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Comment Letter No. 11

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November 16, 2012

Ronald J. Bossio
Senior Project Manager
Financial Accounting Standards Board

Dear Mr. Bossio:

This letter responds to your request that I comment on the FASB Discussion Paper *Disclosure Framework* (File Reference No. 2012-220). Given my capacity as member of the NFP Project Resource Group, I shall confine my comments to the applicability of the proposed disclosure framework to not-for-profit (NFP) enterprise – in particular, the relevance of the framework to "informational needs of donors to not-for-profit organizations" (Question #1 on Page 2 of the document). My comments are informed by my interactions with students and accounting academics who are interested in NFP accounting and financial reporting issues.

When thinking about the relevance of the FASB *Disclosure Framework* effort for donors to NFP organizations, it is instructive to consider the distinguishing features of NFP enterprise that potentially bear on the relevance of financial disclosures. One important feature is differences in private incentives between the participating outside parties. Donors to NFP organizations and investors in for-profit organizations are similar in the sense that both parties provide resources to finance the activities of the organizations. In this regard, donors can be construed as "investors" in the NFP enterprise. In contrast with investors in for-profit organizations, however, donors to NFP entities usually do not retain a contractually enforceable residual claim. That is, donors typically expect and receive nothing of pecuniary value in return for their investment in not-for-profit organizations. Thus, unless their contributions are frequent and/or substantial, donors lack incentives to monitor not-for-profit organizations.

Another difference between commercial and NFP enterprise that bears more directly on the issue is that, for most NFP organizations, a well-developed market for output of NFP organizations does not exist. That is, consumers of NFP output frequently do not "purchase" the output in the usual sense. (Universities, hospitals and other health care facilities, and some museums – NFP organizations that compete with for-profit organizations – are conspicuous exceptions.) Given this context, beneficiaries of the not-for-profit enterprise also lack incentives to monitor or oversee NFP organizations.

The failure of market incentives to discipline NFP managers and to signal the value of NFP output frequently creates circumstances where parties to NFP enterprise disagree regarding the specific objectives. Stated another way, in contrast with commercial enterprise where the objective is to recognize a profit, consensus among the contributing and beneficiary parties to a NFP enterprise regarding whether the NFP endeavor is successful is often difficult to achieve.

To illustrate, consider a NFP with the objective of providing medical care to the indigent. Reasonable people can differ in terms of whether it is better to (1) provide expensive care to a few people who are very ill, or provide less expensive care to many who are only a little ill; (2) elevate the level of curative, or the level of preventive, care; or (3) treat the young or treat the elderly. Thus, while donors and NFP managers may agree regarding a general, and potentially vague, set of social objectives, achieving consensus regarding specific objectives, and – more to the point – identifying measures of success toward objectives that satisfy all parties is rarely straightforward. In contrast, investors in for-profit firms typically agree that net income is the appropriate preeminent performance measure.

Diversity among donors and differences between donors and NFP managers regarding specific NFP objectives, and the attendant disagreement regarding appropriate performance measures, means that the financial reporting needs of NFP donors likely differ substantially from the needs of investors in private enterprise. Hence, my considered opinion is that a disclosure framework that suits the needs of investors and lenders in the private sector is unlikely to serve the needs of donors to NFP organizations. In particular, I expect that the information needs of donors are more diverse and more complex than the needs of investors. Evidence in support of this position is that financial statements provided by NFP organizations in the absence of regulation tend to be more detailed than financial statements provided by for-profit organizations.

Thank you for the opportunity to contribute.

Sincerely,

William R. Baber
McDonough Professor