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August 20, 2015

Ms. Susan Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, Connecticut 06856-5116

RE: File Reference No. 2015-230

Dear Ms. Cosper:

PricewaterhouseCoopers LLP appreciates the opportunity to comment on the Financial Accounting Standards Board's (the "Board") Exposure Draft of 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*. PwC's not-for-profit practice spans a broad array of sectors and industries ranging from large universities and healthcare systems to foundations and museums.

We support the Board's commitment to make not-for-profit entity (NFP) financial statements more meaningful and relevant to those seeking to understand NFPs' operations, liquidity, and use of resources. The Board's more recent discussions of not-for-profit reporting have generated an unprecedented, and healthy, debate about areas in current not-for-profit reporting under U.S. GAAP that should be improved. In particular, we note it has caused preparers to examine their own presentations and give thoughtful consideration to how certain items and transactions could best be presented in financial statements.

Overall philosophy on the NFP reporting model

In general, we believe that the interest of all of the FASB's stakeholders are best served by a common financial reporting framework used by all types of entities—private companies, public companies, and not-for-profits—whether seeking capital or resources in public or private markets. The financial reporting model should only be tailored to a particular class of entities where the specific information needs of the users of the financial statements of those entities, or the nature of the entities' activities, are unique. This is consistent with the Board's long-held view that the NFP accounting and financial reporting model should be based on the model used by business entities, unless departures are justified by characteristics or transactions unique to NFPs. The Board has also consistently supported that the NFP reporting model's provisions should be no more stringent than those for business entities. We believe that that approach has worked well, and that it is in the best interest of financial statement users for this alignment to continue. This will result in a single "core" financial reporting model applicable to all types of entities, with only incremental differences tailored as necessary for the unique circumstances and characteristics of not-for-profits and private companies.

Support for the project and certain proposals

We support the Board's commitment to improve financial reporting and disclosure for not-for-profit entities (NFPs) and believe that improvements can and should be made to the existing NFP reporting model.

We are supportive of the proposals in the exposure draft that relate to issues unique to NFPs that will better enable preparers to "tell their story." We believe condensing restricted net assets into a single class will simplify financial reporting and, along with the proposed presentation of underwater endowments, will better align financial reporting with the requirements of the Uniform Prudent Management of Institutional Funds Act (UPMIFA). In addition, narrowing the guidance on when restrictions on capital gifts should be considered released will reduce diversity in practice. We believe these changes would enhance the usefulness of NFP financial statements.

NFP-specific issues warranting further deliberation

Certain aspects of the proposal that relate to the conceptual objectives of financial reporting of NFPs introduce new concepts or approaches that we believe warrant reconsideration. For example, in addition to reporting revenues and expenses arising from transactions with external parties, an NFP's performance statement would reflect—without limitation—internal transactions involving board and management decisions related to the use of resources, making such resources part of an NFP's performance measure for the period. The proposed requirement to broadly incorporate internal transfers would extend accounting recognition to transactions that are not part of external financial reporting today. While some users may find this information useful, we question its inclusion on the face of the performance statement given it is unrelated to an entity's performance. We note that the FASB, at the time FAS 117 was issued, shared a similar perspective in BC46, noting that "dissimilar information cannot be combined in a single statement without complicating the information, obscuring the statement's purpose or both."

The proposed two-operating-measure model reflects operations with and without the availability dimension. This model would increase financial reporting complexity with respect to the statement of activities and potentially confuse both preparers and users. As described further in the Appendix, instead of two operating measures, we propose that the FASB consider a simpler approach that would focus on a single measure of financial performance, using a more limited concept of "availability."

Additionally, capital gifts are a form of project financing available only to not-for-profit entities; they typically are used in tandem with, or in lieu of, borrowing through banks or the bond market. We believe that reflecting capital gifts as operating revenues, and then requiring transfer of those gifts not monetized into nonoperating activity, distorts the reporting of performance and is not consistent with the economic substance of these transactions.

