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Technical Director
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Financial Accounting Standards Board
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Gentlemen:

This letter is my comment on your exposure draft of April 22, 2015, on not-for-profit (NFP) entities. My experience with accounting issues in NFP entities goes back more than fifty years, and I have participated in several meetings at your office in Norwalk, one of which took place when what became FAS 116 and FAS 117 were under discussion. Most, but not all, of my experience has been with religiously affiliated entities having total assets ranging from $100,000 to $500,000,000—with a few exceptions at both ends.

My first reaction when I opened the printed copy of the exposure draft was that a document of 262 pages would be either verbose or complex. After my first reading, I felt that it was certainly not verbose, but that it could be very complex for many NFP entities, particularly those of smaller or medium size. Many of the smaller and medium entities do not have on their staffs a certified public accountant who can explain and interpret what the Board is saying and how it would apply in each instance. I think there is at least some risk that audits or reviews will be discontinued at some smaller entities on account of the complexity of parts of the exposure draft. Some of my suggestions may also help reduce the complexity of the exposure draft.

Net Asset Classification. In the early 1990's I favored the inclusion of three classes of net assets: unrestricted, temporarily restricted, and permanently restricted. But I recognize that circumstances have changed since then, and I support the Board's proposal to have a single category of net assets subject to donor restrictions. However, this does not mean that underlying records supporting temporary restrictions or board designations can now be cast aside, as I have heard some financial officers suggest. Without such supporting records, an entity's governing body would not know whether or when it is legitimate to move net assets out of the donor-restricted category.

Cash Flow Standardization. With regard to standardizing the direct method of preparing the statement of cash flows, I doubt this is of great importance except among the largest NFP entities. I have seen surveys of financial officers at NFP entities indicating that this statement ranks far below the other statements and the notes in generating questions from report users about report content, regardless of the method used in the cash flow statement. I also think a good case can be made for standardizing using the indirect method. At the same time, I wonder if this statement is not much more important in the commercial sphere and at large NFP entities than at medium size or smaller NFP entities, where prospective donors are not looking for possibilities to increase dividends or the ability to make acquisitions. Perhaps the best solution would be continuing to leave NFP entities free to choose either method—at least for now.

Functional Reporting. Some areas of the exposure draft are of much greater concern to me. One is a broader emphasis on functional reporting without including a prior distinction between functions that could be free-standing entities and those that are dependent on a single core function. Two examples will illustrate the difference. In the first example, a health care center could contain a hospital, a retirement home, and a rehabilitation facility. All three of these functions could be either separate entities or united in a single entity. In a situation in which one NFP entity provides all three of these functions, I think functional reporting makes sense. In the second example, a free-standing secondary school would have its academic program as its single core function and one or more of some other ancillary functions that would automatically cease to operate if anything happened to close the core function. The ancillary functions could include both athletic and non-athletic extracurricular activities, student dining facilities and dormitories, and sometimes also faculty/staff housing. If the academic program were to close, all of the other functions one might find would simultaneously collapse. The premises might be sold for some other purpose, e.g., a resort or a minimum-security juvenile detention facility, or even another unrelated school, but the original secondary school with all its ancillary activities would be lost.

The utility of a functional statement of expense would, I think, be of minimal value to a report user interested in that secondary school. Enrollment in the academic program or being on the faculty or staff is prerequisite for any participation in the other functions. Where a single core function exists, I suggest that the functional statement of expenses not be required; I recommend that it be--at most--an optional statement. I also recommend that NFP entities with a single core function put more details about major ancillary functions either in their statements of activity or in a note if the ancillary functions are complex.

Statement of Activity. My second major concern is the proposed revision of the statement of activity. I fear it is sufficiently complex in accommodating the very legitimate needs of large NFP entities that the Board may have to revisit this matter after there is more experience with the actual implementation of the proposed changes at small and medium size entities. In this regard, the usual evaluation procedures of both the Board and the FAF after the issuance of a new standard could be important here.

Liquidity. I agree with the Board that a note on liquidity takes on even more importance with the elimination of a separate column for temporarily restricted assets and net assets. The note should include at least the totals of all donor-restricted net assets and all designated net assets (since the highest governing body at an NFP entity usually has full discretion over these even if that body would strongly prefer not to use such assets to meet liquidity demands.) I think the liquidity note should also include the amounts of any donor-imposed time or purpose restrictions that are expected to expire within the following fiscal year as well as an estimated total of cash readily obtainable from bank accounts and investments classified as designated. Such bank accounts and investments may not always be readily or quickly convertible into cash at their carrying value.

To increase liquidity at NFP entities, I also agree with the Board's proposal to limit restrictions on gifts for the acquisition of fixed assets to the period from the receipt of the gift to the date on which the acquired assets are placed in service.

Conclusion. If you need any further explanation of my comments, please do not hesitate to ask.

Very truly yours,

Henry T. Chamberlain, S.J.