FASB Emerging Issues Task Force

Issue No. 12-B

Title: Not-for-Profit Entities: Services Received from Personnel of an Affiliate for Which the Affiliate Does Not Seek Compensation

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Previously distributed EITF materials: Issue Summary No. 1, dated March 2, 2012; Issue Summary No. 1, Supplement No. 1, dated June 11, 2012

Background

1. At the June 21, 2012 EITF meeting, the Task Force reached a consensus-for-exposure that in their standalone financial statements, recipient not-for-profit entities (NFPs), including not for profit business-oriented health care entities, should not apply the contributed services guidance in paragraph 958-605-25-17 for recognizing services received from personnel of an affiliate for which the affiliate does not seek compensation. Instead, the recipient NFP should recognize all services received from personnel of an affiliate that directly benefit the recipient NFP, at the cost recognized by the affiliate for the personnel providing those services. The Task Force noted that although components of cost would depend on the nature and type of the personnel services and could vary from entity to entity, at a minimum all direct personnel costs (for example, compensation and any payroll-related fringe benefits) incurred by the affiliate in providing the services should be recognized by the recipient NFP.

*** The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

2. An NFP that provides a performance indicator (analogous to income from continuing operations of a for-profit entity) would report the increase in net assets associated with services received from personnel of an affiliate and for which the affiliate does not seek compensation as an equity transfer, regardless of whether those services are received from a not-for-profit affiliate entity or a for-profit affiliate entity. For other NFPs that do not present a performance indicator, no presentation guidance would be prescribed for the increase in net assets associated with services received from personnel of an affiliate other than prohibiting reporting as a contra-expense or a contra-asset. All recipient NFPs would report the corresponding decrease in net assets or the creation or enhancement of an asset resulting from the use of services received from personnel of an affiliate similar to how other such expenses and assets are reported. Recipient NFPs would provide the disclosures in Subtopic 850-10, Related Party Disclosures—Overall, to services received from personnel of an affiliate. No other recurring disclosures would be required by this Issue.

3. The Task Force also reached a consensus-for-exposure that the amendments resulting from this Issue would be applied on a prospective basis. An entity would have an option to apply the proposed amendments under a modified retrospective approach in which all prior periods presented upon the date of adoption would be adjusted, but no adjustment would be made to the beginning balance of net assets of the earliest period presented. Early adoption would be permitted. Entities would apply the transition disclosure requirements in paragraphs 250-10-50-1 through 50-3 for an accounting change resulting from this Issue. No additional transition disclosures would be required.

4. The amendments resulting from this Issue would apply to the standalone financial statements of NFPs that receive services from personnel of an affiliate and for which the affiliate does not seek compensation from the recipient NFP. The Master Glossary defines an affiliate as a party that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with an entity. Seeking compensation generally would mean seeking the recovery of at least a substantial amount of the direct personnel costs (for example, compensation and any payroll-related fringe benefits) incurred by the affiliate in providing the

services to the recipient NFP. The guidance in this Issue does not address transactions between affiliates in other circumstances.

5. At its July 11, 2012 meeting, the Board ratified the consensus-for-exposure reached by the Task Force on this Issue and approved the issuance of a proposed Update for a 60-day public comment period. The proposed Update was posted to the FASB website on July 23, 2012, with a comment period that ended on September 20, 2012. Twelve comment letters were received on the proposed Update and have been distributed to Task Force members.

6. At the November 1, 2012 EITF meeting, the Task Force will have the opportunity to consider the comment letters received on the proposed Update as it redeliberates the consensus-for-exposure. The Task Force will then be asked whether it would like to affirm its consensus-for-exposure on this Issue as a final consensus.

Summary of Comment Letters Received and FASB Staff Analysis and Recommendation

7. Twelve comment letters were received on the proposed Update. Respondents included:

Constituency Group	Number of Comment Letters Received
Individuals	1 (CL#3)
Professional Accounting Organizations	1 (CL#8)
Auditors	4 (CL#6, CL#9, CL#10, CL#12)
Preparers	5 (CL#2, CL#4A, CL#5, CL#7, CL#11)
Academic	1 (CL#1)
Total	12

Comment letter respondents were asked to comment on the following questions in the proposed Update:

> **Question 1:** Do you agree that the scope of this proposed Update should be limited to the standalone financial statements of not-for-profit entities that receive personnel services from an affiliate, that is, a party that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with the recipient not-for-profit entity? If not, please explain why.

