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Technical Director
File Reference No. 2015-230
Financial Accounting Standard Board (FASB)
401 Merritt
PO Box 5116
Norwalk, CT 06856-5116

Re: FASB Exposure Draft
Not-for-Profit Entities (Topic 958) and Health Care Entities (Topic 954)
Presentation of Financial Statements of Not-for-Profit Entities

The time and effort dedicated to the evaluation of the current Financial Statement Presentation for Not-for-Profit Entities (NFP) is clearly evident in the materials provided with the Exposure Draft. Thank you for the opportunity to contribute observations and suggestions as well as respond to specific questions posed in the exposure draft.

We have done our best to provide a clear and concise response for your consideration.

Overview:

We applaud the intent to enhance reader experience. Unfortunately, we are concerned that the Exposure Draft appears to have lost sight of who the readers are and fails to meet their needs and expectations. Ultimately, many of the changes proposed will inevitably lead to more confusion for our sector. Most of our comments are framed by the belief that NFP financial statements should differ from for-profit statements only in places where such differences are essential to understanding the differences between NFPs and for-profits. We assume most Readers of NFP financial statements are more familiar with for-profit statements, so the more NFP statements can mirror for-profit statements, the better they will be understood.

Readers of our financial statements include members of the Board of Trustees who hold a fiduciary obligation to the institution they represent. Clear and concise financial evidence to support and address these fiduciary obligations should be an important objective.

Readers include Individual Donors and Grant Issuing Organizations who have gifted or "invested" financial resources with the institution to ensure it can fulfill the mission it articulated to earn the privilege of establishing itself as a not-for-profit entity, and establish eligibility for federal and state tax exemption (under certain conditions). Clear and concise financial evidence to support and address how the institution has used these financial resources

to fulfill its mission and the stewardship commitments it has made to donors should be another important objective. Meeting the needs of these Readers will demand our financial reporting focus more on stewardship information and less on valuation and its volatility or stale references to liquidity.

Readers include Bond Holders and other financial institutions serving as Creditors who have invested (or will be asked to invest) financial resources with the institution with an expectation of investment return and repayment. Clear and concise financial evidence to demonstrate the ability of an institution to repay its creditors in the near and long term should be another important objective.

There are many Other Readers of the financial statements of a not-for-profit who will benefit from the information compiled to support the readers specifically mentioned above. Those Other Readers include but are not limited to individuals and organizations dedicated to monitoring compliance with federal laws and regulations, media and benchmarking outlets and peer institutions.

We have framed our response to the Exposure Draft with Readers in mind and hope our comments will help to clear muddy waters in ways the proposed redesign does not.

FASB Stated Objectives:

The Proposed Amendments are intended to address several issues which are paraphrased here, along with our concern and an alternative recommendation.

1. Clarify current net asset classifications

Our concern: The current three tier net asset classification provides an important distinction in regard to differentiating permanent restrictions and temporary restrictions. Most Reader confusion originates with the unrestricted net asset classification, which the Exposure Draft completely fails to address. Readers need more information about unrestricted assets in order to better understand which net assets are available to support liquidity and which are dedicated to long term financial objectives. The exposure drafts tries to solve the wrong problem.

Alternate Recommendation: Require additional detail for Unrestricted Net Assets to clearly present Unrestricted Net Assets available to support operations and Unrestricted Net Assets committed to Net Investment in Plant and Funds Functioning as Endowment. Merging Temporarily Restricted and Permanently Restricted Net Assets is less of a concern so long as additional information about the types of donor restrictions is available in the footnotes. Such as identifying Restricted Assets available to support future operations and designated for future Investment in Plant or Funds Functioning as Endowment or obligated by other Split Interest Agreements, as well as continued disclosure of the Permanent Net Assets to continue to clearly reflect the obligation to retain these assets in perpetuity.

2. Improve presentation of liquidity

Our concern: the current Balance sheet presentation of assets is sufficient to meet questions about liquidity at a point in time. However, as noted above significant confusion exists around the availability of Unrestricted Net Assets, principally because it

includes Net Investment in Plant and Funds Functioning as Endowment, assets which have significant liquidity limitations, in some cases offering no immediate form of liquidity for operating cash or debt service obligations. Readers concerned about liquidity should be looking at Cash and Cash Equivalent Positions and seeking additional clarity from the Statement of Activity and Statement of Cash Flow.

