

LACMA LOS ANGELES COUNTY MUSEUM OF ART
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LOS ANGELES CALIFORNIA 90036

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Technical Director
File Reference No. 2015-230
FASB
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116
director@fasb.org

Re: Comment Letter on FASB Exposure Draft on Not-For-Profit Entities

Dear Director and Board:

On behalf of LACMA (the Los Angeles County Museum of Art), please accept the comments below for consideration regarding FASB's proposed draft financial statement for not-for-profit entities. Thank you for working towards the admirable goals of increased simplification and clarity in not-for-profit financial statements.

As you will have heard from other museums, we, too, generally concur with the alternative views expressed by Messrs. Golden and Kroeker. Consistency with for-profit reporting standards should be paramount. Only changes that are absolutely necessary due to the differences in structure of not-for-profits from for-profits should be introduced. It will not be beneficial to add layers of complexity that don't already exist in the for-profit world. Financial statements, in general, are already so complex that we wonder if important information is lost to financial statement readers in wading through impenetrably long and dense financial documents. Increased complexity is a burden to the entities that have to create usable financial statements. But, more importantly, our trustees tend to come from the for-profit world, and those on the Audit Committee and on the Finance Committee that are the primary overseers of the museum's finances are familiar with for-profit financial statement conventions. Every difference that is introduced between not-for-profit and for-profit financial statements makes it harder for them to do their jobs as trustees.

Question 1: *Do you agree that the disclosures about the nature of donor-imposed restrictions and their effects on liquidity in notes to financial statements would help ensure that necessary information is not lost by combining the temporarily and permanently restricted classes of net assets into one donor restricted category for purposes of presentation in the statement of financial position (balance sheet)? If not, please identify the information lost and why it is necessary. (See paragraphs BC22–BC23 and BC27–BC32.)*

Yes, we agree.

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.)*

Yes, we agree.

Question 3: *Do you agree that disclosures describing the NFP's policy on spending from underwater endowment funds, together with the aggregated original gift amount or the amount that is required to be maintained by donor or by law, would provide creditors, donors, and other users with information useful in assessing an NFP's liquidity and potential constraints on its ability to provide services without imposing undue costs? Why or why not? (See paragraph BC32.)*

Yes, we agree.

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.)*

As proposed, the guidance appears to allow an intriguing amount of flexibility on this subject, but this leads to questions about how valuable it would be to compare different organizations. As an interesting case study, LACMA's financial circumstances might lead us to choose nine months as an appropriate liquidity time horizon. Would this time horizon be what the Board was contemplating or likely to be permissible? If not, we would not see the benefit of this proposal, since a shorter time-horizon would be meaningless and even make it appear as if the museum were more at risk for a liquidity event than it actually is to some financial statement readers. In any case, this would be one of those areas for which consistency with for-profit accounting should be the goal. Given this and the bias against increased complexity, we disagree with this suggested change.

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?*

NA

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 disagree with this suggested change.

It does not seem like a practical recommendation that would end up being applied in a consistent manner by different institutions. Implementation would definitely require major system changes and ongoing reporting would be a tedious and time-consuming affair, given that our programs are constantly evolving. This is certainly something that should not be implemented for the not-for-profit world before it is thoroughly vetted for the for-profit world.

Here are a couple examples for LACMA of what might or might not count as "operations." We would definitely want to include all costs having to do with designing and constructing new museum facilities, along with the interest expense to finance these activities. This may not sound like typical "operating" activities to the uninformed reader, but the not-for-profit entity that runs LACMA was founded for the purpose of building an art museum, so we maintain this is a programmatic activity. On the other hand, in our internal budgeting, construction activity is not considered part of the operating budget for a variety of reasons, including the fluctuation in its scale and its funding sources. Another example would be Capital Campaign expenses. We consider this to be not part of our regular operating budget, but rather an activity that ramps up or down depending on our fundraising needs. The need to make on-going decisions about whether to reflect expenses as "operations" and then to figure out what the financial flows between operating and non-operating activities that would be necessary implies that the usefulness of this distinction for NFP financial statement readers would be questionable.

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.)

First, see our response to question 6. In addition to those comments, note that including disclosures about internally designated limits on availability of resources would add complexity without providing sufficient benefits to make it worthwhile to do so. There is the issue raised in BC67 that any internal designation can be reversed. But it would also introduce its own issues of interpretation. For example, like many institutions, we internally designate some unrestricted funds to be available for eventual debt service purposes. This designation would then make it appear these resources are not available for standard operations, but the fact that these funds are, indeed, available for potential immediate debt repayment would be of interest to some key financial statement readers, such as credit rating agencies.