Alignment of the projects related to fundamental changes to the financial reporting model

The proposal would also change certain aspects of financial reporting that are not associated with unique activities or characteristics of NFP entities. Consistent with our overall philosophy regarding the benefits of a common financial reporting framework, we believe that any specific consideration of changes for NFPs in these areas should be suspended pending the outcome of the FASB's research projects on reporting financial performance and the statement of cash flows for business entities. A requirement for NFPs to present a prescribed measure of operating income and to distinguish operating activity from non-operating activities based on whether it arises from operating, investing, or financing activities would create a fundamentally different reporting model than is used for either for-profit or not-for-profit entities today. In addition, the proposed revision to the definition of operating activities would result in corresponding changes in the current statement of cash flows classifications. The relative benefit and implications of such proposals should be deliberated in the context of all types of entities.

Recognizing the desire of constituents to address the performance measure issue today, and the Board's desire to move this project forward, we propose that the Board consider a phased approach. The first phase would mandate presentation of a single, consistently defined performance measure for all NFPs that would be a net income equivalent (i.e., it would exclude items of other comprehensive income and certain other prescribed items unique to NFPs). In a second phase, the Board could consider the distinction between operating and nonoperating activities for NFPs based on decisions made in its financial performance reporting project for business entities. If the framework developed for business entities proves to be insufficient for NFPs, the Board could consider the need for an alternative distinction for NFPs. Such an approach would allow all entities—both for-profit and not-for-profit—to evaluate proposals related to operating-nonoperating distinctions from a level playing field, and NFPs would benefit from the more robust debate around the issues that would result from consideration of such matters for business entities.

In summary, we support the Board's proposals to make certain targeted changes to NFP-specific reporting now, but believe deliberation of broader issues related to making the distinction between operating and nonoperating activities and the related cash flow implications should be deferred until they can be considered in the context of all types of entities reporting under private sector U.S. GAAP.

We have provided additional details regarding the above comments as well as other observations and recommendations on the FASB's proposals in the Appendix.

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We are aware of the FASB's intent to hold roundtable discussions regarding this project and would appreciate the opportunity to participate.

If you have any questions regarding our comments, please contact Patrick Durbin at (973) 236-5152 or Martha Garner at (973) 236-7294.

Very truly yours,

PricewaterhouseCoopers LLP

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We are supportive of the FASB's objective of creating greater consistency in the reporting of financial performance among not-for-profits. As noted in the cover letter, we believe an approach that considers certain changes now and defers consideration of other potential changes would help achieve this objective while preserving the historical linkage to the model used by business entities.

Alternative performance measure

Our suggested approach to promoting consistency in the statement of activities is to mandate a single, consistently defined measure of performance that would be a net income equivalent for NPFs. The distinction between operating and nonoperating activities would continue to be based on the principles in use today. Providing NFPs with a measure that is consistent with the required performance measure used by business entities and NFP health care organizations would allow continued use of a common financial reporting framework. Under this approach, we suggest that the FASB define a subset of the total change in net assets of an NFP that would be analogous to net income for a business enterprise. In essence, this would involve dividing the change in net assets without donor restrictions into two broad display classifications – "results of operations" and "other change in net assets," consistent with the presentation used by NFP health care organizations today.

Developing a performance indicator for all NFPs based on the principles used for establishing the healthcare performance indicator would, at a minimum, require that items of other comprehensive income (OCI), as well as capital gifts and equity transfers, be excluded from the measure. The Board would also need to consider whether other types of activity reported across the broad spectrum of NFPs should be excluded from the performance indicator. For example, it would appear that changes in net assets without donor restrictions associated with non-capitalized museum collections would always be excluded from the measure, as existing GAAP requires those items to be reported separate from items of revenues, gains, expenses, and losses.