Alternate Recommendation: Require additional footnote disclosure for Unrestricted Net Assets to clearly present Unrestricted Net Assets available to support operations and Unrestricted Net Assets committed to Net Investment in Plant and Funds Functioning as Endowment. Require similar additional detail for the Temporarily Restricted Net Assets to clearly present Temporarily Restricted Net Assets available to support future operations and Temporarily Restricted Net Assets designated for future Investment in Plant or Funds Functioning as Endowment or obligated by other Split Interest Agreements and retain disclosures for Permanently Restricted Net Assets as this already clearly reflects the obligation to retain these assets in perpetuity.

3. Improve presentation of financial performance

Our concern: This is the area where we are most concerned. The Exposure Draft as proposed will create more confusion and fails to clarify Operating and Non-Operating activity in appropriate ways. Reader confusion is concentrated around differentiating operating activity from unrestricted activity and the Exposure Draft fails to achieve this objective because it failed in its first objective to improve the net asset classifications. Unrestricted Net Asset Activity is not Operating Activity and an effort to reconcile the two with transfers is ineffective.

Alternate Recommendation: Define operating revenue activity to clearly include all institutional resources routinely received on a recurring basis to support the mission of the organization including revenue and fees, interest and dividends earned on operating cash balances and the release of restricted net assets to support ongoing operating activity.

Define operating expense activity to include institutional resources expended to support the mission of the organization including interest expense and depreciation.

4. Improve presentation of cash flows

Our concern: There will be challenges associated with gathering data to support the presentation of a direct cash flow statement which will be addressed with institutional system improvements over time. The greater challenge presented in the Exposure Draft is again associated with the modification of definitions of operating cash that increase confusion for our readers.

Alternative Recommendation: Accept recommendation to transition to direct cash flow statement. To improve Reader experience, operating, investing and financing activities should be defined the same as for-profit reporting.

Clearly define Endowment Investment Activity and Property, Plant and Equipment Activity as Cash Flows from Investing Activities.

Clearly define Debt and Liability Activity as Cash Flows from Financing Activities.

With the exception of several recommendations to improve consistency between institutions and provide additional information about the natural classification of expenditures to compliment the presentation of functional expenditures the Exposure Draft falls far short of achieving the enhancements imagined by Readers and the original well intended objectives.

FASB Proposed Questions:

The Board invited individuals and organizations to comment on a series of questions which are paraphrased here, along with our concern and an alternate recommendation when appropriate.

1. Consolidate nature of donor restrictions on the statements, moving disclosure about the nature of donor-imposed restrictions and their effects on liquidity into the footnotes.
Response: Agree.
Footnote disclosure for the temporary and permanently restricted donor restrictions is critical to appropriately demonstrate the dramatically different fiduciary obligations. We recommend continued emphasis on the permanent obligations of the institution and adding additional clarification to the Unrestricted Net Asset to improve clarifications about liquidity.
2. Underwater.
Response: Disagree.
Underwater endowments create an additional obligation against unrestricted net assets which can and should be recognized but should not imply an additional donor restriction beyond that already classified as temporary and permanent.
Essentially, donor restrictions are backed by the full faith and credit of the institution and to the extent an endowment is underwater there is an obligation on otherwise unrestricted net assets and the obligation should be reflected in Unrestricted Net Assets. Permanent Net Assets should always be stated at Historical Gift Value.
3. Underwater.
Response: Disagree.
Current footnote disclosures for endowments are adequate.
4. Liquidity.
Response: Disagree.
No value added.
5. Classified Balance Sheet.
Response: Agree.
No value added by current requirement to classify balance sheet assets and liabilities.
6. Measure of Operations.
Response: Disagree.
While Readers of the financial statements do need a clear measure of operations for reference in the statement of activities the proposed change is likely to confuse more than clarify.

The proposed definition(s) of operating activity need significant improvement and clarification. The Exposure Draft unnecessarily confuses Unrestricted Net Asset activity with Operating Activity by including Investment in Plant activity in Operations which will increase Reader confusion about these investments which are often not recurring in nature and benefit multiple periods of time, irreparably distorting true operating activity.

7. Operations: (a) Resources for Mission (b) Transfers.

Response: Disagree.

