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Technical Director
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We are jointly submitting our comments on the proposed Not-For-Profit Entities exposure draft. Professor Daniel Neely PHD, CPA is a professor of accounting at the University of Wisconsin-Milwaukee and a board member of several nonprofit organizations in the Milwaukee area. Professor Neely's professional research and activity focuses on nonprofit organizations. Andrew Holman is a partner at RitzHolman CPAs in Milwaukee and an adjunct professor in Nonprofit Accounting and Financial Management at the University of Wisconsin-Milwaukee. Mr. Holman has been working in the nonprofit accounting field for the past 40 years and the firms practice currently serves more than 300 organizations in Wisconsin.

It is critically important that changes in nonprofit accounting standards lead to better understanding by users of nonprofit financial statements. It is with this in mind that we make the following comments on the exposure draft by key section.

1. Net asset classes.

   Combination of net asset classes.

   The combination of temporarily restricted net assets and permanently restricted net asset classes will make the statements easier to understand. However, the FASB needs to be aware that there is much continued confusion by users related to revenue recognition of contributions as temporarily restricted. Mr. Holman has had multiple meetings with users who do not understand how a grant received for a future period can be recognized as revenue when received and not yet used. As promulgated, recognition of contribution revenue when pledged or received but not yet used for a restricted purpose does not align with the new revenue recognition standard. While this was intentional it will only serve to confuse users into the future. Therefore the combination of the net asset classes will help users but does not get at the heart of the issue which is temporarily restricted revenue recognition. Our research using IRS form 990 data shows that there were more than $296 billion in temporarily restricted net assets reported by over 194,000 nonprofits in the United States in 2012. Nonprofit stakeholders represented by donors, lenders and participants are in most cases not aware that the existing FASB standard has caused such a large aggregate of "early" revenue recognition. This would certainly cause major credibility issues if it occurred in the for profit sector.

   Change of name of Unrestricted to Net Assets without donor restrictions and restricted assets to Net Assets with Donor Restrictions.

   Although we understand the concern that has been raised about the implication of the term "Unrestricted", the proposed new terms are too wordy and do not fit all types of nonprofits.

From a conceptual basis, users understand the notion of unrestricted versus restricted and it is therefore preferable to keep the two exisitng terms in place.

2. Operating Activities

The nonprofit sector is a diverse conglomeration of many different types of organizations which the Internal Revenue Service has divided into 26 sub-types. The nonprofit sector is also different from other sectors in having at least two bottom lines that are relevant to users—financial and mission/program. In addition, despite some past research to codify standard outcomes and measures in the sector, it has not been possible to determine such standards due to the great diversity and variability of organization mission and finances. The required presentation of operating measures on the statement of activities will add to more confusion on the part of users and is not recommended.

The second requirement to put internal board transfers on the statement of activities is fraught with problems. For unrestricted funds, boards of directors have the authority to designate and undesignated funds. Users understand that such actions are voluntary on the part of a board and can be undone at any time as the funds do not have external restrictions. To put board designated internal transfers on the face of the Statement of Activities implies to the user that such funds are essentially set aside and not available for organization use. This will make it harder for users to understand actual nonprofit fiscal activity and can lead to some organizations making such designations if they are concerned that they have too large of a surplus in a year. It is recommended that standards stay with the current system that permits such designations on the Statement of Financial Position with adequate disclosures but not on the Statement of Activities.

3. Cash Flows

The cash flow statement while required is rarely used by many organizations and would probably note be missed if it became an optional statement. Changing the requirement to the direct method will add to organization expense to track such information with little benefit to most users and is not recommended.

The proposed reclassification on the cash flow statement will have a mixed result for users. The reclassification of long-lived asset purchases, contributions and sales to operating will be confusing to users who can understand the longer time horizon of such activity as investing activities. Payment of interest as a financing cash flow will make sense to users and the same is true of recording interest and dividends as investing rather that operating for cash flow purposes.

4. Liquidity

Users will benefit by having a requirement of either a classified Statement of Financial Position or at least adequate disclosures as proposed in the exposure draft.

5. Underwater Endowments

   Organizations and users will benefit by the exposure draft proposal related to Underwater Endowments. However, state UPMIFA laws are varied so it is advisable to insert that such disclosures should be crafted in accordance with state statute.

6. Investment Returns

   Although it will simplify reporting to net investment expense against returns, many users are interested in such information so it is recommended to allow for such disclosure if desired by the organization.

7. Cost Allocations

   It is important to understand that no research exists that has been able to define overhead or management and general costs in the nonprofit sector. At the same time, no research has been able to define acceptable levels of such costs based on size and type of organization. The current overhead standards come from donor surveys or other old sources and are not supported by any detailed analysis. Disclosure of allocation methods is useful for the user with the understanding that it is not possible to externally define management and general costs for all organizations

8. Expenses

   It will be useful to users to have all nonprofit statements report expenses by their natural classifications regardless of functional allocation. Our experience with users is that they are interested in knowing how much an organization spends in total on items such as personnel and occupancy.

In conclusion, we are supportive of the changes in the exposure draft related to combination of net asset classes, some cash flow reclassifications, liquidity, underwater endowments and expenses reported by natural classifications. We oppose the change of name of unrestricted and restricted net assets, changing the statement of activities to report an operating measure and board transfer, requiring the direct method for the cash flow statement, and reducing disclosure for investment returns.

As mentioned at the beginning of this response, the Board needs to seriously review revenue recognition of contributed revenue as that currently distorts the net asset position of many organizations and leads to users not understanding statements even after the proposed changes.

Sincerely,

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