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.)

See our response to question 6. This is another example of increased complexity that should be avoided.

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 do not have a strong viewpoint on this. However, flexibility might be appreciated under some circumstances.

Question 10: Do you agree that gifts of, or for, property, plant, and equipment (long-lived assets) should be considered operating revenue and support when received (or when placed in service in the case of a gift to acquire a long-lived asset)? Do you also agree that because the long-lived asset is not immediately fully available to be utilized in the current period, an NFP should be required to present a transfer from operating activities to other activities for the amount of the gifted asset or portion of the asset funded by restricted gifts? If not, why? (See paragraphs BC72–BC74.)

This appears to be the obverse of the whole discussion of what expenses to include in “operations.” As such, we do not agree that anything should automatically be considered to be part of operating support. For instance, some campaign gifts might be usable against what would traditionally be considered operations, some might be usable for construction projects and their financing, and some might be for totally different long-run purposes. And in LACMA's case, all of these are often solicited as “unrestricted” campaign gifts. How would it be beneficial to automatically show these gifts as operating revenue?

Question 11: Do you agree that the addition of required intermediate measures of operations for all NFPs would make unnecessary the need for NFP business-oriented health care entities to also present their currently required performance indicator? Why or why not? (See paragraph BC99.)

NA

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?

Flexibility should be retained.

Question 13: *Do you agree that reporting operating expenses by both their function and nature together with an analysis of all expenses (other than netted investment expenses) provides relevant and useful information in assessing how an NFP uses its resources and, thus, should be required? Why or why not? (See paragraphs BC87–BC93.)*

We disagree. There are many reasons why.

This would add increased complexity, both for the reader and for the museum to prepare the financial statements. This would be particularly true if the recommendation to implement separate reporting of “operating” activities is also implemented. The more reporting hoops our accounting systems are required to jump through, the more unwieldy it becomes to attempt to comply with them all.

This represents an expectation to accomplish too many things with the financial statements. The main purpose of financial statements is to allow for readers to understand the financial position of organizations. To expect them to also provide programmatic information is to stretch the purpose of accounting systems and financial reporting beyond what is expected for for-profit entities. We already have the IRS 990 that provides information on the percentages spent on program activities. While some others have suggested that this information would not be burdensome to report due to similar IRS 990 requirements to report in a program/management & general/fundraising matrix, we do not see things this way.

In order to be auditable, financial statements should readily tie to the general ledger. But this general ledger is also the basis for internal financial management reporting that is used by individual department managers and by senior management. The IRS 990 is a report prepared after the museum’s financial statements have been audited and does not directly require allocating costs out of the natural accounts to which they are debited or between different departments directly on the general ledger. In order to keep the correspondence between financial statements and the general ledger, the allocations reflected on the IRS 990 would now need to be done before the financial statements are closed for their annual audit. This would delay the audit.

But the bigger concern is that allocating costs directly on the financial statements would reduce the functionality of the general ledger for day-to-day management of the institution. Managers responsible for department budgets would find costs allocated to their departments for which they have no direct control and the same would apply to department from which costs would be allocated. The role of the general ledger as a management tool via comparing budget to actual spending across years would be lost.

Here are three examples, out of multiple allocations that we apply for IRS 990 purposes, that would distort internal management reporting if they were applied to the general ledger:

- On the 990, utilities are applied based on square feet devoted to different purposes. Examples are gallery spaces – program, educational spaces – program, curatorial offices – program, administrative offices – management & general, Development offices – fundraising. But on the GL, there is no specific department that corresponds to gallery spaces and there are multiple departments that correspond to the various office space allocations. Which department would get a charge for gallery space utilities and would each of our 40-plus departments get some proportionate allocation of utilities? It is also unclear how this relatively simple allocation between “Program,” “Management & General,” and “Fundraising” would be allocable if the IRS 990 “Program” classification were split into smaller component programs.
- Pension adjustments. Each museum department budgets for and monitors the annual cost of salary and employee benefits for which it is responsible. This is currently straight-forward. It is based on whether or not positions budgeted in each department are filled or vacant. Pension costs, like other benefits are allocated to each department proportionate to their share of total salary expense and based on the cash contribution made to the pension plan each fiscal year. At the end of each fiscal year, total pension expense is adjusted based on the actuarial report. This, sometimes major, adjustment is charged to the Unallocated Department and then allocated to Program/M&G/Fundraising only for purposes of the IRS 990, proportionate to total salaries in these three categories. If we allocated this on the GL, department managers would find themselves going either over or under budget based on this pension adjustment.
- Individual positions that are reported in a different IRS 990 category than their GL department would imply. Occasionally our Director budgets and hires a curator to help him plan exhibitions. On the IRS 990 we are able to reflect this single position as “program,” rather than as “general and administrative,” as it would naturally be reflected based on where the Director’s Department is reflected on financial statements. In some cases, senior management positions are allocated between “program” and other IRS categories. Making these allocations directly on the GL would create inconsistencies for organizational structure and

corresponding budgets for purposes of budget reporting, monitoring, and forecasting.

