

May 21, 1999

Tim S. Lucas. Director of Research and Technical Activities Financial Accounting Standards Board 401 Merrit 7

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Association for Healthcare Philanthropy

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Comment Letter No. 12 File Reference: 1082-194R Date Received:

Re: File 194-B

Dear Mr. Lucas

The Association For Healthcare Philanthropy (AHP) agrees with a key objective of the Proposed Statement Consolidated Financial Statements: Purpose and Policy (consolidation proposal); provision of consistent rules for not-forprofit and investor owned entities. (We wish there were an authority that could achieve consistency with governmental entities as well.) AHP is an association of individuals engaged in fund-raising for hospitals and other healthcare entities. Our members work for organizations with a variety of characteristics including those described in this letter. Application of current rules concerning consolidation by not-for-profit entities has been obscure at best and clarification is needed and appreciated.

However, we are concerned with the interaction between this consolidation proposal and the Proposed Statement Transfers of Assets involving Not-for-Profit Organizations That Raises or Holds Contributions for Others (agency proposal). The consolidation proposal provides criteria for defining the relationships between entities; the agency proposal uses different criteria for defining the entities that must use the equity method to report their financial relationship.

The consolidation proposal says there are two key elements of control:

- the parent's nonshared decision-making ability and 1.
- the parent's ability to use that power to increase its benefits and 2. limit its losses.

The consolidation proposal requires consolidation if both of these two criteria are met. The agency proposal, in contrast, requires reporting a financial interest in another entity even if neither of these criteria are met. Thus, not-for-profit organizations will have to jump through a double set of conflicting, possibly contradictory hoops to determine how their financial relationships should be reported.

It will be quite easy for the relationship between a recipient and beneficiary organization to meet both sets of criteria. The parent will then need to decide whether to present a consolidated financial statement or report its interest in its affiliate on an equity basis. We believe this mismatch between these proposals will result in significant confusion and inconsistency unless one or both proposals are significantly altered. As we have said many times before, we find the agency proposal basically flawed and are concerned that these basic flaws have not been resolved prior to the impending release of a final agency statement.

The consolidation proposal says the key objective of consolidated financial statements is to <u>avoid omission of relevant information</u>. However, the agency proposal requires reporting information about assets and revenues that the organization neither possesses nor controls. Thus, the agency proposal requires inclusion of irrelevant information. As a result, the readers of financial statements of not-for-profit organizations will be misled about the reported information. They may also assume that the characteristics of organizations that prepare consolidated financial statements exist when they do not.

A case example may help illustrate our concern. An organization raises money primarily for a specific beneficiary. The fund raising organization has the power to decide how and/or when money will be distributed to the beneficiary and typically imposes restrictions on those distributions. The fund raising organization may also make distributions of minor amounts to other beneficiaries but donors understand that the specified beneficiary is the primary recipient of contributed funds. The fund raising organization has been carefully, legally structured to have complete discretion over funds raised and the beneficiary entity has NO power to direct policies or management of the fund raising entity. Donors give to these type entities rather than to the beneficiary directly (even though a gift to either is often equally tax-deductible) because the fund raising organization has the special ability to determine need and represent the charitable objectives of the donor. (The reasons such fund raising entities are created are comparable to those described in Example 6 of the consolidation proposal: however, the entities are structured in a way that avoids the reasons for consolidation described in Example 6.) While the beneficiary organization may have a residual interest upon dissolution of the fund raising organization, it does not have the power to cause that dissolution. Except for the possible residual interest, the entities have essentially the same relationship as a grant-making foundation and its sponsor described in paragraphs 75 - 76 of the consolidation proposal. Since the beneficiary does

not know how much will be received, when it will be received, or the restrictions that will accompany distributions, how does it determine its "equity interest" in the fund raising organization?

For a second example, assume the facts described in the prior paragraph are the same except that the board of the fund raising organization is composed of both insiders and outsiders that meet the  $1^{\rm st}$  criteria of the consolidation proposal. The beneficiary's residual interest in the fund raising organization meets the 2<sup>nd</sup> criteria of the consolidation proposal. The role of inside board members is to assure that the needs of the beneficiary are understood. The role of these inside directors is defined to exclude a dominate role in deciding the amount of money distributed to the beneficiary, when those funds are distributed, or the restrictions imposed. In actual practice, these inside directors conform to their defined role. In these circumstances, the parent is subject to both the consolidation and agency proposals but there is no guidance as to which guidance is to be followed. Furthermore, the possibility that organizations other than the primary beneficiary will receive distributions seems to define a minority interest under the consolidation proposal but there is no guidance concerning how this minority interest is measured.

We are advising our members concerning ways to avoid the provisions of the agency proposal if they desire, such as rewriting by-laws to allow distribution to alternative beneficiaries or combining the fund raising entities of closely related beneficiary organizations. Nonetheless, we believe a consistent set of rules defining the relationships among entities is essential. Also, the agency proposal should reflect the original provision of SFAS No. 116, which focuses on HOW contributed funds are to be used rather than on WHO is to receive the funds.

In addition to our concern about the interaction between the consolidation proposal and the agency proposal, we believe it would be helpful if the final consolidation statement reiterates the rules concerning parent only financial statements and financial statements for some, but not all affiliates.

Please call me or Ronald Kovener (812-337-8920 or 970-476-5990) if we can provide additional information concerning the views expressed in this letter. We will be happy to meet with the board to discuss these issues further.

Sincerely

William C. McGinly, Ph.D., CAE

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President. Chief Executive Officer