Question 2: Do you agree that a recipient not-for-profit entity should recognize all personnel services received from an affiliate that directly benefit the recipient not-for-profit entity (that is, are similar to personnel directly engaged by the recipient not-for-profit entity) but for which the affiliate does not seek compensation for the services provided? If not, please explain why.

Question 3: Do you agree that a recipient not-for-profit entity should measure the personnel services received from an affiliate at the cost incurred by the affiliate? Furthermore, do you agree that, at a minimum, cost should include all direct personnel costs (for example, compensation and any payroll-related fringe benefits) incurred by the affiliate in providing the services to the recipient not-for-profit entity? If not, please explain why.

Question 4: Do you agree that a recipient not-for-profit entity that presents a performance indicator (such as a not-for-profit business-oriented health care entity) should report the increase in net assets associated with personnel services received from an affiliate and for which the affiliate does not seek compensation as an equity transfer, regardless of whether those personnel services are received from a not-for-profit affiliate entity or a for-profit affiliate entity? If not, please explain why.

Question 5: For a recipient not-for-profit entity that does not present a performance indicator, do you agree that presentation guidance should not be prescribed for the increase in net assets associated with personnel services received from an affiliate other than prohibiting reporting as a contra-expense or a contra-asset? If not, please explain why.

Question 6: Do you agree that, except for the related party disclosures in Subtopic 850-10, no other recurring disclosures should be required for a not-for-profit entity that receives personnel services from an affiliate? If not, please explain why.

Question 7: Do you agree that the proposed amendments should be applied by a recipient not-for-profit entity prospectively? If not, please explain why.

Question 8: Do you agree that a recipient not-for-profit entity should be provided with an option to apply the proposed amendments under a modified retrospective approach in which all prior periods presented upon the date of adoption would be adjusted but no adjustment would be made to the beginning balance of net assets of the earliest period presented? If not, please explain why.

Question 9: Do you agree that a recipient not-for-profit entity should be permitted to early adopt the proposed amendments? If not, please explain why.

Question 10: How much time is needed to implement the proposed amendments? Please explain.

8. In the paragraphs that follow, the FASB staff analyzes the significant comments received and provides recommendations on how the Task Force might proceed.

Scope

9. In Question 1, constituents were asked whether they agreed that the scope of the proposed Update should be limited to the standalone financial statements of NFPs that receive services from personnel of an affiliate, that is, a party that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with the recipient not-for-profit entity. Three respondents (CL#4A, CL#6, CL#7) disagreed with the issuance of the proposed Update. Six respondents (CL#2, CL#3, CL#8, CL#9, CL#10, CL#12) agreed with the scope of the proposed Update as written, and one respondent (CL#1) did not comment. Another respondent (CL#11), while otherwise agreeing with the scope of the proposed Update, believes that consideration should also be given to applying the proposed amendments to the standalone financial statements of the affiliate counter-party that provides the personnel performing the services. The FASB staff notes that the affiliate counter-party would generally recognize the cost of the personnel performing the services in its financial statements and therefore does not believe that including that affiliate counter-party within the scope of this Issue is necessary.

10. Another respondent (CL#5) agreed with the scope of the proposed Update only if the definition of an affiliate is expanded. That respondent currently recognizes and measures at cost personnel services received from another entity. The respondent's concern is that if the other entity providing the services does not meet the definition of an affiliate, the respondent may have to apply the contributed services guidance in paragraph 958-605-25-17, according to which only certain personnel services received (those that require specialized skills or create or enhance non-financial assets) are recognized at fair value. Therefore, the respondent believes that the definition of an affiliate should be expanded so that arrangements for personnel services that the respondent has with the other entity are certain to be within the scope of this Issue. The FASB staff notes that paragraph BC9 of the proposed Update discusses the Codification definition of an "affiliate" and the related definition of "control," which includes control through "…contract, or otherwise." Paragraph BC9 also states that the Task Force believes that the broad definition of

control included in the definition of an affiliate, which includes control by contract or otherwise, would address entities intended to be included in the scope of the proposed guidance. The staff agrees with the Task Force and believes that amending the definition of an "affiliate" and the related definition of "control" is neither necessary nor practical and that the applicability of this Issue should be based on the current definition of an affiliate in the Codification.

