July 30, 2015

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Proposed Accounting Standards Update, Presentation of Financial Statements of Not-for-Profit Entities (File Reference No. 2015-230)

Dear Technical Director,

The Devereux Foundation ("Devereux") appreciates the opportunity to comment on the Financial Accounting Standards Board's Proposed Accounting Standards Update, Presentation of Financial Statements of Not-for-Profit Entities.

Devereux is a not-for-profit corporation, dually designated by the Internal Revenue Service (IRS) as an educational facility and health care organization, with a nationwide network of behavioral health treatment centers for children, adolescents, and adults with complex emotional, psychiatric, and developmental disabilities, including individuals with autism spectrum disorders. Treatment settings range along a continuum from acute psychiatric inpatient and campus-based residential settings to outpatient, foster care, in home, educational, vocational and prevention programs. Our annual revenue is approximately $400 million, which would probably classify us as a large NFP. Additionally, we have relationships with banks, insurance companies, rating agencies and other entities that are used to the current financial reporting system. Heretofore, we have generally applied the AICPA’s Audit & Accounting Guide: Health Care Entities with regard to financial statement presentation.

We have elected to only respond to those questions / issues that are of most interest / concern to us. We have organized our responses under the specific areas indicated in the proposal.

Responses

Statement of Financial Position and Liquidity

Question 2: Do you agree that the aggregated amount by which endowment funds are underwater should be classified within net assets with donor restrictions rather than net assets without donor restrictions? If not, why? (See paragraph BC24.)
While we agree that the aggregated amount by which endowment funds are underwater should be classified within net assets with donor restrictions rather than net assets without donor restrictions, implementing this in practice could be more challenging. For those endowment funds, both established by donors and quasi-endowments established by boards, that are in a pooled investment, it may be difficult to determine how much the endowment fund with donor restrictions is underwater.

**Question 4:** Do you agree that providing information in notes to financial statements about financial assets and liabilities and limits on the use of those assets is an effective way to clearly communicate information useful in assessing an NFP’s liquidity and how it manages liquidity without imposing undue costs? If not, why, and what alternative(s) would you suggest? (See paragraphs BC27 - BC31.)

We disagree that providing information in notes to financial statements about financial assets and liabilities and limits on the use of those assets is an effective way to clearly communicate information useful in assessing an NFP’s liquidity and how it manages liquidity without imposing undue costs.

Adding additional disclosures to financial statements increases the complexity to these statements. While yes, communicating how liquidity is managed is important, we are not of the belief this can be effectively communicated in a footnote, since an unsophisticated user of NFP’s financial statements doesn’t really understand how restrictions on assets work. We believe the current requirements are sufficient.

**Question 5:** Most business-oriented health care NFPs are required to present a classified balance sheet. Continuing care retirement communities and other NFPs may choose to sequence their assets and liabilities according to their nearness to cash as an alternative to using a classified balance sheet. As a result of the proposed requirement to provide enhanced disclosures of information useful in assessing liquidity, would there no longer be a need to hold business-oriented health care NFPs to the more stringent standard for their balance sheets? If not, why?

We believe there is a need to require most business-oriented health care NFPs to classify their balance sheets.

As explained in the prior comment, I don’t believe that the majority of users of the financial statements thoroughly read the footnotes. By having a classified balance sheet as currently required for business-oriented healthcare NFPs, which Devereux is, there is sufficient information detailed on the balance sheet that would enable a user to assess the liquidity of a NFP. Having separate line items within assets whose use is limited describing the types of restrictions enables a user to understand that these assets cannot be used for the general use of the organization. A classified balance sheet provides succinct information as to the liquidity of an NFP to a user of the financial statements.
Statement of Activities, Including Financial Performance

Question 6: Do you agree that requiring intermediate measures of operations would provide users of NFP financial statements with more relevant and comparable information for purposes of (a) assessing whether the activities of a period have drawn upon, or have contributed to, past or future periods and (b) understanding the relationship of resources used in operations of a period to resource inflows available to fund those operations? Do you also agree that classifying and aggregating information in that way would not require major system changes? If not, why? (See paragraphs BC38–BC47.)

We agree that requiring intermediate measures of operations would provide users of NFP financial statements with more relevant and comparable information. Presently, only business-oriented NFP’s are required to have a performance indicator. And these organizations have a tremendous amount of flexibility of determining operating measures within the performance indicator, which makes comparability between organizations difficult.

However, we do not agree with what is to be included and excluded from the intermediate measures of operations as currently presented in the proposal. We further describe our exceptions to what is currently proposed in our responses detailed below.

Question 7: Do you agree that intermediate measures of operations should include only those (a) resource inflows and outflows that are from or directed at carrying out an NFP’s purpose for existence and (b) resources that are available for current-period operating activities before and after the effects of internal governing board appropriations, designations, and similar actions? If not, why? (See paragraphs BC48–BC74.)

We agree that intermediate measures of operations should include only those (a) resource inflows and outflows that are from or directed at carrying out an NFP’s purpose for existence and (b) resources that are available for current-period operating activities before and after the effects of internal governing board appropriations, designations, and similar actions.

