• Boys Clubs.

• Girls Inc. (local chapters—see paragraph 100.13).

• Nonprofit organizations whose purpose is to find a cure for, or help people who have, diseases such as cancer, diabetes, heart disease, or muscular dystrophy.

100.12 **Other Organizations Concentrating on Health, Welfare, or Community Services**

Some nonprofit organizations that concentrate on health, welfare, or community services may obtain revenue from client fees, governmental support, or other revenue sources in addition to contributions from the general public. Thus, it may not be clear whether they should be considered voluntary health and welfare organizations. The primary difference between voluntary health and welfare organizations and other nonprofit organizations is the requirement that voluntary health and welfare organizations include a statement of functional expenses as a basic financial statement. Therefore, if it is difficult to determine whether a particular organization is a voluntary health and welfare organization, the authors recommend including a statement of functional expenses as a basic financial statement. The information required to prepare that statement should be readily available because FASB ASC 958-720-05-4 requires all nonprofit organizations to provide information about expenses reported by their functional classification. Accordingly, any allocation of expenses, such as salaries or occupancy, to various programs and supporting services, which would be reflected on a statement of functional expenses, would have already been made.

100.13 **Classification of National Headquarters May Differ**

The authors understand that the national headquarters of some voluntary health and welfare organizations are classified as other nonprofit organizations while their local chapters, affiliates, or member associations are classified as voluntary health and welfare organizations. Some examples are the national organizations of Goodwill Industries, Girls Inc., and the YMCA. Probably, the reason for this practice is that the national organizations do not provide program services directly to the public as do local chapters but are service organizations to member associations (local chapters), providing them with marketing, communications, public relations, and management services, including national purchasing, training of staff, instructors, etc. Also, national organizations usually receive a large portion of their revenue from dues charged to the local chapters. Typically, the local chapters are independent, and the financial statements of the national organization do not include the statements of the local chapters. However, some organizations' national headquarters that are directly involved in program services, such as the American Red Cross, include the local chapters in their financial statements.

Governmental Nonprofit Organizations

100.14 This *Guide* applies only to *nongovernmental* nonprofit entities. The AICPA Audit and Accounting Guide, *Not-for-Profit Entities* (Audit Guide), provides the following guidance on the characteristics of a governmental entity. Basically, all public corporations and bodies corporate and politic are governmental organizations. However, other organizations are also considered governmental organizations if they have any of the following characteristics:

- Officers of the organization are elected by popular vote.

- A controlling majority of the organization's officers are appointed by elected officials. (The elected officials do not have to be from the same state or local government.)

- A government could unilaterally dissolve the organization and retain the organization's remaining net assets.

- The organization can levy taxes. (That includes being able to enact and enforce the levy.)

Also, other organizations are presumed to be governmental if they can directly issue tax-exempt debt (not through a state or municipal authority). However, the organization may rebut that presumption if none of the other governmental characteristics apply and compelling evidence exists that it should not be considered governmental.

Nonprofit Accounting and Financial Reporting Characteristics

100.15 Except for a few differences, nonprofit accounting and financial reporting follows many of the same principles used by commercial enterprises. As expected, accounting for nonprofit organizations that receive a significant portion of their financial resources from the sale of goods and services is similar to accounting for commercial enterprises; consequently, the unique accounting issues of nonprofit organizations usually are found in the areas of contributions, promises to give, investments, and the financial statement presentation and disclosure issues related to them.

Objectives of Nonprofit Accounting and Financial Reporting

100.16 The objectives of financial reporting for nonprofit organizations differ from those of business enterprises. The main objective of financial reporting for business enterprises is to provide information about an enterprise's performance as measured by earnings. The objectives of financial reporting for nonprofit organizations articulated in Statement of Financial Accounting Concepts [6] (SFAC) No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations*, are to provide information to current and potential resource providers and others in assessing (a) the services a nonprofit organization provides and its ability to provide those services and (b) how management has discharged its stewardship responsibilities, as well as providing information about (c) the organization's economic resources, obligations, and net resources and (d) the effects of transactions, events, and circumstances that change those resources (i.e., the organization's performance or service efforts and accomplishments). More specifically, nonprofit financial reporting objectives are to—

a. communicate the ways resources have been used to meet the organization's objectives and external requirements,

b. identify an organization's principal programs and their costs,

c. disclose the degree of control exercised by donors and funding sources over use of resources, and

d. help the user evaluate the organization's ability to carry out its fiscal objectives.

100.17 These objectives are further refined and expanded in FASB ASC 958-205-05-3 and 4. According to that guidance, the primary purpose of financial statements is to provide relevant information to meet the common interests of donors, members, creditors, and others who provide resources to nonprofit organizations. Similar to the objectives outlined in SFAC No. 4, the authoritative literature states these external users desire to assess the services an organization provides, its ability to continue to provide those services and how managers discharge their stewardship responsibilities and other aspects of their performance. More specifically, the purpose of nonprofit financial reporting is to provide information about—

a. the amount and nature of an organization's assets, liabilities, and net assets;

b. transactions and other events and circumstances that affect net assets;

c. the amount and kinds of inflows and outflows of economic resources during a period and the relationship between the inflows and outflows;

d. an organization's cash revenues, support, and expenses; its borrowing and repayment of borrowing; and other factors that may affect its liquidity; and

e. the service efforts of an organization.

100.18 Groups that are particularly interested in the financial information of a nonprofit organization include the following:

- Funding sources and contributors to the organization.
- Regulatory agencies.
- Governing boards (board of trustees or directors).
- Beneficiaries of the services rendered by the organization.
- Employees.
- Creditors and potential creditors.
- Constituent organizations, e.g., a local chapter or a national organization.

AICPA Audit and Accounting Guide, *Not-for-Profit Entities*

100.19 The AICPA publishes the Audit and Accounting Guide, *Not-for-Profit Entities* (Audit Guide), to assist financial statement preparers in the application of GAAP and to assist auditors in applying generally accepted auditing standards (GAAS) in audits of nonprofit organizations. The Audit Guide focuses on the accounting and reporting issues that are unique to nonprofit organizations. Prior to issuance of the FASB Codification (FASB ASC), the Audit Guide was an authoritative source of GAAP. As discussed in section 103, when the FASB ASC became effective, the Audit Guide became nonauthoritative. Although the Audit Guide is no longer authoritative, it continues to provide guidance that should be considered if the FASB ASC does not specify the requirements for a transaction or event, or its accounting principles for similar transactions or events do not apply.

100.20 In March 2013, the AICPA released the March 1, 2013 edition of the Audit Guide. As discussed in paragraph 103.13, the Audit Guide was originally issued in 1996 and had not been revised or amended, other than for conforming changes, since then. The March 2013 Audit Guide was developed by an expert panel on nonprofit organizations and an AICPA task force to provide financial statement preparers and auditors with nonauthoritative guidance about issues that are unique to the nonprofit sector. As a result of this multi-year project, the Audit Guide contains many new and expanded discussions that are aimed at enhancing preparers' understanding of GAAP for nonprofit organizations and reducing diversity in practice. Some of the features of the 2013 edition of the Audit Guide include new or expanded discussion of—

- Reporting relationships with other entities, including limited liability partnerships, general partnerships, and financially interrelated entities.

- Reporting and measuring noncash gifts, including gifts-in-kind; contributions of fund-raising materials, informational materials, advertising, and media time or space; below-market interest rate loans; and bargain purchases.

- Programmatic investments and microfinance loans.

- Municipal bond debt, third-party credit enhancements, capitalization of interest, and extinguishments and debt modifications.

- Reporting the expiration of donor-imposed restrictions.

- The legal and regulatory environment in which nonprofit organizations operate.

