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Comment Letters Received On the April 14, 1995 Exposure Draft of a Proposed Audit & Accounting Guide Not-for-Profit Organizations VOL. 2 (79-155);

American Institute of Certified Public Accountants. Accounting Standards Executive Committee

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Comment Letters Received
On the April 14, 1995
Exposure Draft of a
Proposed Audit & Accounting Guide
Not-for-Profit Organizations
VOL. 2 (79-155)

79

August 9, 1995

AUG 14 1995

File: FASB4

Joel Tanenbaum
Technical Manager, File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

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Bob Kelly

SUBJECT: Comments on Proposed Audit and Accounting Guide Not-For-Profit Organizations

ISSUE: **VARIANCE POWER AND DONOR-ADVISED PROVISIONS**

The executive staff and board of the San Diego Community Foundation appreciate the efforts of the FASB concerning standardization of accounting and reporting for Not-For-Profit organizations, and the efforts of the AICPA in interpreting and applying the SFAS 116 and 117. In general we agree with the AICPA's interpretation of these new standards.

However, in two areas we believe that a modification of the AICPA's interpretation and reporting criteria pertaining to SFAS 116 and 117 will more accurately reflect the transactions and net assets of Community Foundations.

We appreciate your attention to the issues outlined in the attached documents, and look forward to an appropriate modification of the proposed audit and accounting guide for Not-For-Profit organizations.

Sincerely,

Jerry Ray
Controller

Robert Kelly
President/CEO

Maria Vilar
Chair, Audit Committee

101 West Broadway
Suite 1120
San Diego, CA 92101
Tel 619.239.8815
Fax 619.239.1710

ISSUE: VARIANCE POWER

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FASB underlying concept:

A conclusion from the FASB Concept Statement #4 was that standards should generally be uniform, but that occasional differences may result from the, presence or absence of certain types of transactions in different types of organizations.

Charitable gifts to Community Foundations designated by the donor for application to a Permanent Endowment fund where earnings from that Endowment benefit specified non-profit organization(s), are unique transactions which should fall under the FASB Concept Statement #4, and which should receive unique accounting treatment. Our suggested accounting treatment for such transactions will be discussed later in this document.

Designated or Organizational Endowments:

The charitable gifts described above are typically referred to as Designated or Organizational Endowments, and are an integral component of a Community Foundation's mission, and reason-for-being in fulfillment of it's charitable purpose. Community Foundations solicit donations for general purposes, for certain field-of-interest endowments, and for endowments where the earnings benefit specific non-profit organizations. The latter we will refer to as "Designated Endowments". Contributions to Designated Endowment funds are solicited as part of the Community Foundation's normal business. As such, Designated Endowments are not controlled or owned by the non-profit organization that receives grant distributions from such endowments, but are owned and controlled exclusively by the Community Foundation. The Community Foundation is not acting as an agent or trustee of the non-profit organization which receives such grant distributions.

Pertaining to contributions received which are designated by the donor for Endowments which benefit one or more specific agencies:

- Such gifts are irrevocable charitable contributions by the donor, where ownership of the asset is severed by the donor, and transferred to the Community Foundation. The Community Foundation has ultimate control and discretion over the disposition of the assets transferred and the income earned on these assets.

- Such gifts become Component Funds of the Community Foundation, as Permanent Endowments.

- The Component Fund is not transferrable to the designated agency which receives grant distributions from the Endowment, and as such the Endowment is not a liability to the designated agency.

- The Component Fund is an asset controlled by the Community Foundation, and as such should be reflected on the financial statements as a Permanently or Temporarily Restricted Net Asset of the Foundation.

- The control of such an asset includes Investments, Payout of earnings (amount and frequency), and the Variance Power of the Community Foundation.

Not an Agent, Trustee, or Intermediary:

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The pivotal section of SFAS 116 which has created discussion is paragraph 4, which states:

> This statement does not apply to transfers of assets in which the reporting entity acts as an agent, trustee, or intermediary, rather than as a donor or donee...

The Community Foundation is not an agent, trustee, or intermediary of donor restricted contributions to Designated Endowments, because:

- After the transfer, the Community Foundation has legal title to, and control over, the assets of the designated fund.
- The assets are transferred solely and irrevocably to the Community Foundation, not to the designated charity.
- There is no obligation or intention that the assets will ever be transferred to the agency designated to receive grant distributions from the earnings, and the designated charity has no rights under which to demand the transfer of the endowment to any other institution.
- As a matter of law, designated charities cannot compel distributions from a designated fund.
- There is no consent or implied consent of the designated charity that the Community Foundation is acting on behalf of the designated charity as trustee or agent. Conversely, it is clear that the donor made a choice not to transfer the asset directly to the designated operating charity, but to the Community Foundation.
- The Community Foundation is not subject to the control of any of the designated beneficiaries of the endowment fund.
- The endowment asset is subject to the Community Foundation's liabilities and creditors.
- The Community Foundation has legal recourse to redirect the asset through the Variance Power.

Variance Power:

The Variance Power gives the Community Foundation ultimate discretion over the disposition of the assets of a Designated Endowment. Under the Variance Power, the Community Foundation may withhold distributions from the designated charity and make distributions to other charities if, in the sole judgement of the Community Foundation's governing body, the restriction to the designated charity has become unnecessary, incapable of fulfillment or inconsistent with the charitable needs of the community.

The Variance Power is defined in the governing instrument of the Community Foundation, and incorporated by reference into the Community Foundation's gift instruments. So the right to vary distributions from the Fund exists from the inception of the Fund.

The Community Foundation regularly reviews the charitable needs of the community and the relevance and effectiveness of designated and undesignated grant distributions made by the Community Foundation. The Community Foundation also performs due diligence reviews on charitable organizations to which grant distributions are made, to determine if the charity is effectively meeting community needs, remains a qualified exempt organization, and is efficient in respect to its programs. If the governing body determines that funds need to be redirected in order to effectively meet the community's charitable needs, the Board has the authority to vary the donor's designations concerning earnings payouts on Designated Endowment Funds.

By operation of law, the frequency which the Variance Power is utilized by the Community Foundation is not determinate of the right to use the Variance Power, and therefore of the control over the asset by the Foundation. The right to use the Variance Power prevails. This logic is similar to the right of the governing body to spend net appreciation on a Fund. This right (not the frequency the right is exercised) determines the classification of net appreciation as unrestricted or temporarily restricted.

The Variance Power continues to be a strong reason for which some donors choose a Community Foundation to receive contributions for Designated Endowment funds. The donor realizes the flexibility given by the Variance Power to meet the changing needs of the community, and to adapt to unforeseen circumstances.

Conclusion:

By every legal, logical and practical point of view, the Designated Endowment is a permanent irrevocable asset of the Community Foundation, under it's complete control, and as such should be reflected on the books of the Foundation as a Net Asset, as either permanently or temporarily restricted.

Regarding FASB concept statement #4, and in light of the unique nature of the donor's restrictions on a Designated Endowment, we suggest a modification of the AICPA's proposed treatment of such transactions as follows:

AICPA's proposed treatment:

Book such Designated Endowments as a liability.

This presumes the asset could potentially be due to the designated charity at some point in the future, which is not correct.

This would also imply that the designated charity could potentially have a creditors claim against the liability, which is also not true.

In a for-profit public company, stockholders have legal control over the organization. Yet Common Stock is not recorded as a liability to the stockholders, but is reflected as a separate and unique line-item in the Net Assets section of the financial statements.

Relating this to a Community Foundation, charities which benefit from Designated Endowments do not have legal control over the Community Foundation. Therefore it is clear that the accounting treatment of contributions to designated endowment funds should not be recorded as liabilities.

Our recommended treatment:

Book such Designated Endowments as a separate Net Asset line-item on the financial statements, in the appropriate restricted section, with additional disclosure in the footnotes.

This will draw specific attention to the nature and amount of these unique Net Assets, without incorrectly classifying them as liabilities, and at the same time will accomplish the FASB's intention to standardize and accurately measure these designated gifts.

