1600 Tysons Boulevard, Suite 1400 | McLean, VA 22102

August 17, 2015

Financial Accounting Standards Board Members

Re.: Presentation of Financial Statements of Not-for-Profit Entities Exposure Draft (File Reference # 2015-230)

Thank you for the opportunity to comment on the FASB Exposure Draft, Presentation of Financial Statements of Not-for-Profit Entities (Exposure Draft or ED). I appreciate the extensive amount of time the FASB Board, FASB staff, the Not-for-Profit Advisory Committee and others have spent on preparing the Exposure Draft.

Our company, Attain, LLC provides consulting services to the higher education industry, working with virtually all classifications of private institutions. Additionally, we work with selected larger Not-For-Profit (NFP) organizations, providing advice around strategy, strategic finance, operational activities, grants management, and technology.

My personal experience has included services to this sector for all of my 42 years of experience. Currently I am a partner at Attain, LLC responsible for the Strategic Finance Practice and a Co-author of *Strategic Finance for Higher Education, seventh edition*. I also co-authored or participated in the development of each version beginning with the third edition in the series. I began my career at KPMG where I was an audit partner and ultimately the National Industry Leader for Higher Education and Other NFP Organizations. I also led the education practice for BearingPoint, have served as an interim Chief Financial Officer for a short time at Stevens Institute of Technology, and have served as a Board member on a number of diverse NFP boards. These boards have included 3 Universities, a senior living community, an affordable housing organization, a provider of home health services, several human services organizations and two trade organizations.

A project that I completed for the Federal Department of Education resulted in the development of the Financial Responsibility Standards which heavily relies on the audited financial statements for private colleges and universities, making the department an important user of the annual financial statements.

Having read many of the comment letters provided to the Board to date, I believe there is a paucity of commentary on the impact of the exposure draft on the financial governance of these institutions. While my comments are a bit broader, much of my focus is from a governance point-of-view. I will further state that while the presentation of financial data that is currently in use is an improvement over the prior fund accounting model there are significant deficiencies that this project is well positioned to correct, if focused on enhancement of disclosures, emphasis on the need for compliance with existing standards, I believe much of the correction could be achieved through a process of enhancing disclosures, without the extensive rewriting of the reporting standards that this exposure draft suggests. I have summarized my thoughts below and expanded on certain aspects of those thoughts in the answers to the specific questions.

I believe that the current issues the ED is attempting to address may not require the extensive rewriting of the reporting standards proposed in the ED. Some of the issues relate to a lack of:

- Understanding the current disclosure requirements by institutions and the meaning of those disclosures at the governance level.
- Improving transparency through enhanced disclosures because institutions, particularly their boards, do not have clear understanding about the types of funds the institution holds and its responsibility over those funds,
- Improving the reader's understanding of concepts such as expendable and non-expendable net assets, the varying levels of responsibility over designated, restricted and permanently restricted net assets, and clearly delineating the difference between pooled assets and whether the related net asset categories are fungible.

A summary of my suggestions to the FASB for improving the existing NFP financial statements are:

- Providing improved information on the composition of net assets by availability and broad requirements.
- Considering a classified balance sheet in lieu of the liquidity disclosures currently being contemplated
- Considering separation of operating cash, cash equivalents and short term investments into and unrestricted and either temporarily restricted or "funds whose use is limited" category
- Maintaining, at least, the current three net assets class approach and disclosures on the balance sheet and statement of activities, with more complete disclosure in the notes to the financial statements.
- Considering disclosing net investment in plant from the unrestricted net asset category on the face of the balance sheet, or at least as a subset of unrestricted net assets in the notes, mainly because many users cannot discern from the statements what portions of net assets might not be expendable, which coupled with a classified balance sheet would begin to give better insight on liquidity.
- Continuing the practice that the Statement of Activities report transactions arising principally from external events rather than including designations of net assets in the body of the statement. (While the net assets released from restrictions causes some confusion, it at least is based on an activity outside the control (manipulation) of management.
- Requiring note disclosure of expenses by both natural class/object and function.

Much of what I have described above and expand upon in the answers to the specific questions you have asked are a result of explaining to board members the principal issues existing in a set of financial statements as the principles that are used to create the statements are not as transparent as they could be.

