



August 18, 2015

Technical Director
File Reference No. 2015-230
FASB
401 Merritt 7, PO Box 5116
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director@fasb.org

Re: Comment Letter on FASB Exposure Draft on Not-For-Profit Entities

Dear Director and Board:

The Association of Art Museum Directors (AAMD) has reviewed the FASB Exposure Draft on Not-For-Profit Entities and would like to thank the FASB for its efforts and desire to remove current inconsistencies in financial reporting and improve comparability amongst nonprofit entities. Several of the recommended changes are to be applauded for the improved clarity, however, there are also sections that could result in general confusion and misperception of the entity's financial health.

The AAMD was founded in 1916 with the purpose of supporting its members in increasing the contribution of art museums to society. The AAMD accomplishes this mission by establishing and maintaining the highest standards of professional practice, serving as a forum for the exchange of information and ideas, acting as an advocate for its member art museums, and being a leader in shaping public discourse about the arts community. As such, we would like to express our concerns should the draft be wholly adopted as proposed. In order to reflect the general thoughts and opinions of our member museums, 11 museums have compiled their comments into a single response. The participating museums include The Art Institute of Chicago, Museum of Fine Arts, Boston, Cleveland Museum of Art, The J. Paul Getty Trust, Los Angeles County Museum of Art, The Museum of Fine Arts, Houston, National Gallery of Art, The Metropolitan Museum of Art, The Museum of Modern Art, Philadelphia Museum of Art and The Toledo Museum of Art. The compilation of the museum's comments are presented below. On behalf of its 222 member museums in the United States, the AAMD endorses these comments in full.

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.)*

Yes, we agree that this change would not result in lost information, but we would modify the terminology to “with restrictions” and “without restrictions”. The former would include non-donor restrictions required by statutory charter or state law including time and purpose restrictions on art deaccession proceeds that must be utilized for future art acquisitions.

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, we agree.

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, we agree.

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.)*

We concur with the Board's initial observation that "greater appreciation of an entity's management of, and exposure to, liquidity risk may require forward-looking information" of the sort in a Management Discussion and Analysis (MDA) material that is well beyond the scope of current NFP reporting. However, we respectfully disagree with the Board's approach due to the subjectivity allowed in the guidance. By allowing the entity to select the time horizon in determining liquidity, the financial statement information would not be comparative from year to year or from entity to entity. Paragraph BC29 indicates that the Board considered the option to require a classified balance sheet as well as presenting assets whose use is limited. We believe that these options combined would provide a definitive and objective guide to presenting the assets as well as give the financial statement user the amount of detail necessary to determine liquidity. Alternatively, a more logical avenue would be to expand current guidance consistent with paragraph BC29(c) by "requiring information relating to liquidity added to and integrated within notes that are currently required for specific assets (for example, investment securities and contribution receivables)". Furthermore, the standards being applied to nonprofits in this pronouncement are more burdensome than those applied to for-profits. The subjective liquidity recommendations will lead to a proliferation of different approaches to the notes which will cause an increase in audit costs. Until more guidance is prescribed for for-profit entities, this proposal should be deferred, or nonprofits should instead provide a classified balance sheet in line with current requirements for for-profit organizations.

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?*

See our response to question 4.

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.)*

We agree that intermediate measures of operations could provide users of the financial statements with more relevant information, but we also believe classifications could be manipulated to suit desired results. It does not seem to be a practical recommendation that would be applied in a consistent manner by different institutions. Although we agree with the "availability" criteria, we disagree with the second criterion used by the Board, "using inflows and outflows directed at carrying out an NFP's purpose for existence". The "purpose for existence criteria" is too broad. While the Board has proposed further guidance on how to deal with investment returns for example, there are whole swaths of earned income that may only tangentially be related to an entity's mission or purpose for existence for which no guidance exists. Is a restaurant in a museum consistent with its "purpose for

existence”? How about a museum shop on-site or a museum shop off site? Or a parking facility? The “purpose for existence” (“mission”) criteria seems nebulous at best. There is a high probability that without additional specific guidance, NFP’s would decide in an arbitrary manner what is mission-related and what is not, resulting in even less comparability than now exists. The wide variety of nonprofit organizations and their unique natures should allow for some flexibility in the presentation of an operating measure. We agree with the alternative view that the Board should address operating performance measures for both the not-for-profit and for-profit sectors in a coordinated effort to ensure that accounting and reporting differences are eliminated rather than created. Furthermore, we agree with several of the other commenters that the system requirements for this change could be significant and that software providers for not-for-profits are not always quick to respond to change.