ISSUE: DONOR-ADVISED PROVISIONS

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The donor-advised funds are those endowments where the donor reserves the privilege from time-to-time to make nonbinding suggestions to the Community Foundation regarding the specific charitable organizations or community projects to receive distributions of income from the Fund. Pertaining again to SFAS 116, paragraph 4, it appears the AICPA considers contributions to donor-advised non-endowment funds to be similar to pass-through funds, with the Community Foundation acting as agent, trustee, or intermediary.

The logic against this interpretation is similar to the discussion concerning designated endowments:

- Gifts to donor-advised funds are irrevocable charitable contributions by the donor. Ownership of the asset is severed by the donor, and transferred to the Community Foundation. The donor receives a charitable tax deduction for the gift.
- Such gifts become Component Funds of the Community Foundation.
- After the transfer, the Community Foundation has legal title to and control over the component fund, both as to investment of the asset, and distributions from the fund.
- The endowment asset is subject to the Community Foundation's liabilities.
- The Community Foundation has legal recourse to redirect the asset through the Variance Power, as well as to not accept the donor's suggestion as to the charitable recipient of grant distributions from the fund.
- The Component Fund is an asset controlled by the Community Foundation, and as such should be reflected on the financial statements as Net Asset of the Foundation.

The Community Foundation, not the eventual grant recipient, is treated as the donee for income, gift and estate tax purposes. The IRS requires such gifts to be shown on Form 990 as contributions to the Community Foundation. The IRS has for many years recognized the right of the donor to retain an advisory role in order to recommend grant distributions from donor-advised funds.

From every relevant point of view -- fiduciary duty, control, legal title, and tax treatment -- the relationship between a Community Foundation that receives donor-advised funds, and the recipients of donor-advised grant distributions, is not an agency relationship. Likewise the relationship between a Community Foundation and the charitable donor clearly is not one of the foundation acting as agent for the donor.

- The Community Foundation's fiduciary responsibility is to the public, not the donor.
- The Community Foundation is not subject to the donor's control.
- The Community Foundation has authority to reject the donor's "advice" concerning grant distributions from the fund.
- Legal title to the asset is transferred to the Community Foundation.
- The donor receives the allowable charitable deduction for the gift.

Conclusion:

Contributions to Community Foundations of donor-advised funds are permanent irrevocable assets of the Community Foundation, under it's complete control, and as such should be reflected on the books of the Foundation as Contributions and as Net Assets.

Again in consideration of the unique nature of donor-advised funds, we suggest a modification of the AICPA's proposed treatment of such transactions as follows:

AICPA's proposed treatment:

Book such gifts as liabilities.

This presumes the Community Foundation has a creditor obligation related to such funds, which is not true.

Our recommended treatment:

Book such gifts as a separate Contributions line-item on the Statement of Activities, in the appropriate restricted or unrestricted section, with additional disclosure in the footnotes.

This will draw specific attention to the nature and amount of contributions received to donor-advised funds without incorrectly classifying the transactions as liabilities, and at the same time will accomplish the FASB's intention to standardize and accurately measure these gifts.

Summary of Recommendations:

- Charitable gifts with donor-imposed restrictions to designated endowments and gifts to donor-advised funds should be recorded as Contributions to and Net Assets of the Community Foundation, and should be reflected on the financial statements as separate unique line-items on the Statement of Activities and the Balance Sheet of the Foundation.
- The AICPA's Audit and Accounting Guide for Not-For-Profit Organizations should reflect an interpretation of SFAS 116 that clearly and specifically states that Community Foundations are not Agents, Trustees, or Intermediaries in reference to paragraph 4 of SFAS 116.

DULUTH-SUPERIOR AREA
Community Foundation

(80)

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AUG 14 1995

August 11, 1995

Mr. Joel Tannenbaum, Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Tannenbaum:

Thank you very much for the opportunity to respond to the AICPA's Exposure Draft of the Proposed Audit and Accounting Guide for Not-for-Profit Organizations. We sincerely appreciate your interest in standardizing the financial reporting among not-for-profit organizations. We also appreciate the special attention you have focused on community foundations, on the building of charitable endowments, and the unique role we play in the sector.

Community foundations across the country enjoy excellent reputations as careful stewards of philanthropic endowments. Individual donors of significant wealth and modest incomes, bank trust officers, certified public accountants, stock brokers, estate planning attorneys, private foundations and other not-for-profit organizations place their trust in community foundations to address the changing charitable needs of communities in perpetuity. The significant support we receive from "centers of influence" demonstrates the exemplary work and reputation of the community foundation field.

With regard to your question about whether the variance power provides sufficient discretion to recognize resources received as contributions, the variance power in addition to several other indicators clearly distinguishes community foundation endowment contributions from agency transactions.

Individual donors, "centers of influence", private foundations and not-for-profit organizations provide support through unrestricted, field of interest, donor-advised and designated endowed funds. For each of these types of contributions, community foundations solicit assets in support of their own activity of building a permanent charitable endowment to address the ever-changing charitable needs of the community. The variance power assures that even designated funds will reflect

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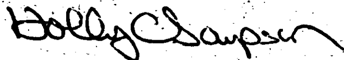
current community needs.

In addition, we maintain control and discretion with the authority to change the form of the assets from cash, public and privately held stock, real estate or tangible personal property to asset forms which conform to the community foundation's investment policy. The community foundation also obtains and maintains legal title of the assets through the irrevocable gift instrument. These indicators, as outlined in the Exposure Draft, along with the variance power, clearly distinguish contributions of endowment to community foundations from agency transactions.

Contributions of endowed funds to community foundations are made with the full and complete understanding that the community foundation owns and has full control and discretion over the funds. Financial statements which exclude a portion of these funds would misrepresent our donors' intent and confuse readers.

Once again, thank you very much for the opportunity to comment. We hope the many comments you receive will be helpful as you explore the unique circumstances which surround contributions of endowment to community foundations. We would be happy to provide additional information, if desired.

Sincerely,



Holly C. Sampson
President

c: Richard R. Burns, Esq.
Thomas L. Sykes, CPA
FASB Task Force

July 20, 1995

COMMUNITY
FOUNDATION OF
GREATER FLINT

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AUG 14 1995

Joel Tannenbaum
Technical Manager, File 3605.AG
Accounting Standards Division, AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Tannenbaum:

I am writing to respond to the proposed *Audit and Accounting Guide for Not-for-Profit Organizations*. As you know, staff and Trustees of community foundations all over the country have displayed keen interest in the proposed changes, and with good reason. As stewards of a community's permanent endowment, a community foundations feels the very real obligation to assure the existence of a strong not-for-profit sector. This is accomplished both through awarding discretionary grants to meet changing community needs, *and* by providing a safe and secure home for the designated gifts of donors who have particular charitable interests or for the organization endowment funds that permit donors to feel secure that the organizations he or she cared about during life will continue to exist and serve their charitable purposes for generations to come.

The fact that the Trustees of a community foundation have the right and obligation to assure that these funds continue to fulfill the purposes for which they were given is the very heart of a community foundation, and the attraction of these foundations has been the responsible stewardship they have provided. Rather than being depositories where organizations "hide" funds, it is my experience that the motivation of donors in establishing a designated fund or contributing to an organizational endowment within a community foundation is that of being assured that their gifts to their communities will be used to support their broad charitable interests over time, whether or not the specific organization continues to exist or provide a relevant service. It is this ability of the community foundation to vary the use of its component funds that makes these organizations so vital to the health of American society.

Information concerning funds within a community foundation is public knowledge and is broadly disseminated to the entire community. Rather than a hiding place for non-profit sector assets, the community foundation provides a sense of security that funds will be available to support that sector, no matter how profligate those in charge of any one not-for-profit group might be at any point in time.

The differences between a fund in a community foundation and that established in a trust department of a bank are so numerous that I'm certain you will receive many comments that address this issue. Suffice to say that few bank trust officers have the

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LAURA B. FROATS
Vice President for Finance
502 CHURCH STREET
FLINT, MICHIGAN
48502 - 1206
(810) 767 - 8270
FAX (810) 767-0496

time or the expertise to make judgments concerning the changing performance or mission of nonprofit organizations over time. Community foundation program staff, on the other hand, have this expertise and exposure as a matter of course. Banks change hands; trust departments that once had a local presence consolidate and move to other locations. Community foundations continue to understand and serve their geographically defined areas. This is no doubt why trust officers often refer donors to the local community foundation instead of simply handling the funds within the banks.