If we were to determine that it is just too complicated and impractical to allocate costs on the general ledger, then we will end up with inconsistencies between the IRS 990 and our financial statements.

We will add that the allocation of costs to programs also seems like an area that will be treated very differently by each institution and thus implies that what might appear comparable between institutions on its face will not truly be comparable.

Perhaps these concerns are idiosyncratic to LACMA, but we believe similar issues probably would apply to many other not-for-profit entities. Many of these organizations are already complex entities with many varied reporting demands made on them by funding agencies and other constituents. At the same time they do not have the rich resources of many for-profit entities. Anything that makes managing them more difficult, such as this reporting requirement, ultimately harms their ability to focus on their main service mission.

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.)*

Yes, we agree.

Question 15: *Do you agree that the disclosure of the amount of all investment expenses is unnecessary but that disclosure of internal salaries and benefits that are netted against investment return is of sufficient relevance, not too costly to obtain, and thus should be required? Why or why not? (See paragraph BC101.)*

We do not currently charge internal salary and benefits against investment return, but we are in accord with fellow institutions that have expressed concerns that disclosing internal salaries would not be relevant to the financial statement user and that doing so could result in the identification of the salaries of specific employees that are not otherwise required to be reported on the Form 990.

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 do not agree. See our response to question 6 for reasons why.

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 write-offs of goodwill generally should be presented within operating activities? If not, why? (See paragraph BC62(b).)*
- c. *Immediate write-offs 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).)*

We are neutral on a. and b. above. But we do not agree with c. Art museums, as a group, worked with the FASB to implement an exception to standard GAAP accounting for works of art added to their collections. For an art museum to remain accredited, it is generally not allowed to treat funds received from selling works of art as fungible with other museum resources, since they cannot be used for any purpose other than purchasing other works of art. So transactions involving works of art should not be viewed as part of general operations. This discussion provides one more example of the doubtful wisdom of requiring presentation of an "operating" statement as part of standard financial statements.

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 agree with Messrs. Golden and Kroeker that the statement of cash flows is currently aligned for NFP's and for-profits. Any change would be costly to implement and result in greater difficulty for those used to reading for-profit financial statements to understand not-for-profit statements.

Question 19: *Does the indirect method's reconciliation of cash flows from operations to the total change in net assets provide any particular type of necessary information that would be lost if, as proposed, that method is no longer required? If so, please identify the potentially omitted information and explain why it is useful and whether it should be provided through disclosure rather than requiring use of the indirect method. If you suggest that requiring the indirect method is necessary, would you require that the amount for cash flows from operations be reconciled to the amount of the (a) change in net assets, (b) change in net assets without donor restrictions, or (c) proposed intermediate measure of operations before or after transfers? Why? (See paragraphs BC75–BC80.)*

See our response to question 18.

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.)*

See our response to question 18.

Question 21: *Are there any particular proposed amendments in this Update that would require a longer period to implement than other amendments? If so, please explain.*

A few would be easy to implement, like the netting of expenses against investment income and the suggested change in presenting underwater endowments. Switching from segregating permanently restricted and temporarily restricted to just reflecting "with donor restrictions" might not be too challenging to reprogram since both permanently and temporarily restricted funds are a subset of the proposed new single category.

The proposed changes to reflect an "operating" section distinct from other financial activities and to switch to a matrix of "nature" and "function" for expenses are daunting. These would require total revamping of our reporting software, our approach to use of the general ledger and, most likely, our chart of accounts. We dread facing the need to spend our scarce resources, both of staff time and out-of-pocket outlays, to make such sweeping changes. We do not see that the suggested benefits of these changes would come anywhere near to making these changes worthwhile.

Question 22: *Are there reasons for any particular size or type of NFP to need a longer time frame to implement the proposed amendments in this Update? If so, please explain.*

No comment.

Thank you for the opportunity to comment on the proposed guidance. If you wish to follow up with regard to any issues we have raised, you are welcome to contact me at (323) 857-6143 or markm@lacma.org.

Sincerely,

Mark A. Mitchell
Budget & Investment Officer
Los Angeles County Museum of Art