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Technical Director
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Thank you for the opportunity to respond to the 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*. I applaud the Board on this comprehensive proposal, most of which I agree with. However, there are two conclusions that I do not agree with and there are two disclosures that give me serious concern.

1. Operating Measure

Although I agree with the Board's conclusion that all not-for-profit entities should be required to present an operating measure on the statement of activities, I do not believe that the Board's attempt to define operating and nonoperating provides a benefit to the users of financial statements. In fact, it could lead the users to reach an incorrect conclusion as to the operating "bottom line" of the entity. I believe that the current practice of allowing each entity to define what is operating and what is nonoperating leads to a better, more informative result, so long as the entity is required to disclose what it considers operating and what it considers nonoperating and applies that policy consistently from period to period.

Under the proposal, interest expense on debt is defined as nonoperating. This conclusion, in my opinion, is flawed. As an example, take an entity that has a program of operating group homes for developmentally disabled adults. It purchases a house to use as a group home (residence) and borrows from a lending institution in order to finance the purchase. It does not make sense to me that the interest expense on the debt would be considered nonoperating while the depreciation and other expenses of operating and maintaining the residence would be considered operating. If the entity considers the interest expense as an integral part of its operations, then it should be permitted to report that expense as operating.

Further, as another example, if an entity considers investment return to be an integral part of its operations, it should be permitted to report that revenue as operating.

2. Statement of Cash Flows

I agree with the Board's conclusion that the direct method of preparing the operating cash flows section of the statement of cash flows provides more useful and understandable information for the users. I have maintained the same position since the issuance of FASB Statement No. 95. Initially, I was very pleased to read the Proposal's requirement to require the direct method. However, I am troubled by requiring not-for-profit entities to report operating cash flows differently from the for-profit world. My mantra for the past twenty-five years has been "similar transactions should be accounted for similarly, unless there is overwhelming evidence to the contrary". I do not see such overwhelming evidence in this instance.

I would encourage the Board to revisit the statement of cash flows for all entities, both for-profit and not-for-profit. I think that the direct method should be required for all entities. Until that is accomplished, I would not favor requiring the direct method for just not-for-profit entities. It should remain at the option of each not-for-profit entity to decide to present operating cash flows using either the direct or the indirect method.

With respect to the other proposed adjustments to specific line items on the statement of cash flows, e.g., cash outflows for the purchase of long-lived assets, I would apply the same reasoning as above. While I agree with the reclassification of these items, I do not believe that not-for-profit entities should classify line items on the statement of cash flows differently than for-profit entities.

3. Expense Allocation Disclosure

I agree with the Board's conclusion that each not-for-profit entity should provide information about how it allocates expenses among the various functional categories, i.e., program and support services. My concern is that there is not sufficient guidance regarding that required disclosure. I can envision a disclosure as short and simple as "Expenses are allocated to the various functional categories based on the nature and usage of the expense". This disclosure does not provide any useful information. At the other extreme, I can envision a lengthy discourse on the allocation methodology used for each material natural expense. That level of detail would lose its usefulness if users do not take the time to read it.

In order for this requirement to provide information useful to the users of financial statements, the Board needs to provide guidance and some examples of expense allocation disclosures.

4. Liquidity Disclosure

Although I agree that providing information in the notes to the financial statements about financial assets and liabilities will be useful in assessing an entity's liquidity, I also believe that it leaves out important information. Disclosing available financial assets and financial liabilities might give the impression that those assets are the only assets available to liquidate the liabilities. However, there may be nonfinancial assets as of the balance sheet date, which will be converted into financial assets at a later time (within the liquidity management time frame), which will also be available to liquidate current financial liabilities.

I believe the Board should provide example disclosures, specifically dealing with the situation described in the previous paragraph.

I am also concerned that the smaller not-for-profit entity will not be able to construct this note and will look to its auditor to prepare this disclosure. This is not uncommon; it is a frequent occurrence. But before we add additional disclosure overload on entities that do not have the ability to prepare this note, we should take a step back and determine whether such a disclosure is necessary or beneficial to the users.

Questions

Following are my responses to the "Questions for Respondents".

1. Yes.
2. Yes.
3. Yes.
4. Yes. However, see comment 4 above.
5. Yes. I do not agree that health care not-for-profit entities should be required to present a classified statement of financial position if other entities are not so required.
6. Yes. I agree that an operating measure should be required. However, see comment 1 above.
7. No. See comment 1 above.
8. The amount of transfers to and from operating is confusing. Also, see comment 1 above.
9. Yes.
10. No. See comment 1 above.
11. Yes.

12. Yes, retained.
13. Yes.
14. Yes.
15. Yes.
16. No. See comment 1 above.
17. No. See comment 1 above.
18. Yes. However, see comment 2 above.
19. No. However, see comment 2 above.
20. No. See comment 2 above.
21. No.
22. No.

Again, thank you for giving me this opportunity to respond.

Sincerely,

Allen L. Fetterman, CPA