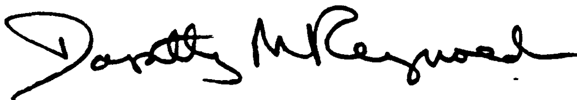
Furthermore, community foundations do not have to undertake a cy pres proceeding in order to change the purpose for which a fund is used. That, indeed, shaped Frederick Goff's vision 76 years ago.

This community foundation has always worked within AICPA guidelines and has always received an unqualified audit. The changes proposed by AICPA will force us, and our peers nation–wide, to weigh the confidence our donors (many of whom are long since deceased) have placed in our commitment to carrying out their wishes against our desire to continue to receive this unqualified opinion. Many will be forced to conduct their affairs outside the guidelines.

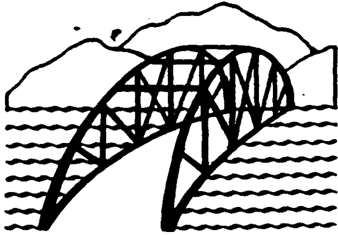
In a time when government is placing an ever increasing burden on the philanthropic sector, and in an era when more and more citizens are finding community foundations to be trustworthy and useful vehicles for their charitable giving, and as this model is being adopted in many societies inventing or re–inventing free market economies, it is truly important for those engaged in fiscal policy development to understand the role community foundations are playing in this society and undertake the development of policies that enhance, not undermine, that role. As proposed, the *Audit and Accounting Guide* will hamper the growth and management of community foundations.

I hope you will listen to the concerns of practitioners in this field. Our concerns are not based on personal gain or loss. We believe what we are doing strengthens our communities and truly encourages that which is best in America – the willingness of its people to share their good fortune.

Sincerely,



Dorothy M. Reynolds
President



THE GREATER KANAWHA VALLEY FOUNDATION

POST OFFICE BOX 3041, CHARLESTON, WEST VIRGINIA 25331
1426 KANAWHA BOULEVARD, EAST, CHARLESTON, WEST VIRGINIA 25301
TELEPHONE 304-346-3620 FAX 304-346-3640

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MEMORANDUM

AUG 14 1995

To: Joel Tannenbaum, Technical Manager
Accounting Standards Division
AICPA

From: Anne C. Lane, Fiscal Officer

Subject: Proposed Audit and Accounting Guide
Not-For-Profit Organizations

Date: July 25, 1995

This memo is to address concerns of The Greater Kanawha Valley Foundation regarding the accounting treatment for contributions received from other not-for-profit organizations (NPO). There are three areas of concern:

1) Misleading financial statements;
2) Variance power; and
3) Differences between foundations and other not-for-profit organizations.

MISLEADING FINANCIAL STATEMENTS:

The recommended accounting treatment of contributions to The Greater Kanawha Valley Foundation could result in the issuance of misleading financial statements for both the foundation and the not-for-profit organizations. Under the proposed audit guide, the Foundation will record liabilities which do not exist and the NPO will record assets which it does not control or own.

The not-for-profit organization will retain assets on its financial statement which it no longer owns or controls. The not-for-profit organization could submit its financial statements to a bank for a loan based upon the assets reflected on its financial statement (which are actually owned and controlled by the community foundation).

The foundation will record a liability which does not exist (the contribution received from a not-

for-profit organization). Using the example above, if the not-for-profit organization has assets (held by the foundation) on its financial statements and the foundation has a corresponding liability on the foundations' financial statements, it builds a very strong case for creditors to look to the foundation for assets, should the not-for-profit organization go bankrupt.

This places the foundation in a very delicate position, since it has no control over the boards, directors or operations of the not-for-profit organization. However, a foundation could be forced into a liability position on behalf of the not-for-profit organization.

This financial reporting could also mislead future and current contributors to believe that The Greater Kanawha Valley Foundation is incurring debt, when it actually is not, and that the foundation is not exercising good management over the funds. This could deter contributors from supporting the foundation in the future.

There is an argument that the current accounting treatment allows the not-for-profit organization to look "poorer" than it really is, which enables the NPO to request additional contributions/grants.
This argument states that the NPO has "effective control" over the assets and enjoys the "economic benefits" from the assets without having to report the assets on its financial statements. The Greater Kanawha Valley Foundation disagrees with this viewpoint.

Not-for-profit organizations place their funds with a community foundation for many reasons (other than to look "poor"):

a. The community foundation has normally been in existence longer than the not-for-profit organization;
b. The community foundation has strong community leaders who have many community interests, rather than one specific organization;
c. The community foundation can manage its money better than a single not-for-profit organization;
d. The community foundation has credibility in the community and may be able to get more contributions than a specific not-for-profit organization could raise by itself;
e. The community foundation has legal and accounting expertise, which not-for-profit organizations cannot always afford.

VARIANCE POWER:

The community foundation board has the power to spend the income and principal from contributions in a way to meet the community needs. If the needs of the community change, then the Board will decide how the funds will be spent in the future.

The foundation not only has ownership of the funds, but also the board can use its "variance power" to decide how to distribute money from the funds. This power is stated in the foundation's trust agreement and also in each trust agreement with contributors.

DIFFERENCES BETWEEN FOUNDATIONS AND NPO'S:

The purpose of a community foundation is to receive contributions from individuals, businesses, other not-for-profit organizations, trusts, estates and any other form of entity. The foundation distributes those funds to meet the various needs of the community.

As such, the purpose of a community foundation differs from other not-for-profit organizations in that the community foundation board decides:

1) what the community's needs are; and
2) which organizations will receive funds to meet those community's needs. The recipient NPO's can change from year to year.

Not-for-profit organizations exist for a single reason: only medical, only arts, only education, etc. The boards of other not-for-profit organizations do not have the power to spend funds for purposes other than their original intent.

CONCLUSION:

1) Record contribution as a liability:

There are certain circumstances when foundations should report contributions as a liability. If an NPO contributes assets to a foundation, but does not relinquish control over the assets, then this transaction should be recorded as a liability of the foundation. Under these conditions, the Foundation has no ownership nor control over the funds. It would truly act as and intermediary. Normally, a foundation does not receive this type of contribution.

2) Record contribution as income:

A community foundation should be able to recognize contributions from NPO's on its income statement for several reasons:

a) it owns the funds- through legal documents and through its daily operations;
b) it controls funds through its "variance power";
c) it has not incurred a liability;
d) it should not be liable for creditors of other NPO's; and
e) it operates and is organized differently from other NPO's.

The foundation should not be required to report liabilities which do not exist. The foundation should not be financially responsible for other not-for-profit organizations.

Due to these reasons, The Greater Kanawha Valley Foundation requests that foundations have separate accounting and financial reporting requirements. Since the basic organization and operation of foundations differs from other NPO's, then the proper financial presentation should be adopted for readers of financial statements. The foundation's financial statements should fairly present the financial position, operations (activities?) and changes in financial position of the foundation.

THE STARK COUNTY FOUNDATION THE SAXTON HOUSE • 331 MARKET AVE. S. • CANTON, OHIO 44702-2107 • 216/454-3426 • FAX 216/454-5855

(83)

AUG 14 1995

CARING ABOUT THE FUTURE WITH GRANTS FOR THE ADVANCEMENT OF HEALTH, SOCIAL WELFARE, EDUCATION, CULTURAL AND CIVIC IMPROVEMENT

August 11, 1995

Joel Tannenbaum, Technical Manager
File 3605.AG - Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

RE: Proposed Audit and Accounting Guide: Not-For-Profit Organizations

Dear Mr. Tannenbaum:

The Stark County Foundation is the community foundation serving Stark County, Ohio. Our foundation was established in 1963 and had assets of $51,754,294 as of 12/31/94.

As you are aware, our foundation and other community foundations are deeply concerned about certain aspects of FASB Statements 116 and 117 as they will be interpreted and applied by AICPA members, including our Certified Public Accountants, Ernst & Young LLP.