The 2013 edition of the Audit Guide also was updated to incorporate the clarified auditing standards.

100.21 When the Audit Guide is cited as a reference in this *Guide*, the reference is to the new 2013 edition of the Audit Guide. The authors believe the new 2013 edition of the Audit Guide contains nonauthoritative guidance about many accounting topics that will be useful to financial statement preparers and auditors. The authors expect to discuss selected topics from the Audit Guide in future editions of this *Guide*.

Nonprofit Organizations Covered and Not Covered by This *Guide*

100.22 This *Guide* provides guidance particularly applicable to preparing financial statements for the nonprofit organizations covered by the Audit Guide. Because of significant differences between the accounting and reporting requirements of nonprofit organizations and health care entities, the Audit Guide does not cover health care entities. Consistent with the Audit Guide, this *Guide* also does not provide guidance for health care entities even though, as noted in paragraph 100.4, the FASB Codification includes them as a type of nonprofit organization. Governmental colleges and universities, employee benefit plans, cooperatives, state and local governments (including special units of government such as school districts and other special districts), and governmental nonprofit organizations (see paragraph 100.14) are among the other entities not covered by this *Guide*. The AICPA publishes the following audit and accounting guides on nonbusiness enterprises not covered by this *Guide*:

- *Audits of Agricultural Producers and Agricultural Cooperatives*.

- *Common Interest Realty Associations*.

- *Depository and Lending Institutions*.

- *Employee Benefit Plans*.

- *Health Care Entities*.

- *State and Local Governments*.

These guides can be ordered by calling the AICPA Order Department at (888) 777-7077 or through the AICPA's online catalog at **www.cpa2biz.com**. Also, the Tax and Accounting business of Thomson Reuters publishes *PPC's Guide to Preparing Governmental Financial Statements under GASBS No. 34*, *PPC's Guide to Audits of Local Governments*, *PPC's Guide to Audits of Employee Benefit Plans*, *PPC's Guide to Homeowners' Associations and Other Common Interest Realty Associations*, and *PPC's Guide to Audits of Financial Institutions*, which can be ordered by calling (800) 431-9025 or from **ppc.thomsonreuters.com**.

100.23 In addition to the aforementioned industry audit and accounting guides, the AICPA publishes an audit guide titled *Government Auditing Standards and Circular A-133 Audits* (GAS/A-133 AICPA Audit Guide). The GAS/A-133 AICPA Audit Guide provides guidance on the auditor's responsibilities when conducting financial statement audits performed under *Government Auditing Standards* and single or program-specific audits in accordance with the Single Audit Act and OMB Circular A-133. While nonprofit organizations that are subject to *Government Auditing Standards* or that receive federal awards are subject to the provisions of the relevant documents, this *Guide* does not cover single audit requirements. Guidance on those requirements is provided in *PPC's Guide to Single Audits* and *PPC's Guide to Audits of Nonprofit Organizations*.

Terms and Definitions

100.24 The authors have chosen to use the term *nonprofit organization* in this *Guide*; however, the terms *nonprofit*, *not-for-profit entity*, and *nonbusiness* are synonymous in the authors' opinion. In many places in this *Guide*, reference is made to the *general purpose financial statements*. The term refers to the basic financial statements of a nonprofit organization. Likewise, the term *generally accepted accounting principles* (GAAP) is frequently used. This chapter defines those terms and discusses applying GAAP and other professional standards in preparing financial statements for nonprofit organizations.

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[1] The FASB ASC is the single source of authoritative accounting principles for nongovernmental entities that prepare financial statements in accordance with U.S. GAAP. The relevant citations to the FASB ASC are provided throughout this *Guide*. See the discussion beginning at paragraph 103.4.

[2] As discussed in paragraph 100.24, this *Guide* uses the term *nonprofit organization* interchangeably with the term *not-for-profit entity* as defined in GAAP.

[3] Health care entities are not covered by the AICPA Audit and Accounting Guide, *Not-for-Profit Entities*; instead, they are covered by a separate AICPA audit and accounting guide titled *Health Care Entities*. This *Guide* also does not provide guidance for health care entities. See paragraph 100.22.

[4] *PPC's Guide to Religious Organizations* provides detailed guidance on tax issues for churches and other religious organizations. [Call (800) 431-9025 for order information or order online at **ppc.thomsonreuters.com**.]

[5] The Black Book has limited availability but is on the National Health Council's publication order form. It

continues to provide relevant guidance.

[6] Statements of Financial Accounting Concepts are nonauthoritative. See paragraph 103.4.

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101 Basic Financial Statements

101.1 The concept of *basic financial statements* is important because the basic financial statements represent what is generally accepted as the end product of a nonprofit organization's financial accounting process. This *Guide* is designed to assist accountants in preparing the basic financial statements, related notes, and other financial information that may be presented with the basic financial statements.

What Is Included in Basic Financial Statements?

101.2 According to FASB ASC 958-205-45-4, a complete set of financial statements for nonprofit organizations includes:

- A statement of financial position.
- A statement of activities.
- A statement of functional expenses (required for voluntary health and welfare organizations only).
- A statement of cash flows.
- Notes to financial statements.

101.3 Basic financial statements can be individual GAAP financial statements such as a statement of financial position, or they can be financial statements prepared in accordance with a special purpose framework [7] (for example, the cash, modified cash, or tax basis). (Note that schedules and explanatory material may be considered either as part of the basic financial statements or as supplementary information depending on whether they are specifically identified in the accountant's or auditor's report as being part of the basic financial statements. Chapter 8 discusses supplementary information in more detail, and Chapter 9 discusses preparing financial statements using an OCBOA.)

101.4 Each of the basic financial statements is discussed in a separate chapter of this *Guide*. Each chapter includes detailed guidance concerning the form of the statement and on applying GAAP to specific accounts in the statement. Chapter 7 discusses the form and content of the disclosures to the financial statements that are required by GAAP.

Comparative Financial Statements

101.5 **Recommendation for Comparative Statements**

FASB ASC 205-10-45-1 encourages, but does not require, presentation of comparative financial statements. Nonprofit organizations that choose to present comparative financial information sometimes present only summarized comparative information that does not include the minimum information required by GAAP. For example, organizations may present prior-year information in total instead of by net asset class, or present information about the prior-year change in net assets without details about revenues, expenses, gains, and losses by net asset class. If comparative information is not sufficient to constitute a presentation in accordance with GAAP, FASB ASC 958-205-45-8 states that organizations should use financial statement titles appropriately describing the summarized prior-year information. Organizations must also disclose the summarized nature of the prior-year presentation in a note to the financial statements. See a discussion of the required note disclosures beginning at paragraph 701.7. Presenting descriptive titles on the face of the financial statements without a corresponding note disclosure does not constitute a proper use of the titles. See a discussion of summarized comparative information at paragraph 205.9.

101.6 Typically, comparative financial statements include statements of financial position, statements of activities, and statements of cash flows for each year presented. However, nothing precludes an organization from presenting the statement of financial position for only the current year and the statement of activities for the current and prior years. If the financial statements include a statement of financial position and a statement of activities, GAAP requires a statement of cash flows for each period that a statement of activities is presented. See a discussion on additional considerations when comparative statements of cash flows are presented beginning at paragraph 601.9, a discussion on different levels of service provided on comparative financial statements beginning at paragraph 205.6, and a discussion on considerations related to comparative statements of functional expenses beginning at paragraph 501.13.