However, we do not agree with what the board considers to be resource inflows and outflows that are from or directed at the NFP’s purpose for existence. Investment return is an excluded resource inflow from the intermediate measures of operations, since the board’s position is that the earnings on investments are not attributable to the NFP’s purposes for existence. We disagree with the board on this point. Many NFP’s, including Devereux, have established quasi-endowments that have grown over time (through the receipt of contributions without restrictions, appreciation of invested assets, and the reinvestment of cash generated from operations) and generate an investment return that enables the NFP to help carry out its purpose for existence. Investment earnings assist NFP’s in funding programs and are an integral part of the many NFP’s business models. In addition, in accordance with state and federal regulations, Spending Rules of endowments
are required to be applied, which is clear evidence that NFPs view investment income as supporting operations, at least in part.

**Question 8:** Do you agree that all internal transfers (governing board appropriations, designations, and similar actions that make resources unavailable or available for operations of the current period) should be reflected on the statement of activities immediately after an intermediate measure of operations before transfers and immediately before an intermediate measure of operations after transfers? If not all internal transfers, on what basis would you distinguish between those transfers that should and should not be reflected and how would you make that distinction operable? Do you also agree that reflecting those internal decisions (or lack of them) on the face of the statement rather than in notes will help an NFP communicate how its operations are managed without adding undue complexities? Why or why not? (See paragraphs BC46–BC47 and BC67–BC74.)

We believe that the presentation of internal transfers provides additional complexity to the financial statements, and that most users of NFP’s financial statements will not understand what these transfers mean. As such, they unnecessarily complicate the presentation of operating results and changes in net assets.

**Question 9:** Do you agree that to promote comparability, the Board should eliminate one of the two optional methods for reporting expirations of donor restrictions on gifts of cash or other assets to be used to acquire or construct long-lived assets? Do you also agree that requiring the expiration of those donor restrictions on the basis of the placed-in-service approach rather than the current option to present a release from restriction over the useful life of the acquired long-lived asset is most consistent with the underlying notions of the intermediate measures of operations? If not, why? (See paragraph BC66.)

We agree that the Board should eliminate one of the two optional methods for reporting expirations of donor restrictions on gifts of cash or other assets to be used to acquire or construct long-lived assets.

By having two methods currently available, it is hard to compare organizations financial statements, as one may be using one method and the other another method. While the notes to the financial statements would disclose the method being used, users of the financial statements would have to consider that in their evaluation of the financial statements.

In terms of the placed-in-service approach that the proposal requires, this does more accurately reflect that the restrictions that were imposed by the donor have been met once the asset has been acquired and placed into service. This approach is consistent with how business-oriented healthcare NFP’s are required to account for gifts of cash or other assets used to acquire or construct long-lived assets. However, this approach could result in large variances year to year depending on the timing of when capital projects are completed.
which would result in operating excess before transfers to swing significantly year over year, and would not be particularly useful to users who focus on that metric.

**Question 12:** Do you think the flexibility currently allowed by GAAP to present a statement of activities as either a single statement or two articulating statements and to use either a single-column or a multicolumn format should be retained or narrowed? If narrowed, why and in what ways?

We think that the flexibility currently allowed by GAAP to present a statement of activities as either a single statement or two articulating statements and to use either a single-column or a multicolumn format should be narrowed.

As a NFP business-oriented health care entity, Devereux has been presenting the statement of activities as a single-column format. We believe that the single-column format provides a better way to present the information than a multicolumn format, as this presentation is easier for users to compare current-year and prior-year information, since they can be presented on the same page.

**Question 14:** Do you agree that requiring investment income to be reported net of external and direct internal investment expenses will increase comparability and avoid imposing undue costs to obtain information about all investment fees (for example, embedded fees of hedge funds, mutual funds, and funds of funds)? If not, why? (See paragraph BC100.)

We agree that requiring investment income to be reported net of external expenses will increase comparability and avoid imposing undue costs to obtain information about all investment fees. Typically, when investment returns are evaluated for a particular investment, it is evaluated net of the fees that are paid, since these fees are embedded in the investment return. However, we do have some reservations as how direct internal investment expenses are determined. For instance, paragraph BC61 states "These proposed amendments also clarify that supporting activities, such as supervision, oversight, centralized services (accounting, human resources, purchasing), program development, membership development, and fund-raising are operating activities. To achieve the purposes for their existence, substantially all NFPs must conduct those supporting activities in carrying out their current-period purposes." A number of individuals fit into the supporting activities of an NFP and may be involved in the investment activities of an organization. It also seems that an NFP has a fair amount of latitude to determine what constitutes direct internal investment expenses. As is currently proposed, investment income is a component of investment return, which is not included within the intermediate measures of operations. Therefore, an NFP could have an incentive to shift expenses outside of operating expenses to make its operating excess look better.
Question 16: Do you agree that interest expense, whether incurred on short-term or long-term borrowing, and fees and related expenses incurred for access to lines of credit and similar cash management and treasury activities are not directed at carrying out an NFP’s purposes and, thus, should not be classified as operating activities? If not, why? (See paragraphs BC59–BC60.)

