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Mr. Jeffrey Mechanick, Assistant Director
FASB

VIA email

Re: Financial Statements of Not-for-Profit Entities

Dear Jeff,

Below are my comments and thoughts regarding the issues I have an interest in, both as a preparer of financial statements within a private foundation and as an academic.

1. Do you agree with the revised net asset classes with renewed emphasis around board designations and disclosures?

I think that collapsing the three categories down to two makes sense. I have never been a fan of expanded disclosure around board designations (because organizations can manipulate it to look like there are less resources available), but understand that the intention of the governing body regarding how they plan to use resources in the future is important and useful information for the reader of the financial statements.

2. Do you agree that requiring intermediate measures of operations would provide users with more relevant and comparable information about the results of operations before consideration of designations/transfers and how an entity is managing the results of its operations?

Yes, I believe that an intermediate measure of operations could be a useful, required disclosure.

3. 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 designations/transfers? In other words do you agree with the mission and availability dimension?

The answer depends on the type of not-for-profit we are talking about and how narrowly the "purpose for existence" is defined, and whether the ensuing measure of operations provides a valid and useful metric in evaluating the not-for-profit.

In a typical private foundation the only income and inflows are from the investment of the endowment. If the interest, dividends, realized and unrealized gains and losses, and the like are not considered part of the operating measure, then you would only have expenses. How does one evaluate an operating measure that is always negative? Is a larger negative better, since the not-for-profit did "more of" mission related activities, or is a smaller negative operating measure preferred, since it might indicate a longer operating horizon for the not-for-profit before it depletes its resources.

An operating measure without a context is useless. The normal context for the operating measure is provided by the comparison between the resources provided and the resources consumed. Where only one is disclosed it does not allow interpretation and assessment of how well the not-for-profit marshalled its resources and how efficiently it operated during the period.

4. 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?

I think that to determine whether interest expense is, or is not, an operating activity, should not be definitional, but determined by the use of the borrowed funds. I understand that money is fungible and my process for determining whether interest expense is an operating activity allows for manipulation of where it is shown. I would therefore understand the imposition of a strict rule. However, as a profession we do rely on the good intentions of the organization in trying to prepare financial statements that are useful for the public.

I would agree that fees paid to provide access to borrowing, lines of credit and the like (such as "unused fees") should not be classified as operating activities, but as financing activities.

5. 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?

In general, I believe that a statement of functional expenses would provide useful information. I find the tax returns (990 and especially the 990-PF) to provide less information for the public than it should. I envision (for a private foundation) the appropriate columns to be Administration and General, Programs, Grant-Making, Investing (with Communications either a separate column or a component disclosed within the Programs column). This level of detail is not required by the 990-PF, and hence not typically disclosed on it.

6. 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)?

Yes, I agree that this make sense and improves reporting. I also believe that related taxes (income and excise) related to the investment income should be netted.

7. 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?

I think that there are a variety of investment expenses that should be disclosed – these include internal investment expenses (as a total, unless the elements are individually material) and external manager expenses, custodial expenses and advisor expenses.

8. 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?

The indirect method of presenting operating cash flows is confusing and should be discontinued. The only reason for the prevalence of the indirect method in use is the misguided notion that it is easier to prepare than the direct method.

Given a comparative statement of position and current period statement of activities, operating cash flows can be prepared using a spreadsheet. Many of my colleagues feel that their financial system will not provide the information required by the direct method (and most accounting software only provides the indirect method statement). The direct method can be prepared using a spreadsheet just as simply as the indirect method if there are specific individual receivable and payable accounts related to each line of the operating statement.

Since we adopted the direct method a number of years ago I have questioned the need to also present the reconciliation (essentially the indirect method). One method is clear, direct, understandable and provides the information in a way the reader is interested in seeing it (the direct method) and one method is convoluted and incomprehensible and does not tell the reader what they want to know (the indirect method). So if the clear and concise method is used, why should one also have to provide the less desirable format?

9. 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?

There is no useful information provided by the indirect method.

10. 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.

The organization should be able to articulate its operating activities, and from that definition the statement of activities and statement of cash flows would so follow. The organization should define its activities, not individual statements.

11. Do you agree with the new liquidity disclosures (both qualitative and quantitative) with an organization-determined time horizon?

I think liquidity is essential to the operation of the not-for-profit and therefore communicating to external users relevant information equally essential. What and how this is communicated is the issue. The extensive disclosures around fair value served to reduce the usefulness of any information that may have been presented. I fear that the same may be true of liquidity. In some respects the timeliness of the financial statements makes liquidity less of an issue and solvency the focus. If the financial statements are disseminated six months after year-end liquidity is almost irrelevant – if the organization is still in business liquidity may not be the overwhelming concern.

The last comment I would like to make is to offer that not all not-for-profits are alike. They can be divided into broad groups (voluntary health and welfare, hospitals, colleges and universities, foundations, etc) and are so dissimilar in operation that it cannot be presupposed that a single set of rules will appropriately apply equally to all. While I wouldn't suggest that each have separate accounting guidance, I would suggest the not-for-profit project be developed such that appropriate alternatives are included to allow the entity to provide the level of reporting the FASB desires at the same time being true to the nature of their operation.

Regards,



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