However, a conversation I often hear is that this should look more like the for-profit models and that we would eliminate confusion if that were so. I believe this to be an egregious error in that the business model of the NFP should be reflected in the financial statement format and content. Ensuring users understand the key elements of their financial statements requires reassessment of the various disclosures of the financial statements, however a wholesale revamping appears somewhat drastic, and the resultant ED will add to the confusion.

Thank you for the opportunity to respond to this ED. Should you wish to discuss any of these matters, please contact me at resalluzzo@attain.com or 585-309-9452.

Very Truly Yours,

Ronald E. Salluzzo

Partner
Attain, LLC

My responses to your specific questions follow:

Statement of Financial Position and Liquidity

***Question 1:** Do you agree that the disclosures about the nature of donor-imposed restrictions and their effects on liquidity in notes to financial statements would help ensure that necessary information is not lost by combining the temporarily and permanently restricted classes of net assets into one donor restricted category for purposes of presentation in the statement of financial position (balance sheet)? If not, please identify the information lost and why it is necessary. (See paragraphs BC22–BC23 and BC27–BC32.)*

I disagree with combining the two restricted net asset classes into one restricted net asset class. I do believe better and more consistent disclosure of the components of each net asset class would improve transparency and understanding of the organization's stewardship responsibility over the various funds that it maintains. I don't believe the classifications today, nor the two class equity components suggested add to an understanding of liquidity unless the ED were to require disclosure of expected timing of releases of those funds for operating purposes; which I strongly oppose due to the potential for manipulation and the likely lack of comparability between institutions since there are too many variables in the operations of institutions.

The concept that the Uniform Prudent Management of Institutional Funds Act (UPMIFA) allows no distinction between contributed values and appreciation of value on endowed assets is a form over substance situation because a substantial burden continues to exist for institutions to demonstrate prudent management of these funds, which often leads to a policy that suggests maintenance of at least original contributed value.

To emphasize a matter related to restrictions, the restrictions that have not expired require a corresponding level of appropriate assets (cash, investments or pledges receivable) that are not available for operations, either immediately or when they convert to cash. Accordingly, in addition to maintaining the three net asset class approach, I believe the face of the balance sheet, or at least a note disclosure should present the amount of cash, cash equivalents and short term investments that are unrestricted and the amounts that are (or should be) held to satisfy a donor imposed obligation. This would enhance an understanding of the availability of funds according to broad sources. If this disclosure were made and a classified balance sheet produced, the framing of liquidity would result, and there would be consistency in the interpretation of the presentation. My experience suggests that users are very confused about the pooling of cash and other liquid assets (as is done with all operating funds) and the likely lack of fungibility of those funds.

Question 2: ***Do you agree that the aggregated amount by which endowment funds are underwater should be classified within net assets with donor restrictions rather than net assets without donor restrictions? If not, why? (See paragraph BC24.)***

I agree. Temporarily restricted net assets should be reduced to the extent of net appreciation that has not been appropriated and then any remainder should reduce permanently restricted net assets. This requires continued disclosure because the issue that would need settling, particularly in a troubled institution, is that one underwater fund may not be settled from the appreciation of a second underwater fund if the funds have donor restrictions that differ.

Question 3: ***Do you agree that disclosures describing the NFP's policy on spending from underwater endowment funds, together with the aggregated original gift amount or the amount that is required to be maintained by donor or by law, would provide creditors, donors, and other users with information useful in assessing an NFP's liquidity and potential constraints on its ability to provide services without imposing undue costs? Why or why not? (See paragraph BC32.)***

I agree with the first part of the question regarding the extent of the disclosures. Disclosures should be required on NFP polices on spending on underwater endowments funds including disclosure as to the number of funds and extent of the level of underwater—both the amount underwater and the total fair value of funds involved.

I disagree with the concept that understanding underwater positions will provide any further useful data on liquidity because the concept of liquidity implies right to use in the relative near term. An institution may have sizeable endowments that, due to a variety of factors such as donor intent, state law, prudence in spending policies, would not allow liquidation of those funds in the normal course of business.