11. The three respondents (CL#4A, CL#6, CL#7), two preparers and an auditor, who disagreed with the issuance of the proposed Update believe that it is unnecessary because existing standards already include guidance for recognizing contributed services. They believe that the accounting treatment for contributed services should not vary based on whether the services were provided by an affiliate or contributed by an unaffiliated donor. However, of the two preparer respondents who disagreed with the issuance of the proposed Update, one commented that the proposed amendments would not affect them and that their concern was that the scope of this Issue should not be expanded to include unaffiliated organizations. During subsequent outreach, the other preparer respondent also expressed the belief that the proposed amendments were not likely to affect them and that their comments were of a conceptual nature.

12. The FASB staff notes that the Task Force previously deliberated prescribing the same guidance for both services received from personnel of an affiliate and those provided by unaffiliated donors and reached a consensus-for-exposure that it was appropriate to prescribe different accounting guidance for services received from personnel of an affiliate. Paragraph BC4 of the proposed Update notes that a contribution is defined in the Master Glossary as a "…voluntary nonreciprocal transfer by another entity acting other than as an owner" and that stakeholders raised concerns about whether the measure of control inherent in an affiliate relationship and information available to the affiliate about the cost of the personnel services provided justify recognition and measurement bases that are different from the guidance in Subtopic 958-605 for voluntary services contributed by unaffiliated donors. As indicated in paragraph BC6 of the proposed Update, the Task Force agreed that services received from personnel of an affiliate are fundamentally different transactions than voluntary services contributed by external donors and thus require different accounting treatment.

13. One respondent (CL#12) observed that in certain instances, a recipient NFP may be included in a reporting group that issues combined or consolidated financial statements, but the affiliate that provides the personnel for performing the services to the recipient NFP is not included within that reporting group. Since the financial statements of the combined or consolidated group are not the standalone statements of the recipient NFP, that respondent recommended clarifying whether the proposed guidance would be applicable to the consolidated (or combined) financial statements of that reporting group, which includes the recipient NFP but excludes the affiliate that provides the personnel for performing the services. The FASB staff believes that the proposed guidance would apply in such circumstances and if the Task Force affirms its consensus-for-exposure, will clarify that in the final consensus.

Issue 1: Does the Task Force wish to affirm its consensus-for-exposure that the scope of the proposed amendments should be limited to the standalone financial statements of NFPs that receive services from personnel of an affiliate, that is, a party that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with the recipient NFP?

Recognition and Measurement

14. In Question 2, constituents were asked whether they agreed that a recipient NFP should recognize all services received from personnel of an affiliate that directly benefit the recipient NFP (that is, are similar to personnel directly engaged by the recipient NFP) but for which the affiliate does not seek compensation for the services provided. Eight respondents (CL#2, CL#3, CL#5, CL#8, CL#9, CL#10, CL#11, CL#12) agreed with the proposed Update and another respondent (CL#1) did not comment.

15. In Question 3, constituents were asked whether they agreed that a recipient NFP should measure the services received from personnel of an affiliate at the cost incurred by the affiliate. Constituents were also asked if they agreed that, at a minimum, cost should include all direct personnel costs (for example, compensation and any payroll-related fringe benefits) incurred by the affiliate in providing the services to the recipient NFP. Eight respondents (CL#1, CL#2, CL#3, CL#5, CL#8, CL#9, CL#10, CL#12) agreed with the proposed Update. However, one of

the respondents (CL#12) recommended that to enhance comparability, only direct personnel costs are recognized. If indirect costs are also recognized, that respondent recommended that the components of cost included in the measurement should be disclosed. Another respondent (CL#1) believes that more guidance is needed on how the cost incurred should be computed, for example if personnel of the affiliate entity that provides the services only works after normal hours for the recipient NFP.

16. The FASB staff notes that the components of cost would depend on the arrangement and the nature and type of services provided and could vary from entity to entity; therefore, the staff does not believe that the measurement should be restricted only to direct personnel costs or that specific guidance should be provided on how to compute the cost incurred in providing services to the affiliate NFP. Further, based on prior outreach, the staff understands that the significant components of personnel costs are likely to be the direct personnel costs; therefore, the staff does not believe that the inclusion of indirect costs in the measurement by some entities should be a reason to prescribe additional disclosures. The staff also notes that the proposed Update clarifies that the related party disclosures under Subtopic 850-10 apply to services received from personnel of an affiliate and observes that most other comment letter respondents did not indicate additional recurring disclosures were necessary.

