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Proposed Accounting Standards Update, *Not-for-Profit Entities (Topic 958) and Health Care Entities (Topic 954): Presentation of Financial Statements of Not-for-Profit Entities*

The Accounting Principles and Assurance Services Committee (the "Committee" or "We") of the California Society of Certified Public Accountants (CalCPA) is pleased to provide our comments to the Financial Accounting Standards Board.

The Committee is the senior technical committee of CalCPA. CalCPA has approximately 43,000 members. The Committee consists of 57 members, of whom 43 percent are from local or regional CPA firms, 30 percent are from large multi-office CPA firms, 13 percent are sole practitioners in public practice, 9 percent are in academia and 5 percent are in international CPA firms. Members of the Committee are with CPA firms serving a large number of public and nonpublic business entities, as well as many non-business entities such as not-for-profits, pension plans and governmental organizations.

As our Committee worked through responses to the Exposure Draft it became apparent that there was great interest in the proposed standard despite more than a few areas of disagreement. Many of our responses below indicate where we had divergent views.

As a whole, the Committee is strongly in favor of efforts to improve transparency and the usefulness of financial statements for NFP's particularly with respect to assets unavailable to meet current and projected future cash flow requirements. The Committee is also in favor of a current period statement of activities based on the utilization of currently available assets in carrying out its mission.

We were also in agreement that any new NFP standard should reflect any desired consistency and comparability to the financial reporting burdens and options available to for-profit enterprises. Specifically, we agreed that changes in requirements for NFP's related to the components of non-operating activity and methods used for the statement of cash flows may be better served by following any new standards applicable to for-profit enterprises.

Following is a summary of the Committee's responses to the Exposure Draft for your consideration.

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.)

A few of our members were of the opinion that enhanced disclosures would not be sufficient to ensure that necessary information is not lost by combining temporary and permanently restricted assets. These members believe that the existing periodic preparation of the financial statements, which include a distinction between permanently and temporarily restricted net assets, is sometimes the only recordkeeping done by many small entities with respect to permanent endowments. They expressed concern that smaller organizations would lose information that would otherwise be captured.

However, the majority of committee members are generally in agreement that, together with enhanced footnote disclosure, combining all classes of restricted net assets into one donor restricted category would not impede the quality of information available to readers and would provide cost savings to preparers.

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.)

Yes. All committee members are in agreement.

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.)

Yes; however, the committee recommends a required disclosure for any individually material underwater gifts.

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.)

The Committee has mixed opinions whether the proposed changes go far enough to alleviate shortcomings in the current rules. Some on the committee believe that providing enhanced disclosures alone is a positive improvement while many others would require a classified balance sheet.

Those that advocate for only enhanced disclosure believe that the effort required to properly classify the balance sheet, particularly for smaller entities with limited resources, would be burdensome. They further cite the imprecision that would result in classifying such assets as pledges and split interest agreements. They also question the relevance of attempting to quantify and monitor the assets on hand available to meet liabilities noting that many organizations have donors that regularly meet liquidity shortfalls as they arise.

Those advocating for a classified balance sheet have suggested that the requirement be relaxed for smaller organizations, i.e., classified balance sheets could be recommended but not required.

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?

No, the Committee believes that rules requiring a classified balance sheet for certain business-oriented NFP's should remain intact.

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.)

The Committee agrees and is supportive of more relevant and comparable information for purposes of assessing the activities of the current period in relation to the resources of the organization, conversely, resources may become available that management does not intend to utilize until a future period.

The Committee is in agreement that while FASB is examining ways to improve reporting of intermediate measures of operations for for-profits, it is reasonable to also require additional measures for non-profits.

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.)

Yes, the Committee is generally supportive of an approach to the intermediate measure utilizing the distinctions of mission and availability. We also agree that investing and financing activities should not be considered mission-related unless programmatic and significant.

However, we also note that some on our committee are not completely comfortable with the approach that all assets otherwise unrestricted, that are made available purely by governing board designation, should be included within the intermediate measure of operations.

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.)

As noted, the Committee was mixed as to how the concept of availability should extend to internal transfers. Most members believe that all internal transfers should be reflected on the statement of activity whether in a discrete section of the statement or within the intermediate measure of operations. These members agree with the board that any other method of designation would be unworkable.

Those in favor of eliminating the intermediate measure of operations before transfers cite complexity and difficulty of understanding. And as noted in Question 7, some were not in favor of reporting management designated transfers at all. We recommend that the Board continue to develop the concept of availability as a result of governing board designation with the goal of reducing some of the apparent subjectivity as currently drafted.

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.)

Yes, the Committee agrees with requiring the placed-in-service approach as it is more consistent with the concept of reporting resources that become available for current-period activities.

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.)

The Committee believes that gifts of or for property plant and equipment should be considered operating, financing or other revenue and support consistent with the concept of whether the asset is used in carrying out the mission of the enterprise. The NFP should report the availability of the asset within current period operations/non operations when the asset is fully available for use.

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, we do not agree that the current performance indicator would be made unnecessary.

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?

Yes, flexibility should be maintained.

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.)

Requiring all non-profits and not just health and welfare organizations to report expenses by both nature and function would be beneficial and should be a required supplemental schedule.

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.)

Most on the Committee support the notion that interest income should be reported on the same basis for NFP's as for-profit enterprises and that the Board should not impose a burden on NFP's that does not exist for for-profits. As such the Committee is supportive of allowing NFP's to report investment income net of external fees but not direct internal fees. We also recommend that the Board allow NFP's that have significant long term investments such as large foundations to report investment income net of external direct internal expenses as part of non-operating activities.

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.)

Refer to question 14. The Committee notes that for smaller organizations investment management fees can be more significant and relevant than internal direct salaries and benefits; but the Board should be guided by the principle that NFP's should not have more stringent requirements than for-profit enterprises.

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.)

The Committee is split on whether all interest, including the expense resulting from day-to-day financing decisions, should be classified as operating or non-operating expense. The Committee believes that the guidance for NFP's in this area should be similar to the guidance expected to be finalized for for-profit enterprises.

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).)
b. Immediate writeoffs of goodwill generally should be presented within operating activities? If not, why? (See paragraph BC62(b).)
c. Immediate writeoffs of acquisitions of noncapitalized 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).)

The Committee agrees with the Board's approach on all three.

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.)

Committee members do not agree that the direct method should be required for NFP's and we believe that NFP's should have the option of using the direct or indirect method as long as for-profit enterprises have an option.

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.)

The Committee believes that some necessary information would be lost if the direct method were required and recommends that if the direct method is used, either by requirement or option, the reconciliation of cash flows to the change in net assets should be required.

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.)

Yes, the Committee believes that as much as possible, the definition of operating activities for the statement of cash flows should align with the definition for purposes of the statement of activities, regardless of any differences between non-profit organizations and for-profit entities.

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.

None noted.

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.

None noted.

We thank you for the opportunity to comment on this matter. We would be glad to discuss our opinions with you further should you have any questions or require additional information.

Sincerely,

A.J. Major III
Chair
Accounting Principles and Assurance Services Committee