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Dear Director,

Please accept this as a response to your FASB Exposure Draft on Not-for-Profit Entities (Topic 958) and Health Care Entities (Topic 954) dated April 22, 2015. As an overview, I would like to say that while I am in total agreement about the need to improve the level and clarity of information disclosed on a Not-For-Profit (NFP) organization's financial statements I do not believe that some of the suggestions proposed here will accomplish that purpose. As a matter-of-fact, I believe that some of the suggestions will only add a complexity that will be even harder to comply with and explain to interested parties or stakeholders.

Background

I am a co-managing partner in a Manhattan CPA firm that has been providing auditing, review and return preparation services to NFP organizations for over 25 years. My firm currently serves over 300 exempt organizations ranging in size from a few hundred thousand to 400 million in gross annual revenue and support. I have served on a number of NFP Boards over the years, written a desk reference book on NFP formation and reporting and created two different certificate programs at NYU SPS and Baruch School of Public Affairs on NFP accounting and reporting. I mention all of this because as someone who has presented and explained NFP financial statement to hundreds of board members and student over the years I believe I have a fairly good finger on the pulse of what an average reader of financial statements is looking for and what they understand.

Personal Observations

Over the 25 preparing and explaining NFP financial statements the areas that I have found the most difficult to compile from my clients books of records, report on and explain are the following:

1. Classification and explaining differences between Contributions and Exchange Transactions
2. Temporarily restricted contributions and grants
3. Allocation of expenses on a functional basis especially with the fundraising functional area
4. Cash flow statements (note: in over 25 years I was only asked two questions related to the cash flows statement.
5. Tracking advertising income related to UBIT and reporting UBI activities.

Most NFP organization with under $5M (and many over) in support and revenue do not have significant accounting and reporting systems with many using low cost accounting software such as QuickBooks and QuickBooks on-line. As such, there is a large disconnect between what is being required to be reported on in accordance with U.S. NFP GAAP and the ability to capture and report the required information. Although many current reporting and disclosure requirements are beneficial to readers of larger NFPs financial statements, they aren't useful for the majority of smaller NFPs and many of the proposed changes will not be either.

Statement of Financial Position and Liquidity

Question 1:
I agree. The notes to the financial statement (instead in the body) will now contain information about the level or restriction (i.e. either temporarily restricted or permanently restricted and whether it is externally restricted or internally restricted. Currently there is some confusion about internally or externally restricted assets and by moving this type of information to the notes it will make the Statement of Financial Position a little clearer and easier to read.

Question 2:
I agree. Unrealized losses related to permanently restricted endowment funds should be included with those funds to present a clearer picture of the value of the endowment funds. Otherwise a reader would have to combine the two amounts to get an accurate picture.

Question 3:
I agree however I believe the cost of doing this for most small NFPs will outweigh the benefits. Since most small NFPs do not have sophisticated accounting systems, there will be an added cost that would not be beneficial to the readers of small NFPs financial statements. I suggest a two tier requirement for this type of reporting. For example, this disclosure could be required for Endowments over a fixed limit (e.g. $5M). For a NFP with an endowment of $10K or even $100K the cost outweighs the benefit.

Question 4:
I agree again for larger NFP organizations but again believe this might be a burden for small organizations. Many times smaller NFPs are struggling with cash flow issues and have multiple demands on their assets. Requiring them to disclose which obligations get priority and which do not will become a game of subjective prioritization and won't be very productive. An alternative suggestion would be to require organizations to disclose how it planned to meet its obligations if current assets are too small to meet its current obligations. Similar to a going concern disclosure but not as elaborate or draconian.

Question 5:
No comment. I do not service health care NFPs and therefore I'm unfamiliar with their operations

Statement of Activities, Including Financial Performance

Question 6:
I strongly disagree. I believe this requirement will create a great deal of confusion and will not add, but rather detract, and make the Statement of Activities more convoluted As mentioned in elaborate detail in the exposure draft in paragraphs BC35-BC47, there was a great deal of discussion on which items of income and expenses would be included in operating activities and which would not. Even with some authoritative definitions and guidelines I believe many organizations will have difficulty complying with this requirement. First, I do not believe that most accounting systems of a significant number of NFPs will have the ability to maintain this level of detail. It would then be left to the external accountant/auditor (if one exists) to assist with breaking out this type of information on the financial statements, which again would be difficult without adequate detailed record keeping.

In my experience NFP have a difficult enough time tracking, allocating and reporting expenses on the current functional basis of program and supporting services. There is a constant push

Question 6 (continued):
on an organization's part to include as many expenses in program activities rather than Management and General or Fundraising. This is due to government and other grantor requirements to use more funds for operating, programmatic purposes than for overhead purposes (i.e. M&G & Fundraising). By adding an additional level of reporting expenses as operating (program, M&G & Fundraising) and non-operating, a greater degree of confusion will ensure and the Statement of Activities will become more convoluted.

Question 7:
I disagree. More specifically, as discussed in my response to Question 6, I believe NFPs will have a very difficult time, and spend unnecessary time trying to determine what constitutes resources used to carry out the NFP's mission. As a general point in my opinion, most NFP believe that all their resources and activities are for the sole purpose of achieving their exempt mission so having them decide what is related to operating and non-operating will be very difficult and most likely meet with a lot of resistance on Management's part.