Readers want and need to know about Operating Activity, inserting two measures for operations will continue to contribute to confusion. Transfers of endowment spending are donor mandated, board directed (by prudent management regulations) to support operations. To add value FASB needs to commit to a clear definition of Operating Activity which should not include gifts restricted for investment in plant which are investment activities to benefit ongoing operations.

8. Internal Transfers:

Response: Disagree.

As stated above, transfer of endowment spending are donor mandated, board directed to support operations. Excluding these transfers from the first measure of operations will increase donor confusion. To add value FASB needs to commit to a clear definition of Operating Activity Readers want and need to know about Operating Activity, inserting two measures for operations will create new confusion.

9. Release of Plant:

Response: Agree.

Proposal improves consistency.

10. Gifts for Plant:

Response: Disagree.

Gifts for Investment in Plant are rarely recurring in nature and clearly benefit multiple periods. Including them in the definition operating activity will create irreparable distortions between years and between otherwise comparable institutions.

Gifts for Investment in Plan should not be included in the definition of Operating Activity.

11. Health Care Performance Indicator:

Response: Agree.

12. Presentations:

Response: If FASB hopes to improve consistency, narrowing the number of reporting options would be beneficial. Moving toward a single statement and single column will bring Readers closer to the for-profit formats that are more familiar.

13. Function and Nature:

Response: Agree.

Readers should find expenditure reporting by both functional and nature to be informative. The statement of functional expenses appropriately demonstrates how the organization fulfills its mission. Footnote disclosure of expenditures by nature is appropriate and useful.

14. Investment Fees:

Response: Agree.

Requiring investment income to be reported net of external and direct internal investment expenses will increase comparability. Consideration should be given to clarifying that both internal and external investment fees should be included in investment return calculations as well.

15. Investment Fees, internal expenses separately disclosed:

Response: Disagree.

Differentiating internal and external management fees does not change the financial reporting and will provide no added value to Readers.

16. Interest Expense:

Response: Disagree.

Interest expenses must be financed by operating revenue. Failure to include them as an operating expense will distort the presentation of this recurring liquidity obligation. It would be better to match these operating expenses with operating income. For most NFP there are two costs for raising capital, interest expense and fundraising expense. If fundraising expenses are commonly recognized as operating expenses, interest expense should certainly be recognized in the same way.

17. Equity/Goodwill Write-off/Collections:

Response: Agree.

Guidance appears reasonable and appropriate.

18. Direct Cash Flow Statement:

Response: Agree.

The direct cash flow statement echoes the Statement of Activity, which should add clarity for the Reader.

19. Indirect Information Lost:

Response: Information lost includes transparency about Mark to Market adjustments, and Depreciation which can be addressed in the related Investment and Property, Plant and Equipment or new Natural Expense Classification Footnote. Footnote disclosure is an adequate replacement for any indirect information. The indirect cash flow statement is simply hard to understand and footnotes can provide adequate information.

20. Definition of operating activity for the Statement of Cash Flows:

Response: It is extremely important that Readers recognize the Statement of Cash Flow definitions as consistent with those required for business entities. Creating/changing definitions will increase Reader confusion.

The definition of Operating Activity should NOT include Investment in Plant Activity for either the Statement of Activities or the Statement of Cash Flow. Interest expense should be included in the definition of Operating Activity for BOTH the Statement of Activities and the Statement of Cash Flow. All investment Income should be reported as Investment Activity on the Statement of Cash Flow which will demonstrate from a cash perspective the dependency between Operating Activity and Investment Activity.

21. Effective Date:

Response: The proposed amendments require substantive revision prior to implementation. The time to implement these changes will not be insignificant, the effective date itself is reasonable for an institution of our size and limited complexity. Our concerns are dominated by our disagreement with the proposed amendments themselves and the YEARS it will take to help our readers understand their implications.

22. Size:

Response: The proposed amendments can be implemented regardless of the size or type of NFP however, smaller NFP with limited staff will struggle to move forward. I would imagine most higher education organizations should be able to implement them on a reasonable time frame.

Thank you again for this opportunity to respond to this Exposure Draft. We hope the discussion and responses provided above are beneficial and would be pleased to discuss and/or articulate our position with you if necessary.

It is an honor and privilege to present our financial statements for our Not-for-Profit Entities on an annual basis. We join FASB in looking forward to the opportunity to improve our Reader experience in the future.

Sincerely,
Linda H. Thornton, CPA(Inactive), MBA
Comptroller
Carleton College