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LETTER OF COMMENT NO. 18

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Financial Accounting Standards Board
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Having recently retired from a practice specializing in audits of not-for-profit organizations, I find it hard to imagine why the FASB is wasting its time on a pronouncement that would require not-for-profit mergers to be accounted for as purchases, at a time when present practice of combining operating funds, property funds and endowment funds in the unrestricted category make it almost impossible for most people, including board members, to understand the financial position of not-for-profit organizations.

Not-for-profits are not buying and selling each other giving rise to purchasing assets. Rather, in almost all cases of combinations they are pooling their operations. To require them to adjust combined assets to present value is a horrible waste of effort and resources to come up with valuations that are meaningless as long as the assets are kept in not-for-profit use rather than sold for other uses.

I am treasurer of Michigan Nature Association (MNA) which owns some 160 properties in the state of Michigan that have been purchased or donated to preserve wild natural areas over a period of 50 years. MNA maintains them in perpetuity as wild natural areas. The Nature Conservancy has an active chapter in Michigan and there are also several other regional land trusts. For efficiency, some of these organizations probably should combine or trade lands. Everyone knows the lands are worth much more for development purposes than their carrying value on the books of the organizations. But what a waste to try to determine that value! Should it be the value at which the land could be sold to a developer when MNA has committed never to sell but preserve these properties in perpetuity? Actually, under those conditions the land is a liability. Should MNA record a liability for the present value of future care require? This is an extreme example, but property used for not-for-profit purposes is worth much less in that use than it would be for other purposes. Requiring property to be adjusted to current value is a hopeless can of worms that would strongly discourage mergers or land transfers that might otherwise occur. Beyond this issue, I believe that it is absolutely essential that the FASB revisit its reporting in the unrestricted, temporarily restricted, and permanently restricted categories. Many organizations show only those three columns in the Statement of Activities.

While in a few cases such a presentation may be adequate, in most cases where there are significant property assets or funds functioning as endowment, the combination of these in an unrestricted column obscures information that people need to know. I have seen many situations where appreciation or decline in market value of endowment assets, unrestricted bequests, or capital campaigns and property purchases added together give a totally misleading result. Often an organization will look good in unrestricted assets when property assets exceed an operating deficit and there is no money to pay bills. An organization will look good during a capital campaign when funds are raised for property assets and then show a loss every year thereafter because there is no intent or even possibility to recover the depreciation in operations since the property was purchased from a capital campaign.

I believe that where there are significant property assets or funds functioning as endowment that the FASB should require separate columns for these and ordinary operations within the unrestricted category. Further, there should be a requirement that there should be a breakdown between operating activities at the top of the page and non-operating activities below. Non-operating should include change in market value of investments, bequests, capital campaign, and other unusual non-operating items. The section could be called "Capital Transactions and Non-operating Items." Depreciation which was not planned to be recovered could be recorded therein and payments on property debts and property assets purchased from operating funds would show up there, facts which affect financial health and people need to see.

Another major issue that needs attention is the treatment of endowment where only the original principal is considered as permanently restricted. Considering all appreciation as unrestricted is misleading. I believe organizations should be required to add an inflation adjustment annually to the principal to protect the purchasing power of the income. Fifty years ago $250,000 would endow a professorship at a college. Today, $1,500,000. The $250,000 donor expected to fund the chair in perpetuity. If the college has spent the appreciation or not regarded it as permanently restricted to the extent of inflation it has not kept faith with the donor. Other potential donors, seeing this result, may decide not to make a similar donation with today's dollars. Today, responsible organizations draw a reasonable amount like 5% from endowment for operations. Financial statements should show in operations above the line the draw broken down by actual earnings and additional draw. The transfer over actual earnings should be below the line in the funds functioning as endowment column. That way the operating result would correctly compare to the budget and a reader could see if endowment draws were responsible and not show a presentation that implies all appreciation was used in operations, or in the case of a market decline imply the market decline was an operating item.

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