Question 4: ***Do you agree that providing information in notes to financial statements about financial assets and liabilities and limits on the use of those assets is an effective way to clearly communicate information useful in assessing an NFP's liquidity and how it manages liquidity without imposing undue costs? If not, why, and what alternative(s) would you suggest? (See paragraphs BC27– BC31.)***

I disagree. Defining liquidity in each organization is complex and subject to interpretation. Rating agencies have used proxies like "days cash on hand" which is an easily manufactured number. I believe a classified balance sheet with restricted cash and cash equivalents would provide enough data to understand the liquidity of an organization. An alternative could be to provide a schedule in the notes to the financial statements "decomposing" the balance sheet into the three net asset classes. I expect some would suggest this would create incremental costs, however, I don't believe this to be true because the books and records of the organization should already maintain this data, if the organizational stewardship responsibilities are being met.

Question 5: ***Most business-oriented health care NFPs are required to present a classified balance sheet. Continuing care retirement communities and other NFPs may choose to sequence their assets and liabilities according to their nearness to cash as an alternative to using a classified balance sheet. As a result of the proposed requirement to provide enhanced disclosures of information useful in assessing liquidity, would there no longer be a need to hold business-oriented health care NFPs to the more stringent standard for their balance sheets? If not, why?***

As I have noted above, I would suggest all NFP's should be held to this more stringent (but not onerous) requirement.

Statement of Activities, Including Financial Performance

Question 6: ***Do you agree that requiring intermediate measures of operations would provide users of NFP financial statements with more relevant and comparable information for purposes of (a) assessing whether the activities of a period have drawn upon, or have contributed to, past or future periods and (b) understanding the relationship of resources used in operations of a period to resource inflows available to fund those operations? Do you also agree that classifying and aggregating information in that way would not require major system changes? If not, why? (See paragraphs BC38–BC47.)***

I agree with the formulation of a relatively standard measure of operating performance which would help readers understand the composition of institutional performance. However, I do not agree with the ED formulation of that measurement, particularly with the introduction of internal decisions substantially effecting the presentation of performance. This seems to be a regression to the practice of reflecting "non-mandatory" transfers, which confused everyone, particularly board members, in the "fund accounting" era of financial reporting.

I favor an operating measure which separates earned revenues (and expenses associated with generating those revenues) from support revenues and expenses. Support revenues would include all philanthropy and the spending rate on endowment, with the expenses associated with those activities presented in that section of the operating statement.

Further, prescribing an operating indicator would, I assume, exclude longer term changes that are not operating in nature, such as excluding changes in investment values net of spending policies, and other non-operating activities such as philanthropy for physical plant.

There should be requirements that certain selected items that should not be reported in any measure of NFP operations, such as items that correspond to those listed in Other Comprehensive Income for for-profit entities (e.g., gains and losses on derivative transactions affecting debt, and gains and losses associated with pensions and other post-retirement obligations including related prior service costs and transition asset changes). Changes in derivatives related to investments should be excluded since NFP entities have to account for those at fair value as part of their investment balances.

A key question for most board members is whether the institution had a surplus or deficit in a particular year. While I believe this is overplayed since an accounting surplus may or may not reflect the appropriate allocation of resources to meet mission based activities, at least the definition of an operating measure should be relatively consistent, easily defined, and transparently presented.

Boards spend far too much time trying to interpret the results and too little time using the information presented to perform their stewardship responsibilities.

Question 7: ***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 internal governing board appropriations, designations, and similar actions? If not, why? (See paragraphs BC48–BC74.)***

While I agree that the current operations of the organization should be included in the operating statement, I disagree with the intermediate measurement suggested based on several points:

- The statement should reflect transactions between the organization and outside parties, which would have economic substance.
- The unique nature of a NFP requires certain activities that are delayed due to donor restrictions, whether time or activity related, to be reflected in a different period than the consummation of a transaction-again the economics of the transaction is dictated from an outside source.
- The concept that a board action is a reportable economic event leads to the potential of substantial manipulation of financial reporting, both in terms of timing and amounts.

