August 12, 2015

Technical Director
Financial Accounting Standards Board
401 Merritt 7
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Re: File Reference No. 2015-230
Proposed Accounting Standards Update – Not-for-Profit Entities (Topic 958) and Health Care Entities (Topic 954) Presentation of Financial Statements of Not-for-Profit Entities

The comments below summarize the consensus opinions of the Washington Society of Certified Public Accountants Not-for-Profit Committee. Our committee formed 25 years ago and is currently comprised of 180 CPAs actively engaged in the not-for-profit community. We work in not-for-profit organizations, public practices specializing in not-for-profit organizations, and as volunteers on not-for-profit boards. The organizations we serve vary in size and mission and the comments below reflect the diversity of the not-for-profit community as well as the collective judgment of our committee members.

Our committee discussed the Exposure Draft at length. As a group, we support the FASB's goals to improve clarity and consistency in not-for-profit GAAP. Not-for-profit organizations share a unique responsibility to society in exchange for their tax exemption, and appropriate disclosure of how they steward their resources is an important part of fulfilling that responsibility. Clear and consistent reporting helps boards, funders and the general public understand not-for-profit organizations and safeguards public perception of the not-for-profit community. The mission is paramount to each organization. Their focus is on serving their communities and improving the world. Our role as advisors and supporters is to ensure that the standards of our profession allow their unique stories to be heard.

We appreciate the opportunity to share the thoughts of our committee and to assist the FASB in meeting these goals. We endeavored to anticipate the impact of the proposed changes on our organizations and evaluate whether the new information would benefit financial statement users. We also tried to anticipate the costs involved in the proposed changes and to suggest alternatives where possible.

We support, with no further comments, the following questions raised by the FASB:

- We agree that the amount by which endowments are underwater should be classified with restricted funds (question 2).
- We agree that disclosure of spending policies and original gift amounts connected with underwater amounts provides useful information without undue cost (question 3).
- We agree that disclosure of investment expense is unnecessary and that disclosure of internal investment salaries and benefits should be a required disclosure (question 15).
- We agree that equity transfers for entities under common control, immediate write-offs of goodwill, and immediate write-offs of permanent collection items should be presented within operating activities (question 17).

We believe the remaining questions require responses that are more detailed. There are five general concerns that underlie our comments:

- Comparability is diminished by applying one-size-fits-all standards across the entire not-for-profit community; diverse not-for-profit activities have significantly different reporting needs.
- Bright-line rules undermine the flexibility offered by principles-based standards which allow organizations to report the information of greatest importance to financial statement users in the clearest way.
- Cost must be proportionate to the benefits for financial statement users.
✓ **Complexity** is made worse by unnecessary differences between for-profit and not-for-profit GAAP for similar transactions and reporting.

✓ **Usefulness and relevance** are improved by simple, concise reports, but some proposed changes would make reports more difficult to read.

**Response to question 1:** We **strongly agree** that including information on the nature of donor-imposed restrictions and their effect on liquidity in notes to financial statements maintains an appropriate level of disclosure. We also discussed:

✓ Reporting only two net asset classes defined as with or without donor restrictions simplifies and clarifies balance sheet reporting, but not-for-profit GAAP must require disclosure of permanently restricted net assets in notes to financial statements.

✓ A classified balance sheet that specifically identifies assets with permanent restrictions may more clearly provide most of the information that a permanently restricted net assets caption provides.

**Response to question 4:** We **strongly disagree** that providing information in notes to financial statements about liquidity and the management of liquidity provides useful information and we believe that this proposed change would require unreasonable cost to implement. In addition, we observe:

✓ Because smaller not-for-profit organizations often have only informal procedures, they may not have externally relevant qualitative information on liquidity.
  
  o An auditor could potentially be asked to draft or accept an aspirational liquidity disclosure with little or no connection to actual operations.

✓ For those organizations that are able to design, compose and formally adopt a meaningful liquidity policy, related disclosures could be long out of date by the time audited financial statements become available to users.

✓ Because each organization would define its own timeframe, comparability between organizations would be difficult or impossible.

✓ Developing and maintaining an auditable liquidity policy would be difficult and time consuming for all organizations, regardless of size or sophistication.

Because this proposed change does not yet apply to for-profit entities and because it would require significant implementation guidance to ensure meaningful, comparable information for financial statement users, we recommend withdrawal of this proposed change at this time.

