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Technical Director, File Reference No. 2015-230
FASB
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Dear Technical Director,

Thank you for giving me the opportunity to comment on the proposed Accounting Standards Update to Topics 958 and 954 of the FASB Accounting Standards Codification. My comments are from the perspective of a governing board member and are primarily directed to the proposed changes to the Statement of Activities. I believe my perspective is somewhat unique. Early in my career, fund accounting represented GAAP for higher education. I was the Controller at Saint Louis University when we elected to early adopt SFAS 116 and 117. At that time, I made presentations on SFAS 116 and 117 to the Association of Jesuit Financial Officers and also served on panel presentations with Piper Jaffray and PricewaterhouseCoopers discussing the impact of the then-new standards on rating agency analytics. In addition, I have overseen the implementation of ERP systems designed to prepare internal financial statements as well as external GAAP statements. I have been both a presenter of financial statements to boards and a recipient of financial reports as a board member. Currently, I am Chairman of the Board of Directors of the Lutheran High School Association, which operates a college-prep high school, a middle school, and a grade school at various locations on Long Island, New York.

I agree with the general consensus that many board members do not understand certain nuances of the current financial reporting model, just as they did not fully understand financial statements prepared under the old fund accounting model. However, most board members clearly understand the mission of the organization on whose board they are serving and are able to discern if that mission is being achieved. From my experience, ***the primary issue that needs to be addressed by the FASB is not the lack of a "mission" focus in the Statement of Activities; it is the divergence between the typical not-for-profit's (NFP's) operating budget and its external GAAP financial statements.***

Unfortunately, the proposed standards with their treatment of endowment earnings and interest expense on the Statement of Activities will only serve to widen the gap between internal and external financial statements, not narrow it. Every NFP that I've been involved with views the spendable earnings from the endowment as an integral part of financial operations. Likewise, interest expense is considered to be part of the operating expense budget, along with salaries, depreciation, utilities, etc. No matter where the FASB decides to place these on the Statement of Activities, NFPs will continue to account for these lines in their operating budgets. While removing endowment earnings and interest expense from operations might be an interesting academic exercise, this treatment, along with the various prescribed subtotals will render the Statement of Activities useless from a governing board's perspective and even more so from the perspective of management.

It's important to frame this discussion in terms of the exchange of financial information between management and its governing board. Typically, management meets with its board (or finance committee of its board) on a quarterly basis, devoting approximately 30 - 45 minutes to specifically discuss financial results. The typical finance committee consists of bankers and heads of large corporations who frankly have little time and are disinterested in the nuances of NFP accounting. A critical concern for a board member in these discussions is whether or not management has achieved its goals within the board approved budget. Unfortunately, the format of the proposed Statement of Activities is so far removed from the typical NPF operating budget, it cannot be used for that purpose. And, the proposed standards offer little flexibility to bring internal and external financial statements together in any meaningful way.

The following "real-life" examples represent attempts to better explain why governing boards want (and need) consistency between internal and external reports.

Example 1:

As noted above, I was the Controller at Saint Louis University when SFAS 116 and 117 were issued. Because management was anxious to provide our Board of Trustees with statements they could readily comprehend, we chose to use the four statement approach with a separate "Statement of Unrestricted Revenues, Expenses, and Other Changes in Unrestricted Net Assets" and a separate "Statement of Changes in Net Assets". We did this for two reasons. First, the "Statement of Unrestricted Revenue, Expenses, and Other Changes in Unrestricted Net Assets" very neatly and very concisely tied into our annual operating budget. The Board especially appreciated that approach. For those of you who remember the hideous multi-column approach of the old fund accounting model, this was welcome relief. Second, by separating temporarily restricted net assets and permanently restricted net assets into a separate schedule we were able to have a more focused discussion about the nature of these funds. As a result of the somewhat complicated conversion from fund accounting to the then new standards, we ultimately re-tooled our general ledger and began preparing our annual operating budget on a SFAS 116/117 basis, abandoning fund accounting—which meant budgeting both interest and depreciation. ***Our board, for the first time, could readily see that three key lines appearing in our GAAP financial statements agreed with our operating budget: "Total operating revenues and other support", "Total operating expenses" and, most importantly, "Increase in unrestricted net assets from operating activities".*** As a result, the Board could focus on financial performance and not waste precious time trying to understand the difference between fund accounting statements and SFAS 116/117 statements. Unfortunately, the proposed standards will obliterate this consistency—operating revenues and other support will no longer include spendable earnings from the endowment, operating expenses will no longer include interest expense, and the budgeted operating measure will be lost. This is not an improvement! Board members understand the mission of the organization they serve; they don't need the FASB muddying up the Statement of Activities to "help" them in this understanding.

Example 2:

My experience in implementing ERP solutions ultimately brought me to Long Island University where I oversaw the implementation the PeopleSoft Finance system. The old mainframe system was designed to maintain the books and records on a fund accounting basis, and indeed, the annual operating budget was prepared and presented on a fund accounting basis. While speaking with the Chair of the Finance Committee of the Board, not surprisingly he expressed frustration with bridging the fund accounting based budget to the GAAP financial statements presented in the annual audit. From the Board's perspective, the GAAP statements were primarily for bond covenant purposes. They continued to rely on the fund accounting statements prepared by management for the institution's financial results, but there was clear unease because the format was quite different than the GAAP statements. Consequently, as we developed the new ERP system, we designed the general ledger to enable easy preparation of the annual operating budget on a SFAS 116/117 basis. The Finance Committee was ecstatic. **They could now rest easy—the audit and the budget were presented on the same basis—LINE BY LINE.** The annual audit report became a meaningful document easily understood by the board. Once again, the proposed standards will obliterate this consistency.

Example 3:

When I joined the Board of (*name of organization withheld*) as Treasurer, the outgoing Treasurer, the CFO of a large for-profit corporation, was puzzled as to why the cash position kept declining year over year. Working with the Finance Director, I realized that there was a long-standing error in the prior budgets which had been prepared on a fund accounting basis. At some point in the distant past, a particularly vocal member of the Finance Committee apparently stated that debt principal payments "were not an expense" and should not be included in mandatory transfers of the current funds for budget purposes. Consequently, principal payments reduced cash in the plant funds with no replenishment from the current funds. Unfortunately, when the organization received an annual audit on a SFAS 116/117 basis, the Finance Committee made no attempt to reconcile it to fund accounting based budget reports. **In this instance the board was relying on financial statements that weren't being audited—and these statements were wrong!** Obviously the auditors could not opine on them because they were not GAAP. This grievous error can be directly traced back to an inconsistency between internal and external reports.

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Once again, thank you for giving me the opportunity to comment on the proposed Accounting Standards Update. The audit opinions for most NFPs are not addressed to rating agencies (who have sophisticated financial analysts); they are addressed to governing boards that are generally less familiar with NFP accounting. Accounting standards that move in the direction of closing the growing chasm between internal budget reports and external GAAP financial reporting would greatly aid board governance. Unfortunately, the proposed standards will move us in the opposite direction. For the sake of the credibility of the FASB, please reconsider this proposed change.

Sincerely,

Mark C. Schmotzer

Mark C. Schmotzer
Chairman of the Board
Lutheran High School Association