17. Another respondent (CL#11), while agreeing that services received from personnel of an affiliate should be recognized, believes that fair value should be the preferred measurement attribute as it best reflects the economic benefit received. That respondent believes that an economic inconsistency exists if a NFP recognizes purchased personnel services at market rates but recognizes services provided by personnel of an affiliate at the cost to the affiliate; however, as a practicability exception, cost could be an acceptable alternative if the personnel services provided do not meet the definition of contributed services under Subtopic 958-605. The FASB staff notes that the Task Force decided that services received from personnel of an affiliate are fundamentally different transactions than contributed services and thus require different accounting treatment. Further, in practice, personnel costs can vary depending on whether the services are internally provided or purchased in the market, and the staff does not believe that to be economically inconsistent.

18. The three respondents (CL#4A, CL#6, CL#7) who disagreed with the scope and necessity of the proposed Update also disagreed to the proposed recognition and measurement guidance and proposed an alternative based on whether the services are contributed and the affiliate providing the services is willing and has the means to capture and provide the cost information. As described in paragraph 11, the preparer respondents (CL#4A, CL#7) do not believe that the proposed amendments in the consensus-for-exposure were likely to affect them. Nevertheless, two of the respondents (CL#4A, CL#6) propose that if the affiliate providing the services shares the cost information, recipient NFPs should be given an option to recognize at cost those services that do not meet the contributed services criteria under Subtopic 958-605. Similar to the above, the other respondent (CL#7) also proposes that the recipient NFP should have the option to recognize personnel services received if the affiliate that provides the personnel performing the services is willing to share the cost information; however, that respondent has not specified whether cost should only be applied to measure services that do not meet the contributed services criteria of Subtopic 958-605.

19. The FASB staff notes that the Task Force decided that services received from personnel of an affiliate are fundamentally different transactions than contributed services and thus require different accounting treatment. Further, giving an option to recognize services received may lead to further diversity in practice, instead of reducing it. Based on analysis and outreach performed with other NFP constituents, the staff's understanding is that affiliates do not have a significant concern in sharing personnel cost information at a senior level within the affiliate group, but may have a concern sharing that information outside the group. Since the proposed Update only applies to affiliates, the staff does not believe that the alternative model proposed in CL#4A, CL#6, CL#7 is necessary or justified. The staff also notes that those entities who do not currently track personnel services will have until the date of adoption to develop a system, which may be as simple as preparing timesheets.

20. Two respondents (CL#4A, CL#6) also expressed concerns regarding the auditability of cost information provided by the affiliate. The FASB staff notes that there are other areas of U.S. GAAP in which the transaction is recorded at cost or carrying amount; for example, common

control transactions or equity transfers for which auditing guidance is not provided in the accounting literature. The staff also notes that AU Section 334, *Related Party Transactions,* issued by the auditing standards board of the AICPA, indicates that when necessary to fully understand a particular transaction, procedures that might not otherwise be deemed necessary to comply with generally accepted auditing standards should be considered. Those procedures include confirming amounts and terms and inspecting evidence in possession of the other party to the transaction.

Issue 2: Does the Task Force wish to affirm its consensus-for-exposure that a recipient NFP should recognize all services received from personnel of an affiliate that directly benefit the recipient NFP and for which the affiliate does not seek compensation from the recipient NFP, at the cost recognized by the affiliate for the personnel providing those services?

Presentation and Disclosure

21. In Question 4, respondents were asked whether they agreed that a recipient NFP that presents a performance indicator (such as an NFP business-oriented health care entity) should report the increase in net assets associated with services received from personnel of an affiliate and for which the affiliate does not seek compensation as an equity transfer, regardless of whether those services are received from personnel of a NFP affiliate entity or a for-profit affiliate entity. Five respondents agreed (CL#2, CL#3, CL#9, CL#10, CL#12) with the proposed Update, others did not comment.

22. In Question 5, respondents were asked whether they agreed that for a recipient NFP that does not present a performance indicator, presentation guidance should not be prescribed for the increase in net assets associated with services received from personnel of an affiliate other than prohibiting reporting as a contra-expense or a contra-asset. Eight respondents agreed (CL#2, CL#3, CL#5, CL#8, CL#9, CL#10, CL#11, CL#12) with the proposed Update, others did not comment.

