AICPA® Not-for-Profit Section

FASB's Not-for-Profit Proposal: Demystifying the Comment Letter Process

On April 22, the FASB issued an exposure draft of a proposed Accounting Standards Update (ASU), Presentation of Financial Statements of Not-for-Profit Entities, which would significantly change the existing not-for-profit financial reporting model (as summarized in the addendum below). Comments on the exposure draft are due by August 20. The proposal can be downloaded for free from the Exposure Documents page on the FASB's website.

Throughout the three-year project, the FASB has heard views provided by various constituencies, including its Not-for-Profit Advisory Committee (NAC), by accounting firms and AICPA expert panels, and by industry associations such as the National Association of College and University Business Officers (NACUBO) and Healthcare Financial Management Association (HFMA). However, the constituency they likely have not heard from, but probably are most interested in, is preparers (in particular, CFOs, CEOs, and board members). The proposal provides a "once-in-a-generation" opportunity for preparers to make a difference in the outcome of a proposal that could have far-reaching consequences.

The prospect of writing a comment letter to the FASB might seem daunting to financial professionals in not-for-profit organizations. NFPs often have relatively fewer and less specialized accounting personnel than do public business entities; because of their resource constraints, they typically are less likely to actively participate in the standard-setting process. In addition, a perception exists that a comment letter is a highly technical GAAP undertaking best left to an entity's auditors. While the resource constraints are a fact of life, the notion that a comment letter response must be highly a technical undertaking is not.

"If I Write a Comment Letter, What Do I Say?"

The proposal contains 22 "questions for respondents." Does each respondent have to answer every question? The answer is no. Commenters have different backgrounds and experiences, and not all respondents will have comments on each issue addressed in the proposal. Therefore, it is perfectly acceptable for preparers to focus on those issues that they are most interested in and are most knowledgeable about. Feedback can be provided in plain English, without citing or referencing technical accounting guidance in GAAP. Specific examples in support of your view can be very helpful.

In some cases, preparers might choose to bypass the questions and provide comments in their own words on why they support or do not support the model from a business perspective. These nontechnical comments are equally valuable to the Board. Below are several questions oriented to this type of comment that might help get you started thinking.

- Who are the primary users of your financial statements – the board or audit committee, bondholders, banks and other lenders, vendors, donors? Would the proposed changes make your statements more useful for these users? Why or why not?

- Today, classification of transactions in a statement of activities as "operating" and "nonoperating" is optional. The proposal would make it mandatory. If you distinguish between operating and nonoperating today, what items do you classify as nonoperating, and why do you believe this makes the statement more useful/informative? How is this similar to or different from the proposal's definition of "operating"? If you do not find a distinction between operating and nonoperating to be useful, why is that so?

- A fundamental view underlying the proposal is that consistent classifications of information across the spectrum of NFPs would make statements of activities more useful and comparable. Do you compare your financial statements to entities within your specific subsector (that is, hospitals, long term care facilities, colleges, trade associations, etc.), or industry (for-profit or not-for-profit), or do you compare yourself to NFPs more broadly? Would a shift to a model that requires all NFPs to report the statement of activities in a similar fashion make your statements more useful or less useful, in your opinion?

- FASB is considering whether to propose similar changes in reporting for business entities, but those projects are in early stages. Should such fundamental changes in reporting activities and cash flows be considered at the same time for all entities (NFPs and business entities)? Or do you believe there is no need to delay potential improvements to NFP reporting while the FASB decides whether to propose similar changes for business entities?

Although constituents tend to comment more often when they disagree with a proposal, it is equally important to let the Board know if you support some or all of a proposal. If there are areas where you don't agree, it is helpful to provide alternative suggestions.

Once your comment letter is complete, you can submit it via e-mail or by mail. (Refer to the Exposure Documents page on the FASB's website for details.) Copies of the letter will be distributed to each Board member, as well as to all staff assigned to the project, and will also be posted on FASB website. Although the Board's website provides a simplified electronic response form, larger well-known organizations may wish to consider submitting comments on letterhead, which can be a powerful communicator.

Remember: your compelling comment or example can make a difference!

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Addendum -- The Proposal in a Nutshell

With the exception of not-for-profit health care entities, not-for-profits currently have significant flexibility in how they reporting operating results, if they choose to report an operating measure at all. Under the proposal, an operating excess (deficit) subtotal would be required for all not-for-profits, including health care entities that today are required to report a net-income equivalent "performance indicator."

The cornerstone of the proposal is a new conceptual approach to defining "operating activity" in a NFP's statement of activities and statement of cash flows. Items would be classified as operating or nonoperating in the performance statement based on whether they arise from operating, investing, or financing activity. The proposed new approach to defining "operating" is a departure from traditional distinctions between operating and nonoperating. Today, the focus is largely on whether management considers activities or transactions to be "ongoing major and central" to an entity's operations. Under the proposal, FASB defines operating classification is determined using new "dimensions" of mission and availability. Mission considers whether resources result from or are directed at carrying out the purposes or mission for which the NFP exists -- that is, providing goods and services to beneficiaries, customers, or members. Generic investing or financing activities (for example, investment income not arising from core programs) would not meet the "mission" dimension and thus, would always be nonoperating.

Availability considers whether resources are available for current period activities, based on the presence or absence of limitations imposed by donor-restricted contributions or by actions of an entity's governing board (or in some cases, management). The availability dimension also governs the treatment of contribution-related activity associated with acquisition of long-lived assets used in operations. Resources restricted by donors for the acquisition of property and equipment would be released from restriction within operations and then simultaneously transferred out of operations when the property or equipment is placed in service.

Movements of resources between operating and nonoperating categories (for example, those associated with board designations of resources or for capital assets acquired through donor-restricted gifts) would be accomplished using a new transfers category, and the operating measure would be reported with and without the effect of the transfers.

In order to drive closer alignment between the notion of "operating" used in statements of activities and statements of cash flows, the proposal would change how certain cash flows are classified. For example, cash payments to acquire property plant and equipment would be reported in operating cash outflows, rather than as investing outflows. Similarly, dividends and interest received by an endowment would be reported as investing inflows rather than operating inflows. In effect, the proposal would create a separate cash flow reporting model for nonprofits. Use of the direct method of reporting operating cash flows would be required.

Other proposed changes include:

• The three existing net asset classes (permanently restricted, temporarily restricted, and unrestricted) would be replaced with two net asset classes (net assets with donor restrictions and net assets without donor restrictions).

• All NFPs would be required to provide an analysis of operating expenses by both their nature and function on the face of the statement of activities, as a separate statement, or within the notes.

• A net presentation of investment expenses against investment return would be required on the face of the statement of activities. Internal salaries and benefits expenses netted against investment returns would be required to be disclosed.

• The amount of endowment funds that are underwater would be reported within the proposed "with donor restrictions" class of net assets (rather than within the unrestricted class of net assets as currently required).

• NFPs would be required to provide quantitative and qualitative information useful in assessing liquidity, including a description of the time horizon used to manage its liquidity.