Fund Accounting

101.7 Historically, fund accounting provided a mechanism for meeting differing needs of various users of nonprofit financial statements. For instance, contributors and funding sources are often interested in statements that account for the use of funds they provide, whether restricted or unrestricted. Regulatory agencies are often concerned with amounts spent for other than program purposes, including management, fund-raising, unrelated business income, lobbying, etc.; governing boards with the proper utilization of all funds; beneficiaries with the efficient use of program funds; and creditors and potential creditors with the unrestricted funds available for the continued operation of the organization. Fund accounting records resources whose use may be limited by donors, granting agencies, governing boards, or other individuals or entities or by law in separate funds. The funds segregate assets, liabilities, and fund balances into separate accounting entities based on specific activities, donor-imposed restrictions, or objectives.

101.8 **GAAP Requirements for Presentation of Financial Statements by Fund**

An organization's maintenance of its accounts by fund does not necessarily mean that its financial statements will be presented by fund. GAAP does not prohibit or require the use of fund accounting. FASB ASC 958-205-45-3 and 958-205-5-7 state that reporting by fund groups is not a necessary part of external financial reporting but they do not preclude providing disaggregated information by fund groups. GAAP does require, however, providing information about three classes of net assets: (a) unrestricted, (b) temporarily restricted, and (c) permanently restricted. (Internal restrictions of net assets, such as board designations, may be disclosed; however, they are considered to be unrestricted.) Fund accounting may not accomplish the goal, as required, of informing the reader about donor restrictions. For example, some of the net assets of a fund established to account for property and equipment may be unrestricted (either because they were acquired with unrestricted net assets or because the donor restriction was satisfied when specific equipment was purchased), and some may be temporarily or permanently restricted because of donor restrictions. So merely accounting for property and equipment in a separate fund does not satisfy the disclosure requirements about donor restrictions under GAAP.

101.9 Fund-accounting-based statements may still be required to compute debt covenant requirements, grantor funding source requirements, or other external reporting requirements. In addition, internal budgets may be prepared on a fund accounting basis. Financial statements that do not present results by funds can accommodate comparative presentations more easily than those using fund accounting. In addition, the GAAP requirements to provide information on unrestricted and restricted net assets and donor restrictions on assets can be met without using multiple columns. For many nonprofit organizations, the authors believe the financial statements most informative to their users will be those that do not use fund accounting and that present comparative results. Some nonprofit organizations that wish to present financial information by fund provide that information in a supplementary schedule.

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[7] AU-C 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, uses the term *special purpose framework* to describe a financial reporting framework other than GAAP. The guidance in AU-C 800 clarifies that the cash, tax, regulatory, and other bases of accounting are commonly referred to as *other comprehensive bases of accounting* (OCBOA). See also the discussion beginning at paragraph 103.22.

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102 An Overview of Standards

102.1 Standards of the accounting profession are established by the American Institute of Certified Public Accountants (AICPA) and the Financial Accounting Standards Board (FASB). As they relate to financial statement engagements, standards of the accounting profession may be classified into five general categories:

a. Generally accepted accounting principles (GAAP).

b. Performance standards.

c. Reporting standards.

d. Quality control standards.

e. Ethics standards.

GAAP

102.2 Generally accepted accounting principles (GAAP) apply to all financial statements [except statements presented on an other comprehensive basis of accounting (see Chapter 9)] and are relevant to all accountants (whether in nonprofit organizations or public accounting) who are concerned with producing meaningful financial statements. GAAP is discussed in more depth in section 103 of this chapter.

Performance and Reporting Standards

102.3 Performance and reporting standards are the principles and procedures that apply only to CPAs in *public accounting*. Those standards must be followed by a CPA when associated with the financial statements (or, in some cases, financial information that is less than complete financial statements) of a client. In general, the extent of procedures is related to the level of assurance the CPA will express on the financial statements. The reporting standards differ for each level of service that CPAs in public practice render with regard to financial statements—audit, review, or compilation.

102.4 Discussion of performance and reporting standards is beyond the scope of this *Guide*. The following guides in the PPC library provide practical guidance on those standards:

- *PPC's Guide to Audits of Nonprofit Organizations*.

- *PPC's Guide to Compilation and Review Engagements*.

- *PPC's Guide to Single Audits*.

- *PPC's Guide to Auditor's Reports*.

Quality Control Standards

102.5 Quality control standards of the profession relate to the internal system that a CPA firm uses to provide itself with reasonable assurance of meeting its responsibility to conform with professional standards in all financial statement engagements. The elements of quality control and illustrative policies and procedures are covered in *PPC's Guide to Quality Control*.

Ethics Standards

102.6 The principles and rules of the AICPA *Code of Professional Conduct* and related ethics interpretations and rulings govern the conduct of all AICPA members. The *Code of Professional Conduct* provides guidance and rules to members in public practice, industry, government, and education in the performance of their professional responsibilities. Based on an ethics interpretation in the AICPA *Professional Standards* at ET section 91, AICPA members are responsible for the conduct of all individuals that are associated with their public accounting practices. As a result, the *Code of Professional Conduct* also applies to non-AICPA members who are under a member's supervision or are partners or shareholders in a member's practice.

102.7 The *Code of Professional Conduct* consists of two sections: (a) the principles and (b) the rules. The principles provide the framework for the rules, which govern the performance of professional services by

AICPA members. Ethics interpretations and rulings provide guidance in specific circumstances and should be consulted if a member has a question about a particular rule.

102.8 All CPAs should also be familiar with the ethical standards of their state CPA society, state board of accountancy, and other applicable regulators.

Summary

102.9 Accountants (whether in public accounting or employed by a nonprofit organization) are concerned primarily with applying generally accepted accounting principles when preparing financial statements. Performance and reporting standards generally only apply to accountants in public practice, vary with the level of service offered, and are beyond the scope of this *Guide*. Quality control standards are used by nearly all accountants. Similarly, the *Code of Professional Conduct* has a direct effect on all AICPA members, whether in public practice or with a nonprofit organization.

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103 Generally Accepted Accounting Principles (GAAP)

Why Is GAAP Important?

103.1 Generally accepted accounting principles are applicable to all financial statements (except statements presented on an other comprehensive basis of accounting) and are important to accountants for nonprofit organizations as well as accountants in public practice. But why?

103.2 Accountants in public practice give varying degrees of assurance on the financial statements with which they are associated. That assurance is expressed in terms of whether the statements are, in all material respects, presented in conformity with generally accepted accounting principles. Thus, a thorough knowledge of GAAP is critical.

103.3 Accountants and financial statement preparers in nonprofit organizations are also concerned with GAAP for several reasons:

- Ethics Interpretation 203-4 (ET section 203.05) states that Rule 203 of the AICPA *Code of Professional Conduct* applies to all members, thus clarifying that members in industry may not represent to auditors, regulators, creditors, or others that the entity's financial statements are prepared in accordance with GAAP when the statements contain GAAP departures.

- Some third-party users of financial statements lose confidence in entity-prepared financial statements if they contain material departures from GAAP.

- GAAP generally reflects economic reality. Financial statements presented in conformity with GAAP generally provide management with one of its best tools. In contrast, departures from GAAP may mislead management.

• Financial statements prepared in conformity with GAAP are a sign of professionalism that most nonprofit organization accountants value.

The FASB Accounting Standards Codification

103.4 The FASB Accounting Standards Codification (FASB ASC or the Codification) is the single source of authoritative accounting principles for nongovernmental entities that prepare financial statements in accordance with U.S. GAAP. Rules and interpretive releases of the Securities and Exchange Commission (SEC) are also sources of authoritative GAAP for SEC registrants. [8]

103.5 Except for certain grandfathered guidance discussed at paragraph 103.8, non-SEC accounting literature that is not contained in the Codification is considered nonauthoritative. The FASB created the Codification by arranging the previous sources of historical GAAP, such as Statements of Financial Accounting Standards (SFASs), Statements of Position (SOPs), and other pronouncements, into a topical structure maintained in an online research platform. The Codification superseded those prior sources of accounting standards.