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.)*

See our response to question 6. We do not believe operations should only be defined based on the “availability” and “purpose for existence” criteria. We believe that the nature of the transaction should be considered. There are many transactions that relate to an entity’s purpose that should not be included in operations and vice-versa. In particular we think paragraph BC49 is germane, and the Board should reconsider certain activities based on the nature of transactions with a focus on whether the transaction is: a) Recurring and non-recurring, b) Large, unusual or both, c) Beyond management’s control. Additionally, note that including disclosures about internally designated limits on availability of resources would add complexity without providing sufficient benefits to make it worthwhile to do so. There is the issue raised in BC67 that any internal designation can be reversed, but that paragraph also would introduce its own issues of interpretation. For example, unrestricted funds that have been internally designated to be available for eventual debt service purposes would make it appear these resources are not available for standard operations, but the fact that these funds are, indeed, available for potential immediate debt repayment would be of interest to some key financial statement readers, such as credit rating agencies.

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.)*

See our response to question 6. We feel that the proposed presentation of transfers is confusing and would not be useful to financial statement users. We particularly cite the example provided by FASB on reporting the transfers related to a donor’s contribution toward the acquisition of PP&E. Additionally, separating endowment spending between true and quasi-endowment (so that the spending from true endowment is shown as operating, and the spending from quasi-endowment comes through transfers) will complicate comparability among different organizations. This is another example of increased complexity that should be avoided. Furthermore, we concur with the alternative view that operating results are more comparable when solely influenced by transactions with a third party, or other outside events and that at worst the proposal as outlined may result in the manipulation of the intermediate measures of operations.

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.)

We do not agree that the elimination of the placed-in-service approach would improve comparability. There are valid reasons to use either of the two currently approved methods, and both methods should remain as options. By requiring the “placed in service” approach, many institutions will opt to create another column on their Statement of Activities to show PP&E activity separately so that depreciation expense which is no longer covered by a release of donor restriction does not distort the bottom line in the operating section of the Statement. These “workaround” measures will not simplify financial statements.

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.)*

We strongly disagree that gifts of, or for, property, plant and equipment should be considered operating revenue when received. This will adversely affect year-to-year comparability, especially during capital campaigns, which could distort the appearance of operations that would otherwise be considered stable.

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.)*

See our response to question 6.

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?*

We believe that the flexibility should be retained.

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.)*

The museums are split on this recommendation. The majority agree that reporting operating expenses by both their function and nature would provide relevant and useful information to the financial statement user and would not be difficult to implement. However, there are some museums that disagree and believe that this recommendation would add increased complexity, particularly if coupled with the intermediate operating measures, as well as a difficult implementation burden. The more reporting hoops an accounting system is required to jump through, the more difficult it becomes to comply. We encourage the FASB to read the individual museum comment letters and consider all responses before finalizing the proposed changes.

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.)*

We agree that investment income should be reported net of 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.)*

We do not agree that disclosing internal salaries and benefits are relevant to the financial statement user. We believe users of financial statements are interested in getting a comprehensive understanding of all investment expenses. Since such a comprehensive approach is not easily feasible, a piecemeal approach may serve to further confuse users by emphasizing costs for organizations that use internal resources to manage their portfolio (who would be required to disclose salaries and benefits) versus other organizations that might use consultants (who will not be required to disclose consultant fees). We are also concerned that depending on the size of a NFP's financial department this disclosure could result in the identification of the salaries of specific employees that are not otherwise required to be reported on the Form 990.