Our primary concern is the definition of "contribution" in FASB 116 as it may be reinterpreted and applied by AICPA to donor-advised funds, designated funds, and community agency endowment funds. A secondary issue is the proposed revision to our accounting presentation under FASB 117 which may change dramatically depending on which present and future assets of our foundation will continue to be accounted for as contributions. I will comment on each of these three types of funds in relation to our foundation's experience:

Donor-Advised Funds. The Internal Revenue Service has held for years that community foundations may have component funds known as donor-advised funds which permit the donor to make recommendations for charitable grant distributions from such funds within the overall framework of the community foundation's areas of interest. The documents establishing these funds and our foundation's "Procedures For Operation of Donor-Advised Funds" (Attachment 1) clearly indicate that the donor relinquishes control of the funds while maintaining a privilege of making recommendations. Following the donor's death, or in some cases, the donor and the donor's children, the assets become general purpose or

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undesignated assets of the foundation in most cases. In other cases, there may be a "field-of -interest" fund which continues to provide grantmaking assets within a charitable field of the donor's choosing. Excerpted donor-advised fund agreement examples are shown on Attachment 2.

Clearly, these assets are and should continue to be classified as contributions to The Stark County Foundation.

Designated Funds. In The Stark County Foundation, Designated Funds constitute our smallest classification of assets by fund type. Most of them were testamentary gifts or bequests although we have three in which the donors are still living. All of these fund agreements permit and require the foundation's Distribution Committee to exercise its variance power in the event the donor's original intent is unable to be fulfilled (see excerpts as Attachment 3).

The Internal Revenue Service has held that the gift of a designated fund to a community foundation does not constitute a "material restriction" and thereby invalidate the charitable tax deduction for such contributions.

Two important attributes of these designated funds strongly identify them as contributions by their respective donors. Firstly, the donors obviously could have given the asset directly to the charity involved, but chose not to do so for one or more reasons including: (1) the existence of the variance power, (2) the permanence of the community foundation as an endowment thereby insuring that the benefitted agency will not consume the asset, and (3) in some cases, wanting to guarantee that the money will not be removed from the community in the future by a "national" charity. Secondly, the authority and responsibility to exercise the variance power rests with a community foundation, not with the designated beneficiary(ies) nor with the donors. Clearly these designated funds are contributions to the community foundation.

Community Agency Endowments. Our foundation holds a number of component funds and trusts which are community agency endowments. These contributions were given to the foundation by the respective agencies, almost all of which are 501(c)(3) entities (see Attachment 4).

The position of AICPA appears to be that no community agency would "surrender" assets to another entity, i.e. a community foundation, without (1) assuming that it really does continue to "own" the assets in effect, and/or (2) an intent to make itself "look poorer" for its own fundraising benefit.

In the case of The Stark County Foundation, contributions of this type are all legally assets of our foundation. Inter vivos or testamentary contributions to these endowments are

permanent assets for the benefit of the agency, not gifts to the agency itself. While community agency endowment agreements generally permit invasion of principal, this is possible usually only when such use of principal is essential to preserve the agency. In those cases the fund agreements normally call for this decision to be made by a super majority of the community agency's board and a super majority of the foundation's distribution committee. This is clearly a contingency; we have made no such distributions of principal in my seven years as chief executive officer of the foundation. In two cases, we have responded to requests of two different agencies to borrow from their endowments for short-term capital needs. In each case, these borrowings were formalized with an interest-bearing Note. In the event of the ultimate contingency - the disappearance of the community agency itself - the fund agreements always require The Stark County Foundation to exercise its variance power (see typical excerpt in Attachment 5).

With respect to the issue of "hiding assets," every community agency endowment is publicized in our annual report. Obviously, every prospective contributor to a particular community agency does not concurrently see our foundation's report, but the agencies themselves often aggressively publicize the existence of the endowment and expect their donors to be motivated by the agency's demonstrated financial responsibility instead of responding to some imagined condition of "looking poor."

A community foundation must be the owner of component funds, including community agency endowments, under current law governing non-profit, tax-exempt organizations. If we agreed to "manage" funds owned by others, we would be illegally offering investment management services - a different type of for-profit business activity subject to its own set of laws and regulations.

Because of (1) the foundation's ownership of these respective community agency endowments, (2) the required oversight and action by the foundation in disbursing income or principal, and (3) the contingent responsibility to exercise the variance power, I believe that these assets have been and are contributions to our foundation for the long-term benefit of the community, albeit for the interim benefit of a specific community agency.

Obviously, responsible disclosure of endowment-benefit assets as a footnote in the community agency's audit or in some other appropriate form is very important in reflecting the community agency's financial situation accurately. However, if each community foundation were required to show a 100% liability for these funds, that presentation would not reflect the reality of each agency's intent, our ongoing control responsibilities, and the future of these component funds and trusts.

Thank you for the opportunity to comment on your draft audit guide prior to its final editing and publication.

THE STARK COUNTY FOUNDATION

James A. Bower
President

JAB/ch

cc: Council on Foundations
Distribution Committee
William L. Luntz, Chairman
William H. Belden, Jr.
Paul R. Bishop
Theodore V. Boyd
Paralee Compton
Lynne S. Dragomier
Randolph L. Snow, Esq.
Glen Schaffert, Ernst & Young, LLP
Sheila M. Markley, Esq. - Day, Ketterer, Raley, Wright & Rybolt

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Attachment 1

THE STARK COUNTY FOUNDATION
and
THE STARK COUNTY FOUNDATION, INC.

PROCEDURES FOR OPERATION OF DONOR-ADVISED FUNDS

Authorized 10-19-76
Adopted 11-14-78
Amended 01-30-90
Amended 06-29-93

For further information, contact:
James A. Bower, Executive Director
The Stark County Foundation
The Saxton House
331 Market Avenue South
Canton, Ohio 44702-2107
(216) 454-3426 - FAX (216) 454-5855
Printed April, 1995

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AMENDED PROCEDURES FOR OPERATION OF ADVISED FUNDS

Section 1. ESTABLISHMENT AND PURPOSE

1.1 The Stark County Foundation (hereinafter "Foundation") has authorized the establishment of Advised Funds by Resolution of the Board of Trustees adopted October 19, 1976. Said Resolution authorizes the adoption of these procedures for the establishment and administration of Advised Funds. These procedures may be amended from time to time, when deemed necessary or desirable by the Distribution Committee.

1.2 Establishment of Funds. Advised Funds may be established by the donation or transfer by any person (hereinafter "Donor") to, and acceptance by, the Foundation of money or property, whether by contribution, gift, bequest, or devise or by transfer from a charitable or other organization (hereinafter "contribution"), to further or carry out the purposes of the Foundation (which purposes are hereinafter referred to as "charitable" and shall encompass only charitable purposes as defined in section 170(c)(1) or (2)(B) of the Internal Revenue Code). Advised Funds are and shall be administered as part of the endowment funds of the Foundation. However, the procedures set forth herein are provided in recognition of a particular purpose of Advised Funds, which is to develop support of, and participation and involvement in, the philanthropic interests and activities of the Foundation by a wide range of living donors.

1.3 Nature and Terms of Funds. Each Advised Fund shall be held by one of the corporate trustees under the Resolution and Declaration of Trust Creating the Foundation, or by The Stark County Foundation, Inc., as a component part of the Foundation. The Distribution Committee of the Foundation or the Board of Trustees of The Stark County

Foundation, Inc., as the case may be, (which hereinafter shall be included within the term "Distribution Committee"), shall have the ultimate authority and control of all property in the Fund, and the income derived therefrom, for the charitable purposes of the Foundation. Each Fund may be recorded on the books and records of the Foundation as an identifiable or separate fund and may be given a name or other appropriate designation as requested by the Donor.

Section 2. ACCEPTANCE OF FUNDS

2.1 Authorization. Any of the corporate trustees or The Stark County Foundation, Inc. with the approval of the President of the Foundation (or such additional officers or employees of the Foundation as the Distribution Committee may from time to time authorize) shall have the authority to accept, on behalf of the Foundation, contributions to establish or add to an Advised Fund. A Donor may not impose any material restriction or condition that prevents the Foundation from freely and effectively employing the contributed assets, or the income derived therefrom, in furtherance of a charitable purpose of the Foundation.

2.2 Value. No minimum amount is established as a prerequisite for creation of an Advised Fund, however, the minimum size to which an Advised Fund should be built up is $10,000, which may be contributed in stages. The Foundation will not certify to a Donor the value of a contribution of property.