We disagree that interest expense, whether incurred on short-term or long-term borrowing, and fees and related expenses incurred for access to lines of credit and similar cash management and treasury activities are not directed at carrying out an NFP’s purposes and, thus, should not be classified as operating activities.

The majority of Devereux’s borrowings, like most NFP’s, are for capital projects that are used for programmatic purposes, which is used to carry out the purpose of existence of the organization. Refinancings of initial borrowings are also part and parcel of the capital project. These programs are operating activities of the organization, and therefore the costs associated with running the programs should be included as an operating expense. During long-term construction projects interest on the borrowings for the project is capitalized as component of the asset. This proposal does not change how interest is capitalized under GAAP. Once the project is completed and placed into service, the interest that was capitalized will be expensed over the life of the asset through depreciation expense, which is an operating expense under the proposal. After the project is complete, that same interest on the borrowings (which were used specifically to finance the asset) would no longer be considered an operating expense in the proposal. This does not make sense since the purpose of the borrowings was to construct an asset that provides operating resource inflows. One would think all of the related expenses of an asset that provides operating resource inflows would be operating resource outflows. Additionally, short-term borrowings on revolving credit arrangements are typically needed to provide necessary liquidity to keep the operations of an organization continuing. Having that expense as a non-operating expense doesn’t seem right as well. To say that interest expense is not directed at carrying out the NFP’s purpose for existence is short-sighted, since without those borrowings and the related interest, an NFP would most likely not be able to fulfill its purpose for existence.
Question 17: Do you agree with the following implementation guidance: a. Equity transfers between NFPs that are under common control and are eliminated in a parent entity's consolidated financial statements and equity transactions between financially interrelated entities should be presented within operating activities unless they are not available for current-period use in carrying out the purpose for the reporting entity's existence? If not, why? (See paragraph BC62(a).) b. Immediate writeoffs of goodwill generally should be presented within operating activities? If not, why? (See paragraph BC62(b).) c. Immediate writeoffs of acquisitions of noncapitalized items for a permanent collection should be presented within the operating activity section if acquired with net assets without donor restrictions? If not, why? (See paragraph BC62(c).)

The whole concept of showing transfers in the statements of operations and activities is rather confusing, even for those that are within the accounting industry. So for a user of an NFP's financial statements, this presentation will not be understandable and particularly useful. Additionally, similar to the placed in service approach for donations for / donated property and equipment placed in service, this could create material swings year to year that are not necessarily indicative of operating results.

**Statement of Cash Flows, Including Financial Performance**

Question 18: Do you agree that the direct method of presenting operating cash flows is more understandable and useful than the indirect method? Do you also agree that the expected benefits of presenting operating cash flows in that way would justify the one-time and ongoing costs that may be incurred to implement that method of reporting? If not, please explain why and suggest an alternative that might increase the benefits or reduce any operational concerns or costs. (See paragraphs BC75–BC80.)

We disagree that the direct method of presenting operating cash flows is more understandable and useful than the indirect method.

The direct method of presenting operating cash flows is rarely used in financial statements. By requiring the direct method of presenting operating cash flows is akin to requiring the sum-of-the-years digits method for depreciating assets, as nearly every organization uses the straight-line method of depreciation. We don't believe that the direct method of presenting operating cash flows is more understandable and useful, since most users are not experienced or accustomed to seeing it that way. In addition, many business-oriented healthcare NFPs are compared against for-profit organizations. By changing the presentation of operating cash flows, financial performance of NFP's will no longer be comparable with their for-profit peers.

We disagree that the expected benefits of presenting operating cash flows in that way would justify the one-time and ongoing costs that may be incurred to implement that method of reporting. Keeping the existing format of the presenting operating cash flows, the indirect method, would eliminate added complexity and costs.
Question 20: Do you agree that although operating activities is defined differently for the statement of cash flows than for the statement of activities, more closely aligning line items presented in the statement of cash flows with the proposed operating classification for the statement of activities will increase understandability even though that reporting would be somewhat different from current requirements for business entities? If you believe that operating items in the two financial statements would not be sufficiently aligned, please indicate how their alignment might be further improved. (See paragraphs BC81–BC86.)

We disagree that although operating activities is defined differently for the statement of cash flows than for the statement of activities, more closely aligning line items presented in the statement of cash flows with the proposed operating classification for the statement of activities will increase understandability even though that reporting would be somewhat different from current requirements for business entities.

One example is the purchase of property, plant, and equipment. Currently, this is presented in the cash flows from investing activities section within the statement of cash flows. The proposal would require this to be included within the operating activities. The purchase of property, plant, and equipment is an *investment* that an organization makes to further its mission. Additionally, by requiring NFP’s to present this as an operating activity, comparability is lost to its for-profit peers, as they are not required to present operating activities in the statement of cash flows in the same manner as NFPs.

We would be pleased to discuss our comments with the Board members or the FASB staff at your convenience.

Very truly yours,

[Signature]

David A. Griffith
Controller
The Devereux Foundation