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 museums are split on this recommendation. Many believe that most interest expense is related to capital structure rather than operations. At the same time, many fundamentally disagree that all interest expense is not related to carrying out an NFP's purpose. It depends on the nature of the expense—day-to-day cash management is inextricably linked to the exempt purpose of the organization. In addition, the draft as proposed is inconsistent in the treatment of long term interest versus depreciation expense. Depreciation is included in the measure of operations if the underlying asset is used to support the mission of the NFP. We believe for logical consistency, the same standard should apply to interest expense. We recommend that the Board seriously consider the individual response letters of each museum before finalizing the proposed changes.

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

See our response to question 6. Specifically regarding the write-offs of the acquisition of items for a permanent collection, we do not agree that these should be included within operating activity. As discussed in our response to question 7, we believe the Board's focus on inflows and outflows directed at an NFP's mission is misguided, and consideration should be given to recurring and non-recurring nature of individual transactions and the unusual nature of certain transactions. While it is obvious that acquiring a major piece of art by an art museum would be directly related to the purpose of the museum, the nature of the transaction necessitates that the write-off be considered non-operating. Due to the opportunistic nature of collecting and the significant expense that attaches to it, many museums do not budget for this activity on an annual basis, but reflect collecting "below the line" in non-operating activity. The expense can be wildly volatile from year to year, and is dependent upon resources available for purchases from donors, endowed funds, and deaccessioning. In a worst-case scenario, a collection item might be sold resulting in a huge gain in income that is not—in fact—available for operating purposes, in alignment with

the American Alliance of Museums' *Code of Ethics*, Collection Stewardship and the Association of Art Museum Directors' *Art Museums and the Practice of Deaccessioning* guidance. In a subsequent year, when those funds are expended, expenses would be wildly inflated and could result in a material operating deficit. In addition, many acquisitions are gifted by generous donors and not measured in the financial statements, further complicating this treatment. This proposed change in accounting should not be legislated, as it has specific implications for the art museum world, and possibly for other collecting institutions as well. This is an industry specific issue and should be determined by the industry.

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.)*

While we agree that the direct method of cash flows may be more understandable, we strongly disagree that the expected benefits would justify the costs of implementation. Requiring nonprofits to change to the direct method will lead to substantial implementation expense (including increased audit fees) and will penalize institutions with limited ability to afford the additional cost. Furthermore, the majority of our financial statement users are accustomed to for-profit financials statements and are familiar with seeing the cash flows presented using the indirect method and the reconciliation to the change in cash. The proposed change to the direct method would result in further confusion, and therefore, we agree with the alternative view. Until the for-profit sector is required to use the direct method, NFP's should be allowed to select which method they would like to use.

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.)*

See our response to question 18. We agree with the alternative view that the indirect method provides a useful link between the statement of cash flows, statement of activities and the statement of financial position and that this benefit would be eliminated by the proposal. The reconciliation of cash flows to the change in net assets is an advantage in the indirect method.

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.)*

See our response to question 18. In paragraph BC110, the alternative view provides one specific but important example--"the changes mandate cash payments for long-lived assets to be reported as an operating cash outflow, while depreciation on fixed assets would be reported based upon whether or not the asset is used to promote the mission of an NFP".

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.*



We are not able to answer at this time. It depends on whether the changes could be accomplished with mapping or if it would require updated software.

***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.*

Change is difficult for all NFPs regardless of size or type due to limited funds and resources. We do not believe an NFP's size should play a role in the implementation timeframe. We encourage the Board to consider a two year implementation timeframe with an option to adopt early. At a minimum, we would like to suggest extending the timeframe to ensure sufficient time to address systematic changes which would need to occur to appropriately implement the guidance.

Thank you for the opportunity to comment on the proposed. If you have any questions on our responses, please do not hesitate to contact us.

Sincerely,

A handwritten signature in cursive script that reads "Christine Anagnos".

Christine Anagnos
Executive Director
Association of Art Museum Directors