Section 3. DISTRIBUTIONS FROM THE FUND

3.1 In General. The Distribution Committee has the right to direct all distributions of income or principal of Advised Funds. The donor of an Advised Fund (or his designee, as permitted in Section 3.2 below) may, after the contribution of money or property to a

Fund, recommend to the Foundation the making of distributions from the Fund which are consistent with the specific charitable objectives of the Foundation. The Foundation shall consider and evaluate all such recommendations, but such recommendations will be solely advisory and the Foundation is not bound by such recommendations.

3.2 Donors and Their Designees Accorded the Privilege of Making Recommendations. The privilege of making recommendations (as described in Section 3.1 above) shall be extended to Donors and their designees, subject to the following limitations:

(a) Ordinarily if an individual establishes an Advised Fund, the privilege of making recommendations is limited to the Donor and his or her spouse, and, unless otherwise specified in the instrument establishing the Fund, recommendations may be made by them separately or jointly. Such privilege of a Donor or the spouse will be continuous with the existence of the Fund unless earlier terminated by (i) death (ii) written notice to the Foundation of resignation or release or (iii) a finding by the Foundation that the person involved is not available or is incompetent to exercise the privilege.

(b) An individual Donor may designate in the instrument establishing a Fund a person or persons other than or in addition to himself and his or her spouse to exercise the privilege to make recommendations, but in such case the privilege will exist only during the lifetime of such Donor or the spouse, unless earlier terminated as described in (a) above. However, the instrument establishing a Fund may designate a child or children (and spouses) of a Donor to have such privilege after the termination of the privilege of the Donor and the spouse, and such designation of a successor or successors to the original Donor or the spouse will be recognized if it furthers continued family participation, support and involvement by such successors. Where persons in addition to the original Donor or his or her spouse may make recommendations, the Foundation may require those persons to designate one person to act for them in submitting recommendations to the Foundation.

(c) A corporate Donor which establishes an Advised Fund will have the privilege of making recommendations for a period not to exceed 15 years from the date of the establishment of the Fund. The privilege to make recommendations may be extended beyond the 15-year limitation if substantial additional contributions are made and the corporation maintains a continuing charitable involvement with the Foundation. A corporation shall be limited to establishing only one Advised Fund within such 15-year period. Such

corporation, or those acting on its behalf, shall designate one person (and may designate his or her successor) to submit the recommendations of the corporation to the Foundation.

(d) If the Donor has provided, in the instrument establishing a Fund, for an Advisory Committee and for the appointment of successors to such Advisory Committee, the Advisory Committee shall continue to have the privilege of making recommendations for a period of 15 years, unless the Advisory Committee chooses to surrender such privilege or for any other reason ceases to function. The decision of the Distribution Committee that an Advisory Committee has ceased to function shall be final and binding on all parties concerned. The privilege of making recommendations may be extended beyond the 15-year limitation if the Advisory Committee is still functioning and requests such an extension.

Hereinafter, the term Donor will include and shall apply to all persons having the privilege of making recommendations as provided above.

3.3 Charitable Needs for Which Distributions may be made. The Distribution Committee with assistance of the President, shall enumerate specific charitable needs to which distributions from Advised Funds may be made and shall from time to time determine the charitable needs most deserving of support from such funds. There is attached, as Exhibit A, a list of such specific charitable needs enumerated at the time of approval of these procedures (hereinafter "List of Charitable Needs"). The Distribution Committee is authorized to modify the list from time to time. It is the policy of the Foundation to encourage recommendations from all sources, including from persons other than Donors, for inclusion of qualified charitable organizations and/or programs, projects and activities of qualified organizations in the list of specific charitable needs.

3.4 Limitations. The following limitations apply to all distributions from Advised Funds:

(a) The minimum amount of any one distribution from an Advised

Fund shall be $100, although the Distribution Committee may, from time to time, set a higher limitation.

(b) The Foundation, as a public charity, will not make any distribution from an Advised Fund except as a distribution from the Foundation for its charitable purposes, and no such distribution may be used to discharge or satisfy a legally enforceable pledge or obligation of any person, including the Donor of an Advised Fund.

(c) A Donor of an Advised Fund shall have the privilege of making recommendations as to distributions out of the corpus of an Advised Fund. However, it is the general policy of the Foundation that a substantial part of the Advised Funds shall remain as a permanent endowment of the Foundation.

3.5 Procedure.

3.51 Recommendations by Donors. Recommendations by a Donor with respect to distributions from an Advised Fund shall be made in writing, addressed to the Foundation. Donors are encouraged to make recommendations with respect to charitable needs enumerated by the Foundation as being most deserving for distributions by the Foundation. Donors shall be furnished the List of Charitable Needs described in Section 3.3. However, a Donor may make a recommendation with respect to a charitable organization not coming within the categories specified on the List of Charitable Needs, in which case the Foundation shall make an investigation as described in Section 3.52.

3.52 Staff Investigation.. With respect to each recommendation by a Donor, the Foundation will make an investigation to determine whether the recommendation is consistent with specific charitable needs deserving of support by the Foundation. The degree of formality employed by the Foundation in making an evaluation will depend upon the nature and category of the grantee organization and information obtained by or already available to

the Foundation with respect to the grantee and the purposes of the grant. If the Foundation determines that the recommendation is not consistent with the specific charitable needs of the Foundation, the Donor shall be advised that the recommendation does not meet the standards for distributions.

3.53 Distribution Committee Action. The Distribution Committee shall act upon all recommendations by Donors and shall allocate funds from Advised Funds in accordance with regular Distribution Committee grantmaking procedures.

3.6 Notification to Grantee as to Source of Distribution. Any distribution from an Advised Fund, unless otherwise requested by the Donor of the Fund, shall identify to the grantee organization the name of the Fund from which the distribution is made.

3.7 Requirement of Current Distributions. It is the general policy of the Foundation that an amount at least equal to the net income of an Advised Fund shall be distributed during the fiscal year in which such net income is realized or before the end of the twelfth month of the next fiscal year, unless the Distribution Committee determines that it is in the best interest of the Foundation to accumulate net income, in whole or in part, for a specific project, which it is contemplated will be accomplished in a reasonable period of time.

Section 4. REPORTS AND EDUCATIONAL PROGRAM

4.1 Annual Reports. A report of all distributions from Advised Funds shall be included in the annual report of the Foundation. Additional reports of Advised Funds may be made as prescribed by the Distribution Committee.

4.2 Educational Program. The President shall conduct an educational program publicizing to Donors and other interested persons in the community these procedures and the

specific charitable needs supported or to be supported by Advised Funds. Such educational program may be part of a larger effort of the Foundation to educate the public with regard to the scope of the charitable services of the Foundation. As an integral part of this program, these procedures shall be disseminated in order to encourage additional contributions to the Foundation.

Sec. 5 CONTINUITY OF FUNDS

5.1 Upon Death, etc., of Donor. Upon the termination, by death or otherwise, of the privilege of a Donor of an Advised Fund to make recommendations, as provided in Section 3.2 above, the Fund shall continue as part of the endowment funds of the Foundation.

5.2 Memorial Funds. If the principal of such Fund exceeds the sum of $25,000 when the aforesaid privilege to make recommendations terminates, the Fund will continue as an identified memorial fund named for the Donor (or for such other period or designation as the Donor may have requested).

EXHIBIT A 83

List of Charitable Needs

Specific Charitable Needs Most Deserving of
Support From Funds of The Stark County Foundation

The following are categories of specific charitable needs consistent with the purposes of the Foundation as determined by its Distribution Committee and President under authority from the Distribution Committee. These categories reflect the broad scope of purposes of the Foundation and the interests of the people of Stark County, Ohio in advancing human needs through a wide range of activities. In determining its priorities, the Foundation acknowledges the benefits derived by the people in the Stark County, Ohio community from constructive projects in social welfare, medical, educational and cultural fields, without regard to their geographic proximity and whether they are otherwise embraced by funds normally available to local agencies for operating purposes. This range of priorities has been the traditional concern of the Foundation and the philanthropic basis upon which it was organized and has operated.