**Response to question 5:** We **agree** that a classified balance sheet helps creditors, donors and other users of financial statements assess liquidity. We also believe that classified balance sheets are the most practical way to provide understandable liquidity information. We therefore think the preferable **alternative** is to require classified balance sheets instead of the proposed qualitative liquidity disclosures. We also believe that the FASB should not mandate classified balance sheets for not-for-profit organizations until it mandates them for all entities. Until then, we are **neutral** about holding business-oriented health care not-for-profits to the more stringent standard for their balance sheets.

**Response to question 6:** We **strongly disagree** that requiring an intermediate measure of operations would provide more useful and comparable information. Fundamentally, we believe that the not-for-profit community is too diverse for a requirement of this nature to be meaningful. The scope of operations and revenue sources encompassed by not-for-profit organizations advocates for existing not-for-profit GAAP, which allows an intermediate measure of operations for those organizations where it is relevant, but does not require it when its presentation adds unnecessary detail to the statement of activities. Moreover, based on discussions with organizations, including those with revenues in excess of $100 million, we believe that this proposed change would require major system change, the costs of which would outweigh the benefits. We also observe:

✓ Classifying information in this way would expand the statement of activities and create unnecessary confusion among users as to which performance measure should be important to them.

✓ Requiring an intermediate measure without a clear and objective principles-based definition of the term would increase management discretion and expose financial statements to manipulation.

As an **alternative**, we support the FASB in identifying and improving the definition of the existing optional intermediate measure of operations. BC40(d) of the Exposure Draft reminds us that use of ‘operations’ as a term can be arbitrary and divergent in practice. The existing guidance for reporting exempt function and unrelated income on Form 990 may provide a useful framework for further discussion of this proposed change.
Response to question 7: We disagree that an intermediate measure should include mission-related resources as defined by FASB and other resources available by virtue of internal actions, although we may be neutral if implementation guidance provides principles-based flexibility as to the types of items to be included in the intermediate measure of operations. As a separate component of the statement of activities, transfers should reflect only changes to board-designated net assets, a term that the FASB must clearly define in the standards. Our committee discussions have highlighted the following concerns:

- Investment income and expenses can be considered related to an organization’s mission; investment return is frequently used to fund planned program activities and interest expense is frequently used to finance facilities used for program activities.
  - Moreover, interest expense and lease expense would result in different treatment on the face of the activity statement even when the nature of both is payment for use of facilities.
- Debt covenants based on existing operating measures could require renegotiation, with potentially adverse consequences for not-for-profits.
- Turnover in management and the board could result in significant changes to board-designated net assets or the components of changes within them based on personal preferences; such changes based on the people involved rather than an external transaction would impair comparability not only among organizations, but within the same organization across periods.
- Current practice already allows disclosure of changes to board-designated net assets as part of the notes to financial statements; there is no compelling need to add standards to mandate presentation in the basic financial statements.
- Implementation guidance should include much greater detail on what would constitute transfers and how they would be differentiated from informal management intentions or from unintended events.
  - Reporting of transfers is less relevant if their approval can occur after year-end, since transfers might reflect an amount that achieves a 'target' operating result.

Although we disagree with the Exposure Draft on this issue, we suggest alternatives to mitigate some of the concerns our committee members have raised:

- The operating measure should relate directly to the organization’s mission, but the definition of mission should be broad enough to allow organizations to represent their unique activities; for example, investment income may be operating for a private foundation.
- The scope of transfers should be limited to changes to formally designated funds authorized by an organization’s board; including other types of transactions, particularly internal management decisions, creates burdensome tracking responsibilities, invites manipulation and impairs comparability between organizations.
- Given the variety of potential transfers, we believe all transfers of board designated funds should be presented net on a single line with details in the notes in order to maintain readability.

Response to question 8: For reasons described above, we disagree with the current proposed presentation of internal transfers on the face of the statement of activities; however, we agree that, whatever the captions, it would be more useful to present a subtotal for an operating measure before the impact of transfers.

Response to question 9: We disagree that the FASB should reduce organizational choice when reporting expirations of donor restrictions relating to long-lived assets. The existing optional methods allow organizations to present financial statements consistently with how they are used for internal decision-making purposes. Although we support the overall objective of comparability, for organizations with limited liquid assets and infrequent capital acquisitions, reflecting a large fixed asset as unrestricted might give readers a misleading picture of the restrictions truly placed on the organization.

Response to question 10: We disagree that contributions related to property and equipment should be considered operating revenue when placed in service. We believe that minor benefits from greater consistency do not outweigh significant implementation challenges and costs.