103.6 The Codification reorganizes U.S. GAAP into approximately 90 accounting topics arranged in a consistent structure. All guidance contained in the Codification carries an equal level of authority. If the accounting treatment for a transaction or event is not specified within a source of authoritative GAAP, an entity should first consider accounting principles for similar transactions or events within a source of authoritative GAAP and then consider nonauthoritative guidance from other sources. Nonauthoritative sources of guidance and literature include—

• Practices widely recognized and generally prevalent or prevalent in the industry.

• FASB Concepts Statements.

• AICPA Issues Papers.

• International Financial Reporting Standards (IFRS) of the International Accounting Standards Board (IASB).

• Pronouncements of professional associations or regulatory agencies.

• Technical Information Service Inquiries and Replies included in the AICPA Technical Practice Aids.

• Accounting textbooks, handbooks, and articles.

However, the accounting treatment specified in accounting guidance for similar transactions or events should not be used in situations where the accounting principle prohibits its application to the particular transaction or event, or where the accounting principle indicates it should not be applied by analogy.

103.7 **Applicability For Nonprofit Organizations**

Nonprofit organizations should follow the guidance in all topics of the Codification, unless specific provisions explicitly exempt nonprofit organizations or the subject matter precludes applicability (for example, FASB ASC 505-30). The incremental guidance applicable specifically for nonprofit organizations is codified in FASB ASC 958, *Not-for-Profit Entities*.

103.8 **Grandfathered Guidance**

In the past some accounting standards have permitted an entity to continue applying superseded accounting standards for transactions that have an ongoing impact on an entity's financial statements, such as a business combination. That guidance is considered grandfathered and remains authoritative for those transactions even though it has not been integrated into the Codification. Grandfathered guidance is discussed in FASB ASC 105-10-70.

103.9 **Organization of the Codification**

The Codification is organized by subject matter in a hierarchy, using areas, topics, subtopics, and sections as follows:

a. *Areas.* Areas represent large collections of accounting guidance. The following are the nine areas of the Codification:

(1) General Principles.

(2) Presentation.

(3) Assets.

(4) Liabilities.

(5) Equity.

(6) Revenue.

(7) Expenses.

(8) Broad Transactions.

(9) Industry.

b. *Topics.* Topics reside in areas and represent a collection of related guidance, such as leases. The following are the main types of topics by area:

(1) *General Principles (Topic Codes 105-199).* These topics relate to broad conceptual matters such as generally accepted accounting principles.

(2) *Presentation (Topic Codes 205-299).* These topics relate only to presentation matters and do not address recognition, measurement, or derecognition matters. Such topics include income statement, balance sheet, statement of cash flows, etc.

(3) *Assets (Topic Codes 305-399).* These topics relate to asset accounts, such as cash, receivables, investments, etc.

(4) *Liabilities (Topic Codes 405-499).* These topics include liability accounts, such as debt, guarantees, commitments, etc.

(5) *Equity (Topic Codes 505-599).* These topics contain guidance about equity accounts.

(6) *Revenue (Topic Codes 605-699).* These topics contain guidance about revenues, such as revenue recognition.

(7) *Expenses (Topic Codes 705-799).* The expenses topics include cost of sales, compensation, incomes taxes, etc.

(8) *Broad Transactions (Topic Codes 805-899).* These topics relate to multiple financial statement accounts and are generally transaction-oriented. Such topics include leases, business combinations, derivatives, nonmonetary transactions, etc.

(9) *Industry (Topic Codes 905-999).* These topics relate to accounting that is unique to an industry or type of activity. Such topics include not-for-profit entities, airlines, software, real estate, etc. The not-for-profit entities topic (FASB ASC 958) provides guidance unique to nonprofit organizations. According to FASB ASC 958-10-05-1, nonprofit organizations should also comply with the applicable guidance in other FASB ASC topics and subtopics unless the specific scope sections exempt nonprofit organizations or the subject matter is not applicable. However, nonprofit organizations should follow the reporting model defined in topic 958 when applying the guidance in other topics and subtopics.

c. *Subtopics.* Subtopics represent subsets of a topic and are generally distinguished by type or by scope. For example, operating leases and capital leases are two subtopics of the leases topic distinguished by type of lease. Each topic contains an overall subtopic that generally represents the pervasive guidance for the topic. Each additional subtopic represents incremental or unique guidance not contained in the overall subtopic. Subtopics unique to a topic use classification numbers between 00 and 99.

d. *Sections.* Sections represent the nature of the content in a subtopic such as recognition, measurement, disclosure, and so forth. Every subtopic uses the same sections, unless there is no content for a particular section. The sections of each subtopic are as follows, where XXX = topic, YY = subtopic, and ZZ = section:

XXX-YY-00	Status
XXX-YY-05	Overview and Background
XXX-YY-10	Objectives
XXX-YY-15	Scope and Scope Exceptions
XXX-YY-20	Glossary
XXX-YY-25	Recognition
XXX-YY-30	Initial Measurement
XXX-YY-35	Subsequent Measurement
XXX-YY-40	Derecognition
XXX-YY-45	Other Presentation Matters
XXX-YY-50	Disclosure
XXX-YY-55	Implementation Guidance and Illustrations
XXX-YY-60	Relationships
XXX-YY-65	Transition and Open Effective Date Information
XXX-YY-70	Grandfathered Guidance
XXX-YY-75	XBRL Definitions

An “S” precedes the section number in the case of SEC content. Within sections, paragraphs are numbered with a two-part number in which the first part represents the section and the second part is a sequential number. The content of a paragraph may be amended, but the paragraph number will remain constant. For example, some of the classification codes for Leases are as follows:

840	Leases (Topic)
840-10	Overall (Subtopic)
840-10-15	Scope and Scope Exceptions (Section)
840-10-50	Disclosure (Section)
840-20	Operating Leases (Subtopic)
840-20-15	Scope and Scope Exceptions (Section)
840-20-50	Disclosure (Section)
840-30	Capital Leases (Subtopic)

840-30-15	Scope and Scope Exceptions (Section)
840-30-50	Disclosure (Section)

103.10 The FASB revises the Codification through the issuance of Accounting Standards Updates (ASUs), which generally include a summary of the new guidance, the amendments to the FASB Codification, the background information and the basis for conclusions, and the amendments to the XBRL taxonomy. The title of a new ASU includes “Accounting Standards Update No. YYYY-XX,” where YYYY is the year issued and XX is the sequential number for each Update, such as 2010-01, 2010-02, etc. All Codification revisions are now issued in this format, regardless of the form in which such guidance may have been issued previously (for example, EITF Abstracts, FASB Staff Positions, FASB Statements, FASB Interpretations, etc.).

103.11 Upon its release, an Accounting Standards Update is not authoritative as a stand-alone document. It is a transient document to initiate the FASB's process of amending the Codification. As the FASB amends existing Codification paragraphs, both the current paragraph and the updated paragraph reside in the Codification until such time that the new guidance is completely effective. The FASB identifies amended guidance as “Pending Content” within the Codification. The Pending Content generally includes information regarding the transition date, a link to any transition guidance, and the text of the content that will be effective upon transition. When the newly amended paragraph is fully effective, the outdated guidance is removed from the paragraph and the amended paragraph remains.

103.12 **How This *Guide* Presents Codification Information**

Codification references have been fully integrated into this *Guide* and are preceded by the label *FASB ASC*. In addition, practitioners who subscribe to the electronic versions of this *Guide* and the FASB Reference Materials may link directly from the summarized guidance in this *Guide* to the related authoritative literature in the Codification.