Since unanticipated or unusual needs may arise, it may be necessary to make exceptions to or modifications of the following list of needs for emergency situations or innovative projects determined by the Foundation as most deserving of support at the time. Further, in view of the necessity to meet changing conditions and to adjust to current responsibilities, the following list of needs and the range of support may be changed or supplemented from time to time, as determined by the Distribution Committee or President. As used in this List, the term "charitable" includes educational and other purposes encompassed within the term.

Needs by Categories of Organizations

A. Charitable organizations or projects primarily serving the Stark County, Ohio area in the fields of:
   1. Basic Material Needs
   2. Community/Civic
   3. Conservation/Environment
   4. Economic Development
   5. Education
   6. Fine Arts/Humanities
   7. Health and Wellness
   8. Human Services
   9. Public Affairs
   10. Religion (for Advised Funds only)

B. Charitable organizations outside the Stark County, Ohio area which the Foundation determines provide an identifiable benefit for the welfare of the Stark County, Ohio community.

C. Charitable organizations outside the Stark County, Ohio, area which are of particular interest to the Donor and which have not previously received a charitable grant from

the Foundation other than from an Advised Fund. All such grants must meet at least two of the criteria below and also be specifically approved by the Distribution Committee.

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1. The organization provides (or will provide) a quantifiable benefit to persons residing in Stark County.

2. The organization is an alma-mater school of the Donor-Advisor(s) making the grant recommendation.

3. The grant under consideration is for $1,000 or less.

4. The annual total for charitable grants outside Stark County from this Advised Fund will not exceed 5% if this grant is made.

The Stark County Foundation recognizes that permitting de minimis grant-making outside the county will encourage the growth of donor-advised funds which will provide long-term permanent benefit for all residents of Stark County.

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Attachment 2

THE STARK COUNTY FOUNDATION

EXCERPTS - DONOR-ADVISED FUND AGREEMENTS

August 11, 1995

A. B--- Family Charitable Fund - paragraphs 3 and 4:

3. Donor or his spouse or their successors as provided herein may from time to time during their lifetimes recommend grants to be made from the Fund, and unless otherwise requested by them, organizations to whom grants are made shall be notified that the grant is from the B--- Family Charitable Fund. Upon the death of Donor and his spouse, Donor's children living in Stark County shall serve successively in order by age, eldest first, as successor advisers to recommend grants. Upon the death of all Donor's children, the Foundation may, at its discretion, appoint successor advisors to be chosen by the Foundation from among Donor's descendants living in Stark County.

4. Not more than 10% of the income of the Fund may be distributed by the Foundation without any recommendations by the Donor, and in the event Donor, his spouse or their successors as provided herein, do not recommend distributions of substantially all the income of the Fund over successive running two-year periods, the Foundation may distribute such undistributed income at its discretion.

B. W--- H. and J--- G. B--- Philanthropic Fund - part of paragraph 5:

Following the death of the last Adviser, the W--- H. and J--- G. B--- Philanthropic Fund will become a permanent General Purpose Fund of The Stark County Foundation, Inc. The Foundation will account for the Fund as a separate memorial fund in perpetuity.

C. The S--- H. S--- and S--- A. S--- Philanthropic Fund - paragraph 5:

5. During his life, Donor may from time to time recommend grants to be made from the assets of the Fund. Upon Donor's death, Donor's wife, S--- A. A---, may from time to time recommend grants to be made from the assets of the fund. Following the death of the Donor and his wife, the privilege of making such recommendations shall pass to the Donor's living children, such recommendations to be made by majority decision. Following the death of all of Donor's children, the right to recommend grants shall lapse.

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Attachment 3

THE STARK COUNTY FOUNDATION
EXCERPTS - DESIGNATED FUND AGREEMENTS
August 11, 1995

A. H--- and A--- B--- Charitable Fund - paragraph 3(g):

> (g) Any income not distributed by reason of the provisions of the such paragraphs (a), (b), (c), (d), (e) and (f) above shall be distributed for charitable, educational and scientific purposes as may be determined by the Trustees of the Foundation, in their discretion.

(Note: This provision is virtually identical to the conditional provision in our other two designated funds established by living donors.)

B. Margretta Bockius Wilson Fund - excerpt of Last Will and Testament of Donor:

> To the STARK COUNTY FOUNDATION of Canton, Ohio, the sum of ONE HUNDRED THOUSAND DOLLARS ($100,000.00) to establish and endow the "Margretta Bockius Wilson Fund" as a memorial to my wife, the said Margretta Bockius Wilson. The net income only from the principal of the said fund is to be paid on a regular basis to the CANTON ART INSTITUTE of Canton, Ohio, to purchase art works for their permanent collection. If for any reason CANTON ART INSTITUTE fails to qualify as a recipient of such income, the Distribution Committee may disregard the previous instructions, and utilize the fund for a similar or related purpose.

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Attachment 4

THE STARK COUNTY FOUNDATION
COMMUNITY AGENCY ENDOWMENT FUNDS
August 11, 1995

Area Agency on Aging
Better Business Bureau, Canton Regional
Blue Coats
Buckeye Council, BSA
Canton Area YMCA
Canton City Schools
Canton Montessori School
Canton Palace Theater
Canton Professional Educators Association
Canton YWCA
Carnation City Players
Doctors Hospital
Family Services
First Ladies Library
Junior Achievement
Meals on Wheels
North Canton City Schools
North Canton Rotary
Plain Local Schools
St. John the Baptist Church
Siffrin Residential Association
Stark County Historical Society
Stark County Humane Society
Timken Mercy Medical Center
United Way of Central Stark County
Visiting Nurse Association
Wilderness Center

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Attachment 5

THE STARK COUNTY FOUNDATION
EXCERPTS - COMMUNITY AGENCY ENDOWMENT FUND AGREEMENTS
August 11, 1995

A. Canton Palace Theater Endowment Fund - from paragraph 9:

> If the Board of Trustees of Palace fails to designate another organization to receive distributions in such event, the Foundation may select another appropriate organization or purpose, qualified under Section 501(c)(3) of the Internal Revenue Code (or any equivalent section) for distributions from the Fund.

(Note: This provision is typical for many of our community agency endowment funds.)

B. Aultman Home For Aged Women, Inc. - paragraph 12:

> 12. If the Board of Trustees of the Home fails to designate another organization as a substitute for it hereunder, the Distribution Committee of The Stark County Foundation may select another appropriate organization, qualified under Section 501(c)(3) of the Internal Revenue Code (or any equivalent section) to be such substitute for the Home under this Agreement.

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Alicia Philipp
Executive Director

Board of Directors
George H. Johnson, President

Samuel E. Allen
J. Veronica Biggins
James N. Brawner, M.D.
Marie W. Dodd
Shirley C. Franklin
Roger I. Hallock
James R. Lientz
Clay C. Long
John E. McKinley
Jackie E. Montag
Ingrid Saunders Jones
Charles M. Shaffer, Jr.
Richard H. Sinkfield
B. Franklin Skinner
Don Speaks
B. Neely Young
David Yu

Legal Counsel
Benjamin T. White
Alston & Bird

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August 11, 1995

Mr. Joel Tannenbaum
Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft - Proposed Audit and Accounting Guide for Not-For-Profit Organizations

Dear Mr. Tannenbaum:

On behalf of the Metropolitan Atlanta Community Foundation, Inc., I am writing in response to the call for comments about the AICPA's Proposed Audit and Accounting Guide Exposure Draft for Not-For-Profit Organizations. Specifically, I wish to comment on the issues of variance power and legal control and their application to community foundations in administering donor-advised, designated and agency endowment funds.

In the seventy odd years that community foundations have served large and small communities throughout this country, a common tenet held by all is that each will provide a permanent repository for philanthropic contributions to benefit future generations in perpetuity. In addition, community foundations across the country, while reflecting the diversity of the communities they serve, have long been similarly organized to offer a variety of flexible services to donors and grantees alike to ensure that changing needs in their respective communities will continue to be most appropriately addressed. At the very core of a community foundation's mission to meet ever-changing community needs is the authority it has under state law and its governing instruments to exercise a variance power. This variance power ensures that the community foundation will be able to act independently of any other parties, be they donors or grantees, in responding to needs within their community.