Question 8:
I disagree. I do not think this requirement is necessary on the face of the financial statement and will definitely add to the complexity of preparing and reading the financial statement. Although Boards at more and more NFPs are setting aside funds (i.e. Board restricted funds) many tend to do this in an ad hoc and informal manner and sometimes restrict and un-restrict excess funds several times during the year. Since many NFPs do not have sophisticated accounting systems getting this information will be very difficult to obtain. It is difficult enough to determine the portion of net assets at year end that is set aside and restricted by the Board. To determine how much was restricted then unrestricted during the year will become much too burdensome.

Question 9:
I agree. My firm has never used the approach of releasing the restriction of capital assets over the useful life. Again, the reason is one of good record keeping which many NFPs do not have.

Question 10:
I agree. I believe that most donors who donate non-cash property whether long-lived or not are donating the asset for organizational operations and don't care or even understand that their use will benefit the organization over several years. I do not agree however that the asset should be allocated between operating and non-operating. Again, I don't believe the creation of an operating and non-operating category will be useful and most likely cause a great deal of confusion.

Question 11:
No comment. I do not service healthcare entities so I am not in a position to comment on this.

Question 12:
Yes I think the current reporting flexibility is adequate. When FASB 117 first came out in 1994 I decided that the multicolumn approach used up too much space on the report and opted for a more hierarchical single column approach to reporting unrestricted, temporarily restricted and permanently restricted support and revenue. Most firms on the other hand use the multi-column approach. Some firm use a hybrid method. Complaints about reporting structure are almost non-existent so I would not change the current approach.

Question 13:
I agree. As explained in BC87-BC93, most if not all NFPs capture expense activity by natural classification. Many do not capture their activities by function and must get assistance from their outside accountant/auditor to compile this information for financial statement and 990 reporting. Even though FASB117 (ASC 958) only required a functional expense report for VHWOs our firm has been preparing a Statement or Schedule of Functional Expenses for every NFP we audit or review with the exception of those organization that are extremely small. With the very small NFPs we report both classifications right on the Statement of Activities. Therefore I recommend requiring all NFPs (not just VHWOs) to present a Statement/Schedule of Functional Expenses unless the required information is presented on the Statement of Activities or in the Notes.

Question 14:
I agree. Because many times it is difficult to ascertain the amount of investment expenses, by removing this requirement reporting will be simplified while not losing any pertinent information.

Question 15:
I disagree. Since allocation of salaries tend to be so subjective (despite requiring it to be rational, uniform and consistent), I do not believe an accurate allocation will be made with regard to investment expenses, and if made, will most likely be understated. Currently it is difficult enough to determine the proper allocation of salaries between program and supporting services, not to mention to government and foundation grants. Requiring another level of allocation of salaries will be an addition burden.

Question 16:
I disagree. Again, I believe separating operating and non-operating activities will be a burden on both the tracking side as well as the reporting side. I further believe that classifying investment expenses as non-operating will not be useful or beneficial to the reader.

Question 17:
Again I disagree with the proposed principle of separating operating from non-operating activities as previously discussed.

Statement of Cash Flows, Including Financial Performance

Question 18:
I disagree. As I mentioned in my personal observations, as much as we accountants believe that the Statement of Cash Flows is a necessary report and useful to the reader my experience has not supported this fact. In my experience very, very few staff accountants or CFOs know how to prepare the statement and as such the statement is typically prepared by the external accountant/auditor. This coupled with the fact that even with an explanation Board members don't really understand what the statement is disclosing and have no interest in discussing it contents. Furthermore, as mentioned previously, a larger percentage of NFPs do not have sophisticated accounting systems and therefore will not maintain the information necessary to prepare a Statement of Cash Flows using the direct method. This combined with lack of interest by stakeholders (with maybe the exception of bankers and other external debt holders), makes switching to the direct method a non-beneficial change.

Question 19:
I'm not sure if any information would be lost if switching from the indirect method to the direct method but I believe that adding changes due to donor or non-donor restrictions and transfers will only add complexity to preparing the statement, not to mention that it won't be understood by any reader other than bankers or other very financial literate people.

Question 20:
Answer contained in previous answers above.

Question 21:
Yes. The changes of adding the separation of operating and non-operating activities.

Question 22:
My answer to this question is broader. I know FASB typically favors issuing standards that apply to all organizations regardless of their revenue size. But I strongly believe that there should be a revenue and support (or expenditure) test that dictates whether certain rules apply. Although some of the proposed changes in this draft might enhance the readability and usability of financial statements by stakeholders of larger NFPs, I do not think they add anything for smaller NFPs. An organization with revenue and support in excess of $10M will typical have a more robust and sophisticated accounting system and more experienced and knowledgeable accounting staff. As such they will more easily be in a position to comply with these new rules. In addition, stakeholders in larger NFPs tend to be more demanding and knowledgeable themselves and as such be in a positon to better understand the enhanced disclosures.

Thank you for this opportunity to present my opinion about the proposed accounting standards update affecting Not-For-Profit entities.

Sincerely,

Laurence Scot

Laurence Scot, MBA, CPA
Co-Managing Partner