Previous Development of Accounting and Reporting Standards for Nonprofit Organizations

103.13 The need for uniform and comparable accounting and financial reporting standards for nonprofit organizations has long been recognized. For example, a document entitled “Accounting Principles and Procedures of Philanthropic Organizations” was published in 1957, and the first edition of *Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations* (the “Black Book”—see paragraph 100.9) was published in 1964. Publication of the Black Book in part prompted the AICPA to issue the AICPA Industry Audit Guide, *Audits of Voluntary Health and Welfare Organizations* (AVHW), in 1974. AVHW was followed by SOP 78-10, *Accounting Principles and Reporting Practices for Certain Nonprofit Organizations*, in 1978. In addition, separate AICPA guides existed for hospitals and colleges and universities so that differences existed in the accounting standards for various types of nonprofit entities. Meanwhile, FASB issued SFAC No. 4, which provided a broad framework for accounting for nonprofit organizations, and SFAC No. 6, *Elements of Financial Statements*, which defined assets, liabilities, net assets, revenues, expenses, gains, and losses for nonprofit organizations. In response to inconsistencies in certain accounting and financial reporting practices, the FASB issued SFAS No. 116, *Accounting for Contributions Received and Contributions Made*, and SFAS No. 117, *Financial Statements of Not-for-Profit Organizations*, in 1993. The AICPA continued the trend toward consistent accounting and financial reporting practices for nonprofit organizations when it issued the Audit and Accounting Guide, *Not-for-Profit Organizations* (Audit Guide), in August 1996. Beginning with the March 1, 2009, edition, the Audit Guide was renamed *Not-for-Profit Entities*. [9]

103.14 The March 1, 2008, edition of the Audit Guide was one of the sources of accounting literature used for compilation of the FASB ASC because it provided accounting guidance for nonprofit organizations that did not exist elsewhere. For example, it was the primary source of guidance on accounting for split-interest agreements. All of the authoritative accounting literature constituting GAAP for nonprofit organizations now resides solely in the FASB ASC. As with all sources of accounting guidance other than the FASB ASC, the Audit Guide is nonauthoritative.

Measurement Principles versus Disclosure Principles

103.15 Generally accepted accounting principles include both measurement principles and disclosure principles. Measurement principles are those principles that govern the recognition of transactions, for example, the period in which a transaction will be recorded and the amounts to be recorded. Examples of measurement principles include the following:

- The cost of property and equipment should be depreciated over the estimated useful life of the asset.

- Liabilities should be recorded for expenses incurred but not paid as of the date of the statement of financial position.

103.16 Disclosure principles are those principles that determine what specific numbers and other information must be presented in the financial statements. The following are examples of disclosure principles:

- Depreciation expense for the period should be disclosed.

- Aggregate amounts of maturities of long-term debt for each of the five years following the latest statement of financial position presented should be disclosed.

- The current and long-term portion of lease commitments should be disclosed (if a classified statement of financial position is presented).

This *Guide* provides in-depth guidance on both measurement and disclosure principles.

GAAP and Materiality

103.17 Materiality is a term used to describe the significance of a departure from generally accepted accounting principles. Only material departures require correction. Determining what is material to the financial statements taken as a whole is one of the most difficult decisions in the profession. Statement of Financial Accounting Concepts (SFAC) No. 8, *Conceptual Framework for Financial Reporting—Chapter 1, "The Objective of General Purpose Financial Reporting," and Chapter 3, "Qualitative Characteristics of Useful Financial Information,"* states the following regarding materiality:

> Information is material if omitting it or misstating it could influence decisions that users make on the basis of the financial information of a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude or both of the items to which the information relates in the context of an individual entity's financial report. Consequently, the [FASB] cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

103.18 Accordingly, there are no quantitative guidelines in authoritative accounting literature for determining materiality. However, the Audit Guide discusses several alternative bases that can be used to determine materiality for planning an audit. The authors believe that those bases could also be used in determining what is material to the financial statements. Those bases include the following:

• Net asset classes.

• Changes in net assets or net asset classes.

• Total revenues and support.

• Revenues of each net asset class.

• Total expenses.

• Other measures, such as total unrestricted contributions, total program expenses, the ratio of program expenses to total expenses, or the ratio of fund-raising expenses to contributions.

103.19 The authors generally recommend, however, that quantitative benchmarks, if used, be based on items such as total assets or total revenue and support rather than changes in net assets because many nonprofit organizations closely match revenue and expenses and operate on small margins. A benchmark used by some accountants for nonprofit organizations follows (a discussion of applying the benchmark in the statement of financial position begins at paragraph 300.23):

Effect of Departure on Total Assets or Support and Revenue	**Materiality to Financial Statements**
<1/2%	Not material
1/2%-1%	Danger area—could be material
1% or greater	Probably is material

103.20 Some accountants further refine the benchmarks suggested in paragraph 103.20 by basing materiality on a sliding scale percentage of total revenue and support or total assets. Although benchmarks may serve as guidelines, it cannot be overemphasized that the use of a benchmark is not a substitute for professional judgment. Also, as previously indicated, benchmarks for nonprofit organizations may be different than those for commercial entities (e.g., usually little or no increase in net assets, nature of activities, use of financial statements by users, etc.).

103.21 The SEC staff issued Staff Accounting Bulletin (SAB) No. 99, *Materiality*, to provide additional guidance on applying materiality thresholds to financial statements. Although SABs are not applicable to the financial statements of nonpublic entities such as nonprofit organizations, the guidance at FASB ASC 250-10-S99-1 may be useful to all financial statement preparers. Views of the SEC staff are that exclusive reliance on certain quantitative benchmarks to assess materiality is not appropriate. In other words, it is not acceptable to assess materiality purely on a quantitative threshold, such as 5% of total assets or revenues. The SAB states that financial statement preparers and auditors also must assess qualitative considerations when determining whether or not a misstatement is material. In addition to assessing whether the financial misstatements are materially misstated after considering the effect of aggregating all misstatements, the guidance requires assessing whether each individual misstatement is material. If the misstatement individually is considered material, the effect cannot be eliminated by other misstatements that diminish the effect of the misstatement on other financial statement items. FASB ASC 250-10-S99-1 also states that management should not make intentional immaterial misstatements to manage earnings (or in the case of nonprofit organizations, the change in net assets).

Other Comprehensive Bases of Accounting (OCBOA)

103.22 The conventions, rules, and procedures that define GAAP constitute the accounting framework that is considered the norm. Both accountants and users of financial statements generally expect financial statements to be prepared in conformity with GAAP. However, bases of accounting other than GAAP [referred to in the authoritative literature as *special purpose frameworks* or *other comprehensive bases of accounting* (OCBOAs)] are a widely used alternative to the numerous and sometimes complex accounting requirements prescribed by GAAP.

103.23 The FASB Accounting Standards Codification does not include guidance for preparing financial statements using an OCBOA. References to OCBOAs appear in the AICPA's auditing standards and standards for compilation and review services. AU-C 800, *Special Consideration—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, defines special purpose frameworks and provides guidance to the auditor for determining the acceptability of a special purpose framework. Considerations for preparing OCBOA financial statements are discussed in Chapter 9. Accountants may also wish to refer to *PPC's Guide to Cash, Tax, and Other Bases of Accounting*.

Reference Sources for GAAP

103.24 This *Guide* answers many questions concerning currently the application of GAAP and should greatly facilitate the process of preparing financial statements for nonprofit organizations in conformity with GAAP. However, it is not a substitute for the authoritative literature. To have access to the technical pronouncements that constitute GAAP, accountants should obtain access to the FASB Accounting Standards Codification.