For other types of activity, it may be appropriate to initially report certain revenues, expenses, gains, or losses outside of the performance indicator that would be recognized within the results of operations of a different period (in a process similar to the recycling of items of other comprehensive income by business entities today) when the reason for the exclusion from the performance measure no longer applies. Such an approach might be suitable for reporting unrestricted investment returns earned from quasi-endowments that are voluntarily managed together with true endowments using the statutory prudent management and spending policies required by UPMIFA. A prudent spending policy typically limits the amount of total investment returns earned that can be spent in support of a given period. Applying an OCI-like reporting principle would initially exclude the investment returns from the performance indicator and "recycle" into the performance measure the amount that is appropriated for spending. This would, in effect, incorporate some aspects of the "availability dimension" that we believe would be broadly acceptable to most NFPs. Although OCI concepts have been criticized as introducing too much complexity to the income statement for business entities, we believe that this approach is far simpler than the proposed "two measures" that involve intra-entity transfers, and we believe it would be better understood by all constituents.

Requiring NFPs to display a net income equivalent performance measure would also simplify financial reporting by removing the NFP-specific requirement for discontinued operations to precede the "change in net assets" totals. If NFPs report a net income equivalent performance measure, they could display discontinued operations in the manner prescribed by Topic 205.

We believe this approach has many benefits. It would significantly improve comparability in reporting among NFPs and would address the areas where we believe change is most needed. It would also address concerns that have been raised regarding the classification of interest expense and reporting of capital gifts. And because all entities (for-profit and not-for-profit) would report a similar measure for results of operations, consistency with reporting by business entities would be maintained or enhanced, which we believe would greatly benefit users.

Statement of cash flows

Given the extremely limited use of the direct method of reporting cash flows in practice by NFPs and business entities today, we do not believe it is appropriate to mandate its use by NFPs. Such a mandate, coupled with the proposed cash flow classification changes, would be tantamount to creating a separate reporting model for reporting cash flows for NFPs as compared to business enterprises. Having two separate models is inconsistent with our overall philosophy regarding the benefits of a common foundation of principles for financial reporting that extends across all entities. We believe that having two different models would be detrimental to NFP board members, vendors, users, and investors who are all familiar with the cash flow reporting model that applies to all entities today. As such, we recommend the Board defer changes to the statement of cash flows until they can be considered more broadly for all private sector entities.

If the Board nonetheless decides to require the direct method for NFPs, we believe that a reconciliation of the performance measure to cash flows from operating activities should continue to be required. Consistent with our recommendation for a single intermediate measure that reports results of operations, we recommend that the starting point for that reconciliation be the performance measure, rather than the total change in net assets (which is the current GAAP requirement).

Liquidity

We believe that in most situations, liquidity information would be more effectively communicated through a classified balance sheet than through mandating additional disclosures. Therefore, we suggest that NFPs present a classified balance sheet unless a presentation based on order-of-liquidity provides information that is more relevant (such as may be the case for certain NFP insurers, mortgage companies, or continuing care retirement communities). Entities that present a classified statement of financial position should not be required to present further disclosure about contractual maturities of assets and liabilities falling due within 12 months, beyond the general GAAP requirements.

If an NFP determines that presentation based on order-of-liquidity provides more relevant information, disclosure of information about the maturities of short-term and long-term financial assets and liabilities would be appropriate. We believe that this information should be consistent with the liquidity information required by financial instruments standards. Entities that use an order-of-liquidity presentation should also disclose why the order of liquidity model has been selected and the basis used to determine the order of liquidity.

We also suggest that the existing guidance for NFP health care organizations regarding noncurrent classification of assets limited as to use (ASC 954-210-45-2, which is based on the general requirements of ASC 210-10-45) be incorporated within ASC 958. Such presentation guidance would greatly improve the awareness and reporting of information related to any limitations on the use of assets. We also note that the recently updated AICPA guide for not-for-profit organizations significantly expanded its commentary on this subject in "*Effects of restrictions, designations, and other limitations on liquidity"* (in chapter 3). The Board may wish to consider whether reporting of liquidity information might also be improved by incorporating some of that guidance within ASC 958.

Presentation of expenses by function and nature

We are supportive of the option to continue to present expenses on the face of the statement of activities by either functional or natural classes, as is done today. However, we do not support the requirement that all NFPs either present or disclose expenses by both functional and natural classification.