- The proposed change reduces reporting flexibility, which may impair the ability of organizations to reflect transactions clearly.
- Assets without a purpose or time restriction may require donor permission to be sold or disposed; such situations make it difficult to obtain information about liquidity from the operating measure.
- The proposed change treats assets differently based on how they were acquired, which makes accounting processes to recognize the release of restrictions more complex.
Response to question 11: We disagree with the proposed addition of a mandatory intermediate measure of operations as described in our responses to questions 6, 7 and 8. If it were mandated, then we would agree that the currently required performance indicator for health care entities would be unnecessary.

Response to question 12: We believe the current structure should be retained. Optional methods allow organizations to present their financial statements in a manner closest to the presentation used for internal decision making. Additionally, the current presentation allows not-for-profit organizations who have operations similar to those of for-profit entities to present their financial statements in a way that complies with not-for-profit GAAP, but remains as comparable as possible with for-profit peers.

Response to question 13: We agree that reporting expenses both by function and by nature provides relevant and useful information. We believe that most organizations already track this information and that the costs of implementation would not be excessive. In addition, we believe that the required presentation should include an option to place functional expenses in a note to the financial statements rather than requiring a dedicated statement. However, we believe that some organizations, particularly trade and membership organizations, should be excluded from this proposed change. We suggest limiting mandatory functional expense reporting to organizations that rely significantly on contribution revenue to accomplish their mission.

Response to question 14: We disagree that investment income should be reported net of external and direct internal investment expenses.

- Investment expense is rarely material; therefore, creating dedicated standards for it would increase complexity while providing little value.
- The proposed change is inconsistent with treatment of these items on the Form 990, which would increase complexity and decrease understandability.

As an alternative, we suggest limiting the scope of this proposed change to organizations with invested assets greater than $500 million or organizations with direct internal investment expenses that include payroll costs.

Response to question 16: We strongly disagree that interest expense should be excluded from operating activities. Many organizations use borrowings to finance activities that directly fulfill their exempt purpose (e.g., organizations that provide low-income housing). Moreover, a line of credit used to fund ongoing operations may not be directly attributable to a specific program activity, but may support programs as a whole.

Response to question 18: We agree that the direct method is more useful for cash flow presentation and is more desirable in the long run, but we are neutral on whether it would improve understandability to users now or would be an appropriate change in the near term. We support the members of the FASB who believe that this question (and others broadly applicable in GAAP), are better placed in a consideration of GAAP that includes for-profit entities.

Response to question 19: We agree that for the statement of cash flows, moving from the indirect to the direct method would not lose information and we agree that the direct method is a more understandable presentation. Current not-for-profit GAAP allows the direct method where it is most useful and does not require different presentations based on for-profit or not-for-profit status. The proposed change would introduce an unnecessary distinction between types of entities and should therefore be delayed until GAAP as a whole can change.

Response to question 20: We disagree that for the statement of cash flows, aligning the items more closely with the statement of activities while not eliminating all inconsistencies would increase understandability. The existing inconsistencies cause confusion, but maintain the dubious virtue of inertia. We support a change in the definitions, but believe that the definitions should be identical in order to improve understandability. Moreover, we believe that including property and equipment within the scope of operating activities would reduce understandability for readers since property is often acquired with capital campaign funds rather than operating funds.

Response to questions 21 and 22: The Exposure Draft did not include an implementation period for any of the proposed changes, however we do not expect any particular type of not-for-profit organization to need more time than others. We believe that liquidity disclosures could potentially require the most time to implement since such procedures would need to be developed, formalized, and then tested.

From a larger perspective however, we believe that proposed changes in areas where generally accepted accounting principles are analogous to the principles applicable to for-profit entities, the not-for-profit community should not take the lead on adopting new standards or be held to more costly reporting requirements. We support many of
the FASB's proposed changes, but believe that some of them would be more appropriately included in revisions to GAAP applicable to all entities rather than to the not-for-profit community alone.

**Conclusion:** In the judgment of our committee, the variety of missions and activities among not-for-profit organizations justifies the reporting flexibility that is present in current not-for-profit GAAP. The proposed standards diminish both flexibility and comparability within the not-for-profit community and make reports less readable and relevant to users. At the same time, the Exposure Draft also creates differences between not-for-profit and for-profit GAAP in areas where standards can and should be the same. Finally, they impose time and dollar costs that exceed the benefits to users.

Accounting standards define how not-for-profit organizations communicate their financial stories and their missions to the world. The comment letter process allows us together to improve the reporting framework that helps not-for-profit organizations build a better world. We appreciate the opportunity to comment on this Exposure Draft and we appreciate the FASB’s efforts to consider all comments it receives.

Sincerely,

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Chair, Not-for-Profit Committee of the Washington Society of CPAs

On Behalf of the membership of the Not-for-Profit Committee of the Washington Society of CPAs, including the following individual members who actively worked on this comment letter:

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