Question 8: ***Do you agree that all internal transfers (governing board appropriations, designations, and similar actions that make resources unavailable or available for operations of the current period) should be reflected on the statement of activities immediately after an intermediate measure of operations before transfers and immediately before an intermediate measure of operations after transfers? If not all internal transfers, on what basis would you distinguish between those transfers that should and should not be reflected and how would you make that distinction operable? Do you also agree that reflecting those internal decisions (or lack of them) on the face of the statement rather than in notes will help an NFP communicate how its operations are managed without adding undue complexities? Why or why not? (See paragraphs BC46–BC47 and BC67–BC74.)***

I disagree – Any and all transfers and Board designations should not be reflected on the statements. I stated my belief in the answer to question 7 that reflecting these types of transactions through the operating statement reduces comparability and reliability of information presented. Any internal decisions on designations of net assets without donor restrictions or other Board actions within that net asset class should be disclosed in the notes. I will make special note to the treatment of spending policies on endowment funds. These are subject to governing board action both by UPMIFA and often by donor gift instruments which often suggest spending should be done in compliance with the organization's normal spending policies. In this case, the board action to release appreciation (and in limited situations contributed value) for current operations represents an economic event that is delegated to the governing board and expected to be carried out in a prudent fashion. Historically note disclosures around this spending and the impact of UPMIFA have been extensive and should continue to be provided.

Question 9: ***Do you agree that to promote comparability, the Board should eliminate one of the two optional methods for reporting expirations of donor restrictions on gifts of cash or other assets to be used to acquire or construct long-lived assets? Do you also agree that requiring the expiration of those donor restrictions on the basis of the placed-in-service approach rather than the current option to present a release from restriction over the useful life of the acquired long-lived asset is most consistent with the underlying notions of the intermediate measures of operations? If not, why? (See paragraph BC66.)***

I agree. All contributions received as cash or investments with donor restrictions for use for construction or acquisition of property, plant and equipment should be released when the asset is placed in service and not over time. There are limited exceptions to this based on unusual circumstances, such as a gift of real property that must be held in perpetuity.

Question 10: ***Do you agree that gifts of, or for, property, plant, and equipment (long-lived assets) should be considered operating revenue and support when received (or when placed in service in the case of a gift to acquire a long-lived asset)? Do you also agree that because the long-lived asset is not immediately fully available to be utilized in the current period, an NFP should be required to present a transfer from operating activities to other activities for the amount of the gifted asset or portion of the asset funded by restricted gifts? If not, why? (See paragraphs BC72–BC74.)***

I disagree. Contributions received for the construction or acquisition of property, plant and equipment or their subsequent release from restrictions should not be part of any operating measure. There should be no transfers or internal designations reported on the face of the statement of activities as discussed above. Further, there should be required disclosures as to the amount of such contributions either received or released from restrictions in the notes or on the face of the statement of activities.

Question 11: ***Do you agree that the addition of required intermediate measures of operations for all NFPs would make unnecessary the need for NFP business-oriented health care entities to also present their currently required performance indicator? Why or why not? (See paragraph BC99.)***

No. I disagree with the proposed changes to a required intermediate measure of operations for NFPs as presented in the ED and how that measure would be derived. I would keep the current health care entities performance indicator.

Question 12: ***Do you think the flexibility currently allowed by GAAP to present a statement of activities as either a single statement or two articulating statements and to use either a single-column or a multicolumn format should be retained or narrowed? If narrowed, why and in what ways?***

I agree. Maintaining the flexibility of one or two statements and using either one or multiple columns permits the NFP to better effectively communicate financial information in a manner unique to their financial statement users. The choice of a format is a key communication decision and should be left to the discretion of the NFP and their users.

***Question 13:** 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? Why or why not? (See paragraphs BC87–BC93.)*

I agree that a NFP should report in a note a matrix of their operating expenses that reflects expenses both by nature/object and function/program The pattern of spending by natural classification is more meaningful to board members and likely consistent with the data they are used to seeing in their for profit businesses. However, the allocation of resources by the functions of the NFP is also valuable because this provides insight into the allocation of the spending patterns within each of those functional areas. These note disclosures should be required for all fiscal years presented and that the expense captions used in the matrix should be the same captions disclosed in the financial statements of activities and cash flows so users can correlate the information.

***Question 14:** 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)? If not, why? (See paragraph BC100.)*

I agree with the change. Investment income should be reported net of external manager fees and direct internal investment expenses.