103.25 The staff of the AICPA's Accounting Standards Team has issued 25 technical practice aids (TPAs) (TIS 6140.01-.25) specifically related to nonprofit organizations. TPAs provide guidance on accounting issues, but are nonauthoritative. When appropriate, the TPAs are discussed at the relevant points in this *Guide*. The TPAs are included in the AICPA's Technical Practice Aids service.

103.26 The Tax and Accounting business of Thomson Reuters offers all the authoritative literature issued by the FASB and the AICPA (all hyperlinked to PPC's guides) on Checkpoint. The AICPA literature is also available on *PPC's Accounting and Auditing* CD-ROM. [For information, call (800) 431-9025.] The FASB's website contains information about board actions and upcoming meetings, the quarterly plan for FASB technical activities, membership information, and ordering information and prices for FASB products. In addition, the full text of all ASUs are available on the FASB website, as well as the literature that was superseded by the FASB ASC (such as FASB Statements of Financial Accounting Standards, Statements of Financial Accounting Concepts, FASB Interpretations, FASB Technical Bulletins, FASB Staff Positions, and EITF Abstracts). Although the FASB no longer updates or maintains the superseded standards, they remain available for reference on the FASB website. The FASB home page can be found at **www.fasb.org**. The Codification can be found at **http://asc.fasb.org/home** and is also available on Checkpoint at **checkpoint.riag.com**.

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[8] SEC registrants must also follow rules and interpretive releases of the Securities and Exchange Commission (SEC). The Codification includes certain SEC rules, regulations, interpretive releases, and staff guidance that are relevant only to SEC registrants. Such guidance is segregated within the Codification and does not represent the authoritative sources of such content.

[9] As discussed in paragraph 100.20, the AICPA released a completely revised and amended edition of the Audit Guide in March 2013.

END OF DOCUMENT -

104 CURRENT ACCOUNTING AND REPORTING DEVELOPMENTS

Introduction

104.1 In the past, this *Guide* generally has not addressed the FASB's ongoing projects and proposed standards in significant detail. Obviously, FASB projects do not change GAAP until after extensive deliberations, due process and issuance of new standards in the form of a final ASU. Also, tentative decisions reached during the course of a project can, and often do, change quite significantly prior to issuance of final guidance. For the accountants and management of the typical small to midsize nonprofit organization, monitoring the progress of the FASB's technical agenda is impractical and unnecessary, since many issues on the agenda are unlikely to affect the financial statements because the subject matter is generally not relevant to the nonprofit sector, or because nonprofits are specifically excluded from the scope of the project.

104.2 However, the authors believe that some FASB projects nearing completion warrant the attention of customers that use this *Guide*. Accountants and management of nonprofit organizations, and the auditors that service them need to be aware that certain FASB projects could significantly impact the financial statements. This section highlights important aspects of projects the authors consider to be significant for nonprofit organizations. Additional information may be obtained from the FASB website at **www.fasb.org**. Future editions of this *Guide* will provide updated guidance and incorporate the requirements of any final standards issued as a result of these projects.

Joint Projects of the FASB and IASB

104.3 For several years, the FASB and the International Accounting Standards Board (IASB) have been working toward converging U.S. GAAP with International Financial Reporting Standards (IFRS). Those efforts are aimed at reducing the differences between U.S. GAAP and IFRS with the ultimate goal of having a single set of high-quality globally accepted accounting standards. Although it is unlikely that convergence of all accounting and reporting standards will be achieved, substantial changes to present-day U.S. GAAP can be expected when the following projects are completed.

104.4 **Revenue Recognition**

In June 2010, the FASB released an initial exposure draft of a proposed ASU, *Revenue from Contracts with Customers*. The FASB subsequently held several roundtable discussions regarding the proposal. Based on the comments received and the other feedback received from constituents, the FASB made significant changes to the proposed guidance. In November 2011, the FASB issued a revised exposure draft, *Revenue from Contracts with Customers*, and in January 2012, the FASB issued another revision of the exposure draft with the details of proposed amendments to the FASB ASC. Recent joint meetings of the FASB and IASB (the Boards) aimed at addressing issues in the project have included discussion of allocating transaction prices, contract costs, repurchase agreements, disclosures, and transition and effective dates.

104.5 As currently proposed, the new guidance would establish a single revenue recognition standard that would apply across various industries and capital markets. It would also eliminate inconsistencies in revenue recognition standards and practices, and remove existing industry-specific revenue recognition requirements. The proposed guidance is based on the principle that revenue from contracts with customers should be recognized when an entity transfers goods or services to the customer. The revenue is the amount the entity receives or expects to receive from the customer in exchange for transferring those goods or services.

104.6 Under the proposed guidance, an organization would be required to identify its performance obligations in a contract and would only recognize revenue when it satisfies each performance obligation. An organization satisfies a performance obligation when it transfers a good or service to a customer, and a good or service would be considered transferred when the customer obtains control of the good or service.

104.7 The FASB has indicated that the final ASU on revenue recognition is planned to be issued in the second quarter of 2013. As of the date of this *Guide*, the FASB has tentatively decided to require nonpublic entities (that is, most nonprofit organizations) to apply the requirements in the new standards for annual reporting periods beginning after December 15, 2017, and interim and annual reporting periods thereafter. The FASB also tentatively decided that nonpublic entities may elect to forego certain disclosures required in the proposed standards.

104.8 **Leases**

The goal of this project is to ensure that all assets and liabilities arising from lease contracts are recognized in the statement of financial position. The proposed guidance would provide both lessee and lessor accounting requirements. It would apply to assets considered property and equipment, and would include a number of scope exceptions.

104.9 In August 2010, the FASB released an exposure draft of a proposed ASU on leases. After release of the exposure document, the FASB also held several public roundtables and other types of workshops to get feedback from a variety of constituents. Based on this feedback, the Boards redeliberated significant aspects of the proposed guidance. Due to the extensive changes to the initial exposure draft, the Boards decided a second exposure draft of proposed new standards on leases will be exposed for public comment. As of the date of this *Guide*, the revised exposure draft is scheduled for issuance in the second quarter of 2013. The FASB's project description does not indicate a potential effective date for the new guidance. The following paragraphs include a brief discussion of some of the tentative decisions reached to date on lessee and lessor accounting for leases.

104.10 Accounting by Lessees.

Following the general premise that assets and liabilities arising from leases should be recognized in the statement of financial position, lessees would be required to recognize an asset representing their right to use the leased item for the term of the lease. The proposed guidance refers to that asset as a *right-of-use asset*. The lessee would also be required to recognize a liability for its obligation to make lease payments. The asset and liability would be measured using the present value of the lease payments. Thus, the new guidance essentially eliminates the operating lease accounting method currently allowed under existing U.S. GAAP and will likely represent a significant change in accounting methods for many organizations.

104.11 Determining the lease term for many leases will require judgment to properly measure the asset and liability. The proposed definition of *lease term* is the non-cancellable period that a lessee has committed to lease the asset. Renewal options should be considered, and if there is a significant incentive for the lessee to extend the lease, that renewal period should also be included in the lease term. The lease term would only be reassessed if there are significant changes in factors that would impact the initial decision.

104.12 The FASB has tentatively decided that these accounting requirements would not apply to any leases with a maximum possible term of 12 months or less. Those leases would be accounted for much like an operating lease in the current authoritative accounting literature.

104.13 As proposed, assets and liabilities under existing operating leases must be measured and recognized when the new accounting standards are required to be implemented. Thus, nonprofit organizations need to be prepared for significant changes to their financial statements. The authors expect that many debt covenants will have to be modified (or debt covenant waivers obtained) when the new standards become effective.