The variance power held by a community foundation vests its governing body (typically a board of directors) with immediate and full control of all funds, including donor-advised, designated and agency endowment funds. In establishing these funds, donors relinquish all control over the administration and disposition of them. Any property contributed by donors to establish a donor-advised, designated or agency endowment fund at a community foundation become the assets of the community

foundation. Written agreements between donors and community foundations clearly articulate that assets and their ownership have been transfered entirely to the community foundation. No other persons or organizations have any ownership interests, legally or beneficially, in the funds or in the assets held in a fund. Community foundations have full discretion to exercise their variance power whenever they believe it to be in the best interest of their community. Designated beneficiaries from donor-advised, designated or agency endowment funds have no authority to either exercise or prevent the use of the variance power.

In addition to the variance power, community foundations control fully the administration and disposition of all donor-advised, designated and agency endowment funds. While donors to a community foundation have the opportunity to provide recommendations or suggestions in the administration and disposition of funds contributed to the community foundation, it is the foundation's governing body which has the sole authority to oversee and act on the adminstration and disposition or distribution of those donated funds. These donated funds are outright contributions that are conveyed to the community foundation with the full and complete understanding and agreement that the community foundation assume sole ownership of the funds and complete discretion as to their disposition. Legal and binding agreements between the community foundation and donors stipulate clearly the full control vested in the community foundation. As such, we believe these are clearly contributions and not agency transactions.

With respect to the above and for illustrative purposes, let me offer several provisions drawn from the Amended and Restated Articles of Incorporation of Metropolitan Atlanta Community Foundation, Inc.:

> <u>Article Three: Nonprofit Corporation and Charitable Purposes</u>
>
> The corporation shall be a nonprofit corporation under the provisions of the Georgia Nonprofit Code. It shall be organized, and at all times thereafter operated, exclusively for public charitable uses and purposes within the meaning of section 501(c)(3) of the Internal Revenue Code, that in the absolute discretion of the Board of Directors, most effectively will serve the needs and interests of the metropolitan Atlanta community and benefit and promote the

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well-being of the people of the metropolitan Atlanta community. In furthance of such purposes, the corporation shall have full power and authority:

(a) To acquire or receive from any individual, firm, association, corporation, trust, foundation, or any government or governmental subdivision, unit or agency, by deed, gift, purchace, bequest, devise, appointment, or otherwise, cash, securities and other property, tangible or intangible, real or personal, and to hold, administer, manage, invest, reinvest, and dispurse the principal and income thereof solely for the charitable purposes hereof; . . .

(d) To modify any restriction or condition on the distribution of funds for any specified charitable purposes or to specified organizations, if in the sole judgement of the Board of Directors (without the necessity of the approval of any trustee, custodian, or agent), such restriction or condition becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the metropolitan Atlanta community.

In addition, the following provisions are offered from the Amended and Restated Bylaws of Metropolitan Atlanta Community Foundation, Inc.:

Article Nine: Gifts to the Corporation

(9.3) Donors' Acceptance of Governing Instruments of the Corporation:

By making a gift to the corporation, each donor accepts and agrees to all the terms of the articles of incorporation of the corporation and these bylaws, and provides that the fund or funds so created shall be subject to the provisions relating to presumption of donors' intent, to modification of restrictions or conditions, to replacement or removal of of participating trustees, custodians, or agents, and to amendments and termination, and to all other terms of the articles of incorporation and bylaws of the corporation, and any trust, custodian or agency agreement between the corporation and the trustees, custodians, or agents having custody of the funds of the corporation each as from time to time amended.

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(9.7) Presumption of Charitable Intent

. . . If a direction by the donor, however expressed, would if followed, result in use contrary to the intent so presumed, or if the Board of Directors is advised by counsel that there is substantial risk of such result, the directions shall not be followed, but shall be varied by the Board of Directors so far as necessary to avoid such result.

(9.8) Power of Modification

Notwithstanding any provision in the bylaws or in any instrument of transfer creating or adding to a fund of this corporation, and in accordance with the articles of incorporation of the corporation, the Board of Directors shall have the power to modify any restriction or condition on the distribution of funds for any specified charitable purposes or to specific organizations, if in the sole judgement of the Board of Directors (without the necessity of the approval of any participating trustee, custodian, or agent), such restriction or condition becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the metropolitan Atlanta community. The Board of Directors shall exercise this power by the affirmative vote of a majority of all the directors then in office.

And also in addition, the following provisions are offered from the Procedures for Establishment and Operations of Advised Funds of Metropolitan Atlanta Community Foundation, Inc.:

(1.3) Nature and Terms of Funds

Each Advised Fund shall be the property of the Foundation owned by it in its normal corporate capacity. In such capacity, the Foundation shall have the ultimate authority and control of all property in the Fund, and the income derived therefrom, for the charitable purposes of the Foundation. Each Fund may be recorded on the books and records of the Foundation as an identifiable or separate fund and may be given a name or other appropriate designation as requested by the Donor. Anything herein or in the deed of gift or other instrument of transfer creating an Advised Fund to the contrary notwithstanding, each Advised Fund shall be a component part of the Foundation and shall

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be subject to the governing instruments of the Foundation, including the articles of incorporation and bylaws as amended from time to time.

(2.1) Authorization

The Executive Director of the Foundation (or such additional officers or employees of the Foundation as the Board of Directors may from time to time authorize) shall have the authority to accept, on behalf of the Foundation, contributions to establish or add to an Advised Fund. A Donor may not impose any material restriction or condition that prevents the Foundation from freely and effectively employing the contributed assets, or the income derived therefrom, in furtherance of a charitable purpose or purposes of the Foundation.

(4.1) In General

The Board of Directors has the right to direct all distributions of income or principal of Advised Funds. The Donor of Advised Funds (or his or her designee, as permitted in Section 4.2 below) may, after the contribution of money or property to a Fund, recommend to the Foundation the making of distributions from the Fund which are consistent with the specific charitable needs and interests of the Foundation. The Foundation shall consider and evaluate all such recommendation, but such recommendations will be solely advisory; and the Foundation is not bound by such recommendations.

It is important to note that all prospective donors to the Foundation, either individuals or nonprofit organizations, are provided with copies of all governing instruments of the Foundation. In addition, professional staff of the Foundation and its legal counsel clearly explain to all prospective donors the power and authority vested in the Foundation's Board of Directors and the full and complete control exercised by the Board of Directors in administering all activities of the Foundation. All donors to the Foundation understand and agree that all assets conveyed to the Foundation become the property of the Foundation, with the Foundation's Board of Directors having full and complete control of those assets.

Any suggestion by the AICPA that donor-advised, designated or agency endowment funds should be treated as anything other than a

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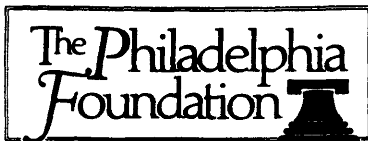
contribution, and as such an irrevocable transfer of assets, would be in direct conflict with existing regulations and governing instruments by which community foundations must operate.

We appreciate this opportunity to comment on the Exposure Draft. Further, we urge the AICPA to accomodate the special circumstances presented by community foundations in their efforts to address community needs and increase the philanthropic resources available in their communities.

Sincerely,

Alicia Philipp
Executive Director

AP/d



1234 Market Street, Suite 1900
Philadelphia, Pennsylvania 19107-3794
(215) 563-6417

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AUG 14 1995

August 11, 1995

Joel Tanenbaum
Technical Manager, File 3605.AG
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

RE: Issue 1 Variance Power and Donor-Advised Provisions

Dear Mr. Tanenbaum:

Does variance power provide not-for-profit organizations with sufficient discretion to recognize resources received as contributions? Does the not-for-profit organization's history of exercising its variance power affect the answer to this question?

This question also needs to consider the donor's intent in giving the funds to the community foundation rather than giving it directly to the nonprofit organization. The community foundation provides an oversight function that these donors value. Donors set up their funds as memorials that they want to continue to serve their communities in perpetuity. They recognize that organizations go out of business for many reasons; a cure is found for a disease, an issue facing society is solved, mismanagement, etc. They look to the community foundation to maintain the intent of the original gift.