Existing GAAP requires all NFPs to provide information about expenses by functional classification (e.g., programs, management, general and administrative), while information about expenses by their natural classification (e.g., salaries, depreciation, rent) is optional except for voluntary health and welfare entities. In the basis for conclusions, the Board indicates that providing an analysis of operating expenses by both functional and natural classifications information is useful to donors "in assessing how an NFP uses its resources and its stewardship for resources entrusted to them." While such information that clearly shows the nature of operating expenses and how they relate to an NFP's programs and supporting activities may be useful for donors, we are unclear as to its utility or relevance in financial statements of entities that are not dependent on contributions. Therefore, we suggest limiting the requirement to NFPs that derive their revenue primarily from voluntary contributions from the general public, with optional reporting for all other NFPs. However, if the Board ultimately decides to require this disclosure as proposed, we suggest that NFPs that have limited or no fundraising activity and that operate a single program be excluded.

Investment-related activity

The exposure draft proposes extensive new requirements related to the presentation of investment activity in the statement of activities and statement of cash flows, including a requirement to identify all investment activity as either "programmatic" or "nonprogrammatic" in nature. It would also require all nonprogrammatic investment returns to be presented as a single line item (or subtotal) in the statement of activities, and reported net of investment expenses.

These proposals would impose requirements for reporting investing activity that go beyond the current GAAP requirements for business entities. It appears that many of these requirements are driven by the importance of endowments to the successful operation of many NFPs. Although many NFPs carry investments at fair value and engage in total-return investing of their investments, others have investing activity that is similar in nature (and accounted for similar) to those of business enterprises. As such, making these requirements applicable to all NFPs, regardless of the nature of their investing activities, appears unnecessarily onerous.

The proposed changes also have significant implications for reporting of the activity associated with strategic investments, such as joint ventures entered into for operating purposes. While today the equity interest in the income or loss associated with such ventures is typically presented as part of operating activity in the statement of activities, the proposal would also require capital transactions associated with those ventures to be classified as operating in the statement of cash flows. This would be a significant change in practice and a departure from the reporting by business entities. As stated previously, we believe changes to cash flow classifications should only be made as part of a general reconsideration of the cash flow reporting model for all entities. While we acknowledge there may be some benefit to better differentiation between strategic and portfolio investments, this could be incorporated into the reconsideration of the presentation and disclosure requirements applicable to all entities.

As a result of the above concerns, we recommend that a distinction between programmatic and nonprogrammatic investing activities not be required and suggest that all nonprogrammatic investment returns not be presented as a single line or caption. In order to address the information needs of users of financial statements of entities that engage in these types of investing activities, we suggest that the Board consider refining these requirements to focus on activities related to "total return investing" or some other differentiator. For all other NFPs, we believe the general requirements related to the presentation and disclosure of investments should be consistent with the current GAAP requirements used by all other private sector entities.

Health care entities

Today, NFP health care organizations enjoy the most consistent reporting of any NFP sector. We believe the existing NFP health care model provided in ASC 954 is effective due to its alignment with the business entity reporting model and should be retained. Our recommendation related to establishing a performance indicator for all NFPs would help drive some degree of comparability across the spectrum of NFPs.

Previously, we stated our view that certain aspects of reporting should be considered for all private sector entities at the same time. If the Board nonetheless considers those matters for NPFs and business entities separately, we recommend that NFP health care organizations within the scope of ASC 954 (and other NPFs that voluntarily apply a business reporting model) should be excluded from these aspects of the NPF project and instead, be considered under the comparable projects for business entities. We are concerned about the magnitude of the change that would be associated with moving such organizations from a business reporting model to a nonbusiness model.

Disclosures

Information that is relevant to NFP financial statement users will vary depending on the nature of the NPF's operations. The greater the organization's dependence on contributions from the general public as its source of operating capital, the more likely its financial statement users will be interested in disclosures related to contributions and/or endowments. Accordingly, as the Board redeliberates this proposal, we recommend that consideration be given to making disclosures that are focused on contribution-related areas scalable, based on the level of activity and the significance of those transactions to the overall financial statements.