104.14 Accounting by Lessors.

The FASB has tentatively decided on two approaches to be used by lessors to account for leases: (a) a receivable and residual approach and (b) an operating lease approach. The lessor would use the receivable and residual approach for leases where the lessee acquires and uses more than an insignificant portion of the leased asset over the lease term. For leases where the lessee consumes only an insignificant portion of the leased asset, the lessor would use an approach similar to current operating lease accounting.

104.15 Lessors that account for leases under the receivable and residual approach would derecognize the underlying leased asset and recognize a lease receivable and a residual asset in its place. The lease receivable would be measured at the present value of the lease payments to be received, discounted at the rate charged to the lessee. The receivable would subsequently be measured at amortized cost using the effective interest method. The residual asset would initially be measured as an allocation of the carrying amount of the leased asset and would subsequently be measured by accreting it to the estimated residual value at the end of the lease term.

104.16 For leases that are not accounted for using the receivable and residual approach, lessors would use an approach similar to current operating lease accounting. Accordingly, the lessor would not derecognize the leased asset and would continue to recognize it in its statement of financial position. The lessor would recognize lease income using a straight-line method, and depreciation on the leased asset using an appropriate depreciation method.

104.17 **Financial Instruments**

The goal of this project is to significantly improve reporting of financial instruments. The project has been separated into three components: (a) classification and measurement, (b) credit impairment, and (c) hedging. Disclosures related to liquidity and interest rate risk are also being discussed by the FASB as a part of this project. In concept, the new guidance would affect the accounting for a variety of financial instruments including investments in debt and equity securities, investments in nonmarketable equity securities, loans, deposit liabilities, accounts payable, and accounts receivable. Short-term receivables and payables may be measured at amortized cost. Certain financial instruments, such as pension obligations and leases, are exempt from the scope of this project.

104.18 In December 2012, the FASB issued an exposure draft of a proposed ASU, *Financial Instruments—Credit Losses*. This proposed new guidance would replace the current impairment model, which reflects incurred credit events, with a model that recognizes expected credit risks and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The proposal would require an entity to impair its financial assets based on the current estimate of contractual cash flows not expected to be collected. The impairment would be reflected as an allowance for expected credit losses. The estimate of expected credit losses would be based on information about past events, including historical loss experience, current conditions, and reasonable and supportable forecasts that affect the expected collectability of remaining contractual cash flows. At the date of this *Guide*, the comment period on this exposure document would end in May 2013.

104.19 In February 2013, the FASB issued another proposed ASU in this project, *Financial Instruments—Overall*, which relates to the classification and measurement phase of the project. This proposal aims to improve financial reporting for financial instruments by developing a consistent, comprehensive framework for classifying those instruments that links the measurement of financial assets to how an entity expects to benefit from the cash flows embedded in those assets. The proposal covers the recognition, classification and measurement, and presentation of financial instruments. The exposure draft provides a lengthy overview of the proposals for classifying various types of financial assets and liabilities. As currently proposed, nonpublic entities (that is, most nonprofit organizations) would be exempt from only the requirement to disclose the fair values of financial assets measured at amortized cost and the requirement to disclose information about core deposit liabilities. At the date of this *Guide*, the comment period for this exposure document is scheduled to end in May 2013.

104.20 The new guidance that comes from the project on financial instruments, when effective, is expected to have a significant impact on banks and other financial institutions. Because nonprofit organizations generally already report all equity securities with readily determinable fair values and debt securities at fair value, the new standards will not represent a significant change in the measurement of many investments held by nonprofit organizations. However, as currently proposed, the new standards would require financial assets that represent investments held for the collection of contractual cash flows to be reported at amortized cost. The proposals will simplify the assessment of impairment of cost method investments and eliminate the fair value option for reporting equity method investments.

FASB Activities Related to Nonprofit Organizations

104.21 **ASU No. 2012-05**

In October 2012, the FASB issued ASU No. 2012-05, *Statement of Cash Flows (Topic 230): Not-for-Profit Entities: Classification of the Sale Proceeds of Donated Financial Assets in the Statement of Cash Flows*. ASU No. 2012-05 is effective for interim and annual periods beginning after June 15, 2013. Early adoption from the beginning of the fiscal year of adoption is permitted; but for fiscal years beginning before October 22, 2012, early adoption is only permitted if the organization's annual and interim financial statements have not been made available for issuance.

104.22 ASU No. 2012-05 was issued to address diversity in practice for presenting the proceeds from sales of certain donated financial assets in the statement of cash flows. When donated financial assets are liquidated almost immediately upon receipt, some financial statement preparers consider the sale an operating activity because the nonprofit organization's intent when accepting the securities is to sell them and obtain cash for operations. Other accountants view the cash received from the sale of the financial assets as an investing activity, and classify it accordingly. The new guidance describes the conditions that require the cash received from the sale of donated financial assets to be classified as an operating or a financing activity, depending on whether the donor restricts use of the contribution to long-term purposes. ASU No. 2012-05 is discussed in Chapter 6.

104.23 **Proposed Guidance For Personnel Services Received From an Affiliate**

In July 2012, the FASB issued an exposure draft of a proposed ASU titled, *Not-for-Profit Entities (Topic 958): Personnel Services Received from an Affiliate for Which the Affiliate Does Not Seek Compensation*, to provide guidance about recognizing and measuring personnel services received from an affiliate. Under the proposed ASU, a nonprofit organization would be required to recognize any personnel services that it receives from an affiliate and for which the affiliate does not seek compensation in its financial statements. The recipient nonprofit organization would measure these personnel services at the cost recognized by the affiliate for the personnel providing the services. The decrease in net assets or creation or enhancement of an asset that results from the personnel services received from the affiliate should be reported along with similar expenses or assets. Presenting the increase in net assets associated with the personnel services as a contra-expense or a contra-asset would be prohibited. Also, the proposed ASU would add the term *affiliate* to the FASB ASC Master Glossary and define the term to include parties that control, are controlled by, or under common control with another entity either directly or indirectly through one or more intermediaries.

104.24 The FASB staff was directed to perform additional research in consideration of the comment letters received in response to the exposure document. On March 28, 2013, the FASB redeliberated the proposal and the clarifications that had been ratified by the FASB's Emerging Issues Task Force (EITF). The clarifications from the EITF would (a) allow an organization to recognize personnel services received from an affiliate at fair value if the cost recognized by the affiliate for such services would significantly understate or overstate the value of the services received, and (b) not require new disclosures other than those already required by FASB ASC 850-10 for related party transactions and FASB ASC 235-10-50-1 through 50-3 for financial statement disclosures. As of the date of this *Guide*, the ASU had not been issued, but an effective date for the new standards had been published. When issued, the ASU will be effective for fiscal years beginning after June 15, 2014, with early adoption permitted. Financial statement preparers are cautioned that the final ASU may contain changes from the proposed guidance summarized in this discussion. Future editions of this *Guide* will discuss the new ASU in detail. Developments in this project can be monitored on the FASB website at **www.fasb.org**.

104.25 **FASB Project on Not-for-Profit Financial Reporting: Financial Statements**

The objective of this project is to reexamine existing standards for financial statement presentation by nonprofit organizations by focusing on improving (a) net asset classification requirements and (b) information provided in financial statements and notes about liquidity, financial performance, and cash flows. Although the FASB has not published substantive updates about this project since it was announced in 2011, as of the date of this *Guide*, the FASB's technical plan indicates the Board is expected to issue an exposure draft in the second half of 2013.

104.26 **FASB Research Project on Not-for-Profit Financial Reporting: Other Financial Communications**

This long-term project was also added to the FASB's technical plan as a research project in 2011. This project is aimed at studying how nonprofit organizations tell their financial story outside of their basic financial statements to donors and other financial statement users. As part of the project, the FASB will look for organizations willing to experiment with communication techniques with the expectation of learning whether it can promote other means of effective communication.