23. In Question 6, constituents were asked whether they agreed that, except for the related party disclosures in Subtopic 850-10, no other recurring disclosures should be required for an NFP that receives services from personnel of an affiliate. Four respondents agreed (CL#2, CL#3, CL#5, CL#10) with the proposed Update as written; another four respondents did not comment. Comments received from two other respondents (CL#1, CL#12) have been described and discussed in paragraphs 15 and 16 above. In addition, one respondent (CL#9) believes that the policy for recognizing services received from personnel of an affiliate should be included in the NFP's significant accounting policies and another respondent (CL#11) recommended that the measurement bases used by the recipient NFP should be included with the existing related party disclosures.

24. The FASB staff notes that the proposed amendments do not provide recipient NFP's with an election to apply an alternative accounting policy. Further, paragraph 235-10-50-1 through 50-3 requires that a description of all significant accounting policies, including principles and methods peculiar to the industry in which the entity operates, shall be included as an integral part of the financial statements. Therefore, the staff does not believe that additional recurring disclosures are necessary or should be prescribed by the Update.

Issue 3: Does the Task Force wish to affirm its consensus-for-exposure that

a. A recipient NFP that provides a performance indicator (analogous to income from continuing operations of a for-profit entity) should report the increase in net assets associated with services received from personnel of an affiliate and for which the affiliate does not seek compensation as an equity transfer, regardless of whether those services are received from a not-for-profit affiliate entity or a for-profit affiliate entity

b. For other recipient NFPs that do not present a performance indicator, no presentation guidance should be prescribed for the increase in net assets associated with services received from personnel of an affiliate other than prohibiting reporting as a contra-expense or a contra-asset

c. **The disclosures in Subtopic 850-10, Related Party Disclosures—Overall, apply to services received from personnel of an affiliate, and no other recurring disclosures would be required by this Issue?**

Transition and Early Adoption

25. In Questions 7 and 8, constituents were asked whether they agreed that the amendments in the proposed Update should be applied prospectively by a recipient NFP. Further, whether they agreed that a recipient NFP should be provided with an option to apply the proposed amendments under a modified retrospective approach in which all prior periods presented upon the date of adoption would be adjusted but no adjustment would be made to the beginning balance of net assets of the earliest period presented. Except for one respondent who preferred modified retrospective adoption (CL#10) to increase comparability, the other respondents either agreed (CL#2, CL#3, CL#5, CL#9, CL#11, CL#12) with the proposed Update or did not comment. Additionally, respondent (CL#9) commented that the Board should encourage rather than merely permit the retrospective approach.

26. In Question 9, respondents were asked whether they agreed that a recipient not-for-profit entity should be permitted to early adopt the proposed amendments. Six respondents agreed (CL#2, CL#5, CL#9, CL#10, CL#11, CL#12) with the proposed Update, others did not comment.

Issue 4: Does the Task Force wish to affirm its consensus-for-exposure that:

a, **The guidance in this Issue should be applied on a prospective basis**

b. **An entity would be provided with an option to apply the proposed amendments under a modified retrospective approach in which all prior periods presented upon the date of adoption would be adjusted, but no adjustment would be made to the beginning balance of net assets of the earliest period presented**

c. **Early adoption should be permitted?**

Effective Date

27. In Question 10, constituents were asked how much time would be needed to implement the proposed amendments. Two respondents (CL#2, CL#11) suggested 12-18 months, one (CL#9) suggested 2 years. Other respondents either stated that no or minimal implementation time was required (CL#5, CL#10) or did not comment. The FASB staff's outreach with other NFP constituents also indicated that the proposed amendments are not expected to require significant time to implement, as in many cases the information required is readily available.

28. Considering the regular learning cycle for NFPs and that some entities may have to implement a system to track personnel services within the scope of this Issue, the FASB staff recommends that if the Task Force affirms its consensus-for-exposure, the guidance should be effective for fiscal years beginning after September 15, 2013, and interim and annual periods thereafter, with early adoption permitted.

Issue 5: Does the Task Force agree with the FASB staff recommendation that the guidance should be effective for fiscal years beginning after September 15, 2013, and interim and annual periods thereafter?