***Question 15:** 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? Why or why not? (See paragraph BC101.)*

I disagree. The current disclosures concerning the composition and reporting in the statement of activities of net investment income should be maintained and expanded. All types and sources of investment income should be disclosed, including identifying investment income related to working capital/operating funds investments and investment income related to endowment funds investments. In addition, these disclosures should be by net asset class and should agree to other disclosures, such as changes in endowment funds.

***Question 16:** 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? If not, why? (See paragraphs BC59–BC60.)*

I disagree. Interest expense should be included in any performance measure on the statement of activities since it represents an outflow of resources from the NFP. Interest expense, whether for capital projects or to support current operations is an expense associated with the core activities of the organization. This is a key component of the financing of operations and physical plant and distorts operations if excluded. For profit organizations use measures that exclude interest (and taxes, depreciation and amortization) because this measure helps a potential investor understand what the enterprise value might be. Such a concept is not relevant to a NFP.

Question 17: ***Do you agree with the following implementation guidance:***

a. Equity transfers between NFPs that are under common control and are eliminated in a parent entity's consolidated financial statements and equity transactions between financially interrelated entities should be presented within operating activities unless they are not available for current-period use in carrying out the purpose for the reporting entity's existence? If not, why? (See paragraph BC62 (a).)

I agree with the guidance.

b. Immediate write-offs of goodwill generally should be presented within operating activities? If not, why? (See paragraph BC62 (b).)

I agree with the guidance.

c. Immediate write-offs of acquisitions of non-capitalized items for a permanent collection should be presented within the operating activity section if acquired with net assets without donor restrictions? If not, why? (See paragraph BC62(c).)

I agree with the guidance.

Statement of Cash Flows, Including Financial Performance

Question 18: ***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? If not, please explain why and suggest an alternative that might increase the benefits or reduce any operational concerns or costs. (See paragraphs BC75–BC80.)***

I agree that the direct method for the statement of cash flows is more informative and understandable to users. The indirect method does not meet user needs and its operating section is confusing as well as prone to preparer and auditor errors, especially concerning classification of operating, capital and endowment contributions received. This would be consistent with my view that the direct method would provide board members, as important users of the statements with a better understanding of resource flows in the organization in the periods presented.

However, I also believe the NFP should not be held to a higher standard of reporting than other industries and believe FASB should complete its assessment of this presentation model for all industries. Weighing these competing needs, I opt for assessing this presentation issue within the context of an evaluation of all industries together, and not this one on a one off basis.

***Question 19:** 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? If so, please identify the potentially omitted information and explain why it is useful and whether it should be provided through disclosure rather than requiring use of the indirect method. If you suggest that requiring the indirect method is necessary, would you require that the amount for cash flows from operations be reconciled to the amount of the (a) change in net assets, (b) change in net assets without donor restrictions, or (c) proposed intermediate measure of operations before or after transfers? Why? (See paragraphs BC75–BC80.)*

I would maintain the reconciliation as it would improve user understanding and act as a proof for preparers and users. This will be significant as there are differences between the operating measure on the statement of activities and the operating section in the statement of cash flows.

The reconciliation should be to change in total net assets as is currently required since all items will ultimately be converted to cash, not just operation related items.

***Question 20:** 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. (See paragraphs BC81–BC86.)*

No. I disagree. The proposed statement of activities format on the Exposure Draft is confusing, especially including board transfers and transfers between operating and non-operating sections in the body of the statement. The presentation of activity needs to be understandable which requires transparency. I have often said that the financial statements are no more than the accumulation of economic events over a period of time expressed according to a set of standards that we call GAAP. If we allow differences in the models between the two statements, and we provide the opportunity for manipulation of transactions through organizational intervention, I believe the ability of a set of financial statements to explain the economic events comprising the statements is significantly reduced.

Effective Date

***Question 21:** Are there any particular proposed amendments in this Update that would require a longer period to implement than other amendments? If so, please explain.*

No. All changes should take effect at the same time.

***Question 22:** Are there reasons for any particular size or type of NFP to need a longer time frame to implement the proposed amendments in this Update? If so, please explain.*

No. All NFP entities should adopt the revised standards at the same time.