104.27 In connection with this project, the FASB staff conducted a survey of a nonprofit financial communications advisory group about opinions regarding the existence, availability, and sufficiency of other financial communication outside the financial statements. A summary of the responses was provided to the FASB's Not-for-Profit Advisory Committee (NAC) for consideration in September 2012. (See paragraphs beginning at 104.32 for discussion of the activities of the FASB's NAC.) Although the FASB has not published substantive updates about this project since it was announced in 2011, as of the date of this *Guide*, the FASB's technical plan indicated the Board expected to begin deliberations on the project in the first quarter of 2013.

Other Significant FASB Projects

104.28 **Discontinued Operations**

The goal of this project is to develop a similar definition of and disclosure requirements for discontinued operations. An exposure document of proposed new guidance was initially issued in September 2008, and then the project was moved into a lower priority project until it was reactivated in late 2012. After two years of inactivity, the Board met in December 2012 to affirm its decision to issue a new exposure document and discuss disposals of subsidiaries in which the parent entity retains a noncontrolling interest and the proposed disclosures.

104.29 As a result of deliberations in March 2013, the FASB issued proposed new guidance for public comment in early April 2013. The proposed ASU, *Presentation of Financial Statements (Topic 205)—Reporting Discontinued Operations*, redefines *discontinued operation* and would require organizations to provide additional disclosures about discontinued operations such as operating, investing, and financing cash flows. The comment period for the proposed ASU ends in late August 2013.

104.30 **Projects on the Liquidation Basis of Accounting and Going Concern**

Since May 2007, the FASB has been working on a project that was originally aimed at providing guidance on (a) the required disclosures of risks and uncertainties that may interfere with an entity's ability to meet its obligations when due and (b) the adoption and application of the liquidation basis of accounting. An exposure draft of a proposed statement entitled, *Going Concern*, was issued for comment in October 2008. The FASB received a substantial number of comments about the proposal. As a result, the FASB revisited the scope of the project and decided to divide it into two phases that would address: (a) how and when the liquidation basis of accounting should be applied, and (b) the assessment of an entity's ability to continue as a going concern and the related disclosures. An exposure draft of a proposed ASU on the liquidation basis of accounting titled, *Presentation of Financial Statements (Topic 205): The Liquidation Basis of Accounting*, was issued in July 2012 and a final ASU is scheduled to be issued in the second quarter of 2013.

104.31 In the first quarter of 2013, the FASB began formal discussion of the going concern project again. The FASB decided that, consistent with the present requirements in GAAS, an organization would be required to provide sufficient information to enable financial statement users to understand the principal events that give rise to an organization's potential inability to meet its obligations, the possible effects of those events, and management's plans. Disclosures would be required when existing events or circumstances indicate conditions are near the threshold *more likely than not* that the entity may be unable to meet its obligations in the ordinary course of business within a reasonable period of time from the date of the financial statements. Guidance for what represents a *reasonable period of time* and how to consider the effects of existing events or conditions would be provided in the new ASU. Nonpublic entities would be exempt from certain provisions that would require an entity to assert in the financial statements that there is substantial doubt about its ability to continue as a going concern when the likelihood of the entity's inability to meet its obligations within a reasonable period of time becomes probable. As of the date of this *Guide*, an exposure draft of a proposed ASU on going concern is expected to be issued in the second quarter of 2013. Developments in this project may be monitored at **www.fasb.org**.

Activities of the FASB's Not-for-Profit Advisory Committee

104.32 The NAC was established by the FASB in October 2009 to support its efforts to address the accounting and reporting needs of nonprofit organizations and the users of their financial statements. In its advisory role, the 15-member NAC provides the FASB with input and feedback on existing GAAP, current and proposed FASB projects, and long-term issues. It also assists the FASB to communicate and reach out to the nonprofit sector and other interested parties.

104.33 In early 2011, the NAC formed three committee subgroups to look at ways to improve the financial reporting model for nonprofit organizations. The groups were organized to address ways to (a) improve the reporting of financial performance in the statement of activities; (b) improve the ways that liquidity and financial health are reflected in the statement of financial position and the notes; and (c) enhance how organizations tell their story by looking at guidance for functional and segment reporting, summarized financial statements, and other qualitative discussions by management. The work done by the NAC and its subgroups culminated in a presentation of key conclusions and recommendations in a joint meeting with the FASB in September 2011. Subsequently, the FASB chairman announced the addition of two projects to the FASB technical plan in November 2011; developments in these projects are described beginning at paragraph 104.25.

104.34 **Initial Recommendations of the NAC**

As described in paragraph 104.33, the NAC established three working groups to develop alternatives for the FASB to consider as potential improvements to financial reporting by nonprofit organizations. Each group was responsible for studying initiatives that might be undertaken and developing tentative recommendations and alternatives for consideration by the full NAC. The following paragraphs summarize some of the NAC's initial recommendations to the FASB.

104.35 Reporting Financial Performance Group.

This group considered how to improve the statement of activities and the statement of cash flows, including the interrelationship between those two statements. Among the recommended changes to reporting standards for nonprofit organizations are:

- *An operating measure in the statement of activities.* Whereas the current financial reporting model shows the total change in net assets, it is important to distinguish between operating and nonoperating changes in net assets, somewhat along the lines of the required measure used in the health care sector and the voluntary measure used by some in the higher education sector.

- *Improved Reporting of Liquidity.* The distinction between temporarily restricted net assets and permanently restricted net assets is not the most useful division of net assets because those classes do not adequately reflect liquidity and the availability of resources.

- *Presentation of Financial Statements.* A single reporting model with opportunities for a nonprofit organization to select certain choices from a predetermined range of options, with full disclosure of which choices the organization selected, and appropriate explanations of reasoning behind each choice.

104.36 "Telling the Story" Group.

This group considered potential financial statement improvements beyond the statement of activities and statement of cash flows to help nonprofit organizations bring context to their financial stories. Among the recommendations to the FASB are:

- Some type of management's discussion and analysis section is needed to provide commentary and analysis of the reporting organization's operating results and related fiscal health.

- Nonprofit organizations that have several program activities need to provide segment or line-of-business reporting, perhaps through or linked with a statement of functional expenses.

104.37 Liquidity/Financial Health Group.

This group considered how to best reflect liquidity or other key measures of financial health in the statement of financial position or in the notes to financial statements better. Among the recommendations to the FASB are:

- Provide better information about nonprofit organizations' liquidity positions, including information about non-donor limitations on net assets.

- To improve liquidity information, financial statements need additional disclosures about the composition of the unrestricted net asset class.

- Linking the investment and endowment footnotes would give a better idea of the liquidity of investments.

104.38 In addition to those recommendations, NAC also said that financial statement disclosures need to be streamlined to improve their relevance and clarity because users of financial statements often indicate that disclosures are neither clear nor concise. NAC offered the following as suggestions to start the discussion of needed revisions:

- Pension and OPEB disclosures that go beyond key information needs.

- Fair value measurement disclosures for Levels 1, 2, and 3 investment assets.

• Fair value disclosures for debt.

• Boilerplate information about tax uncertainties.

104.39 Current Activities of the NAC.

The NAC's most recent meetings were held in late February and March 2013. In these meetings, the group discussed recent trends noted in the nonprofit environment, received updates on various nonprofit projects on which the FASB staff are working, discussed observations about recent FASB exposure drafts, and discussed various FASB projects. The NAC also met with the FASB to discuss observations and concerns. Information about NAC and copies of meeting information is available on the FASB website at **www.fasb.org**.

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