

COMMENT LETTER

Project: 2015-230 Presentation of Financial Statements of Not-for-Profit Entities

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Financial Accounting Standards Board
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Background

Thank you for the opportunity to comment on the proposed updated to Topic 958 Not-for-Profit Entities of the Accounting Standards Codification.

The firm I work for provides service exclusively to not-for-profit entities, generally in the small to midsize range (\$500K - \$20M).

Additionally, I have worked as both a user of not-for-profit financial information in a financing role for not-for-profits, as a preparer of not-for-profit financial information as a consultant to a range of non-profits and now as an auditor of not-for-profit financial information.

Importance of the cost constraint in not-for-profit context

Nonprofits are generally smaller and may have limited accounting budgets. Based on the Core File statistics from The Urban Institute approximately 96% of filing entities have expenses of less than \$10M.ⁱ

Additionally supporters of not-for-profits expect funds to be accounted for properly, spent wisely, and not unnecessarily wasted on administrative activity.

As a result of this environment (smaller organization, desire for efficient and effective expenditures of funds held in trust) the cost constraint outlined in Statement of Financial Accounting Concepts No. 8 is of particular importance in the not-for-profit community.

“Cost is a pervasive constraint that standard setters, as well as providers and users of financial information, should keep in mind when considering the benefits of a possible new financial reporting requirement.”

Deviation from standard accounting results in friction in usability

Many donors to not-for-profits and many board members serving on not-for-profit boards come from the for-profit business community. In addition the vast majority of guidance and tooling is designed for the regular business community.

As a result there is often a high cost in creating unique standards for the nonprofit community that deviate from those used by the broader business community. These costs are both in usability by the reader, cost of preparation by the nonprofit, training and hiring and other areas. Additional issues arise around bank loan covenants and other areas.

As a result of these factors, absent a compelling reason, deviations from accepted GAAP practice should be minimized for not-for-profit entities.

Specific Comments

These are comments based on the summary of changes.

- 1) Present on the face of the statement of financial position amounts for two classes of net assets at the end of the period, rather than for the currently required three classes.

Support – but allow for optional disclosure of the temporary and permanent restrictions as subcategories and require such disclosure in the footnotes.

- 2) Present on the face of the statement of activities the amount of the change in each of the two classes of net assets rather than that of the currently required three classes.

Support

- 3) Present on the face of the statement of activities two additional amounts (subtotals) of the operating activities that are associated with changes in net assets without donor restrictions.

Support

- 4) Present on the face of the statement of cash flows the net amount for operating cash flows using the direct method of reporting.

Strongly Disagree – Maintain consistency with practice by other sectors - see commentary below for details

- 5) Classify certain cash flows differently than how they are classified under current guidance, as follows:

- a. Classify as operating cash flows (rather than as investing cash flows)—those cash flows resulting from (1) purchases of long-lived assets....

Disagree – Maintain consistency with practice by other sectors

- b. Classify as financing cash flows (rather than as operating cash flows)—those cash flows resulting from payments of interest on borrowings, including cash management activities.

Maintain consistency with practice by other sectors

- c. Classify as investing cash flows (rather than as operating cash flows)—those cash flows resulting from receipts of interest and dividends on loans and investments other than those made for programmatic purposes.

Maintain consistency with practice by other sectors

- 6) Provide enhanced disclosures about the following:
- a. Governing board designations, appropriations, and similar transfers that result in the addition or removal of self-imposed limits on the use of resources without donor-imposed restrictions.

Support

- b. Composition of net assets with donor restrictions at the end of the period and how the restrictions affect the use of resources.

Disagree in part – narrative about how the composition affects the use of resources is subjective, may be duplicative of information already in the financials and adds costs without clear benefit. This would be more appropriate in a management discussion and analysis section.

- c. Management of liquidity and quantitative information as of the reporting date about financial assets available to meet near-term demands for cash, including demands resulting from near-term financial liabilities.

Strongly Disagree - Maintain consistency with practice by other sectors – imposes added costs. A classified or ordered balance sheets and description of items on the balance sheet provides this information more naturally and at lower cost. This belongs in a management discussion and analysis section or a reader can inquire of the not for profit if added information is needed (very common in a lending and other situations).

- d. Expenses, including amounts for operating expenses by both their nature and function. That information could be provided on the face of the statement of activities, as a separate statement, or in notes to financial statements.

Partially disagree - Do NOT require that expenses that have been netted on the Statement of Activities (such as cost of goods sold, certain event expenses, certain investment expenses) appear here. Simply allow this analysis to reconcile cleanly to the functional expense disclosure on the statement of activities. Nonprofits DO NOT need another concept of total expenses, stick to one idea for consistent presentation. This also maintains alignment with the Form 990. Complexity reduces the readers ability to understand the financials.

- 7) Use the placed-in-service approach for reporting expirations of restrictions on gifts of cash

Support

- 8) Report investment income net of external and direct internal investment expenses.

Support

Additional commentary

Direct Method of Cash Flows

Decrease in utility

- The proposed change introduces a significant difference in a core financial statement from that used by other financial statement preparers creating friction for users and preparers of financial information.
- The indirect format communicates the “why” of changes to cash flows in a succinct manner (ie, Accounts receivable went up and payables went up to keep cash steady). This tells the story clearly and quickly (organization is financing off its vendors as a result of difficulty collecting pledges owed).
- The indirect method helps connect the statement of cash flow back to the accrual based balance sheet.

Increase in costs

- The direct method imposes significant one-time costs to organizations and audit firms to transition to develop preparation and audit procedures for a new approach.
- The indirect format is generally straightforward to prepare from a comparative balance sheet and other information.
- The direct method imposes ongoing costs to organizations, statement of cash flows produced by software is often in the indirect format.

Cash flow classification

Creating an alternative approach for long-lived assets that deviates from standard practice in other sectors feels unnecessarily confusing and costly for only modest benefit.

For many not-for-profits investments in long-lived assets are investing activities, and are often budgeted using a capital budget as distinguished from their operating budgets.

While some of the proposed changes seem well reasoned others feel overbroad, better suited to a management and discussion section of financial statements (vs general purpose financials) or would result in increased divergence from existing standard accounting in the larger accounting community or increased cost not justified by the benefit received. I hope the board considers the comments it receives carefully and moves slowly in areas with this significant amount of change.

Thank you for the opportunity to comment.

Sincerely,

/s/ August Zajonc, CPA

ⁱ NCCS Core File (Public Charities), 2013, The Urban Institute, National Center for Charitable Statistics, <http://nccsweb.urban.org/>