For example, The Philadelphia Foundation has funds that were set up for organizations fighting polio and tuberculosis. When cures were found for these diseases, the variance power was invoked and the funds are now available to fight others diseases including AIDS and cancer. The Greater Philadelphia Chapter of the Alzheimer's Disease and Related Disorders Association Endowment Fund was set up by a donor who sincerely hopes that the disease will be conquered and the funds available for other purposes.

Another fund names the Young Women's Christian Association of Philadelphia. This YWCA had major financial problems and filed bankruptcy. The Board voted to invoke the variance power and with held payments to the organization. This year the YWCA of Bucks County received a grant from this fund. Seven other funds name organizations that have gone out of business. The variance power was invoked. In some cases, organizations that serve similar needs were substituted; in others, the principal was used to make undesignated grants.

Two funds were set up to make grants only to white Protestant organizations. This was contrary to public policy so the Board invoked the variance power. These funds are now undesignated.

Documentation of all these transactions is in the minutes of the meetings of the Board of Directors.

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Do donor-advised provisions, in combination with variance power, provide not-for-profit organizations with sufficient discretion to recognize resources received as contributions? Does the not-for-profit organization's history of deviating from the resource provider's advice affect the answer to the question?

Community Foundations are vehicles for philanthropy for donors in our community. When a donor sets up a fund at a community foundation, that donor is seeking to make a difference in our community. The donor is not simply looking for a tax deduction and a mechanism to pass through money to another charity. Our program staff works with each donor individually. Our program staffs are constantly out in the community and they are experts on community needs. Each donor benefits from professional program management for his fund.

Some examples of donor advised funds at the Philadelphia Foundation are:

1. The donors are interested in organizations dealing with issues involving women and violence. Each spring the assigned program officer meets with the advisory committee of the fund and presents her research and recommended agencies to the committee. The committee makes their selections from these recommendations.

2. The donor wishes to remain anonymous so we work through his bank trust officer. He is interested in children at risk. The program officer presents her research to the bank trust officer for approval.

Many of our donor advisors serve on advisory and other committees at the Foundation. They participate in community tours that the Foundation organizes periodically. They look to the Foundation for opportunities to become involved in the community and to contribute time as well as money.

Not all of our donor advisors take advantage of the support of the program staff. Some prefer to recommend organizations to receive grants to the Foundation. In these case, the grants manager requests program information, tax status, financial statements and any other information necessary to allow the grant to be presented to the Board for approval. Still, our program officers are always looking at opportunities to interest donor advisors in emerging community issues. In many cases, they have been successful in influencing the decisions of donor advisors to expand their philanthropic interests.

Our donor advised agreements routinely include two clauses that limit the term of the donor advisor:

1. The donor advisors can appoint one successor(s) only. For example, a parent may appoint a child. At the child's death, the fund becomes a field of interest fund, if the donor expressed a field of interest, or an undesignated fund of the Foundation. Some community foundations limit the term of donor advisors to twenty or twenty-five years.

2. In the event that no one advises the Foundation on the distribution of the Fund for three consecutive years, the Foundation may deem that no one has an interest in advising with respect to the Fund, and may terminate such rights after written notice to the last known address of the last designated spokesperson.

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Can the accounting for the income from resources that must be retained in perpetuity differ from the resources held in perpetuity? For example, can the receipt of resources that must be retained in perpetuity be accounted for as a contribution if the income from the resources is accounted for as an agency transaction?

All funds given to the Philadelphia Foundation, except custodial management funds, are contributions for legal and tax purposes. A donor has the option of giving the funds directly to a nonprofit organization and, instead, has chosen the Foundation. That is because nonprofit organizations that receive grants from The Philadelphia Foundation are subject to financial and programmatic oversight by program staff and to investment and accounting oversight by the finance staff.

Splitting endowment funds from income for accounting purposes will make financial statements meaningless for those people who rely on them. For example, suppose the Young Women's Christian Association of Philadelphia had included the net present value of the fund in which the organization is named on their Balance Sheet as an asset. The creditors would have expected these funds to be available to pay debts. However, The Philadelphia Foundation exercised its variance power and now another organization receives the income from these funds. The creditors would have been misled.

Financial statements are used by many to evaluate performance and accountability. If income and principal are accounted for differently, nonprofit statements will become meaningless and confusing. Our designated funds are 20% of our assets. How do you measure investment performance if you count all principal by only 80% of the income? What happens when the variance power is exercised on these assets? Does the income suddenly increase by 20%?

Sincerely,

Diane M. Freaney, CPA
Chief Financial and Administrative Officer

PLANTE & MORAN, LLP
Suite 700
107 West Michigan Avenue
Kalamazoo, Michigan 49007-3940
Certified Public Accoun
Management Consulta
616-385-1858
FAX 616-385-2936

August 8, 1995

(86)

AUG 14 1995

Mr. Joel Tanenbaum
Technical Manager, File 3605.AG
Accounting Standards Division, AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Tanenbaum:

This letter is regarding the AICPA exposure draft of the Industry Audit Guide for Not-for-Profit Organizations, particularly as it relates to community foundations. Below please find my response to the AICPA's request for comments on the issue of variance power and donor-advised provisions.

Background

Statement 116 establishes standards of financial accounting and reporting for contributions received and contributions made. Paragraph 5 of Statement 116 states that "(a) contribution is an unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner." Paragraph 4 of Statement 116 states that "this Statement does not apply to transfers of assets in which the reporting entity acts as an agent, trustee, or intermediary, rather than as a donor or donee." Paragraph 53 of Statement 116 states that "the recipient of assets who is an agent or trustee has little or no discretion in determining how the assets transferred will be used." Paragraph 26 of FASB Concepts Statement No. 6 states that an asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred."

Community Foundations

In an overall sense, community foundations have been formed to provide a community asset base from which earnings therefrom can be used to attend to the otherwise unmet financial needs of the community, whether civic or charitable in nature, as determined by the governing board of the foundation, typically a Board of Trustees.

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Although community foundations organized in trust form are composed of many separate funds, federal income tax law treats the separate funds as a single, tax-exempt, publicly supported entity (as described in Sections 501(c)(3) and 509(a)(1) of the Internal Revenue Code) if the six requirements, including the establishment of variance power for its governing body, are met. Variance power provides the governing body of the foundation specified powers including the power to modify donor-imposed stipulations on the distribution of funds if, in its sole judgment and discretion, such suggestions become, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served.

Some of the needs of the community coincide with the charitable wishes of individuals within the community, who may make a contribution to the community foundation to create an endowment for the ongoing support of that cause (or donor advised gift). In all but unusual cases, the foundations accept those contributions with the complete understanding of the donor that the foundation's allocation committee, or Board, will accept recommendations annually as to how the income is disbursed, or will follow the precatory language of a gift agreement, while maintaining the discretion and right (or variance power) to exercise its own authority on the distribution of income and/or assets.

Whether a community foundation has control and discretion over a donor-advised gift may be evident from the written instrument establishing the fund. A donor's use of precatory language in the instrument establishing the fund is strong evidence that the donor intended that the community foundation have control and discretion over the fund. Precatory language is not legally binding. Thus, for example, if in the instrument establishing the fund, the donor states that it is the donor's "desire," the donor's "wish," or the donor's "hope" that the income of the fund be distributed to one or more specifically named charitable organizations, the community foundation should conclude that it has ultimate control and discretion over the fund.

Issue

AcSEC has asked that respondents comment concerning the effect of variance power and donor-advised provisions on the accounting for resources received under agreements that have those provisions. In particular, AcSEC has asked that respondents consider the following questions:

- Does variance power provide not-for-profit organizations with sufficient discretion to recognize resources received as contributions? Does the not-for-profit organization's history of exercising its variance power affect the answer to this question?

- Do donor-advised provisions, in combination with variance power, provide not-for-profit organizations with sufficient discretion to recognize resources received as contributions? Does the not-for-profit organization's history of deviating from the resource provider's advice affect the answer to this question?

Response

Variance power, including donor-advised contributions, should provide the community foundations with sufficient discretion to recognize resources received as contributions. Title to the asset contributed has passed to the foundation, and the income, even when morally encumbered by a precatory declaration, is distributed by the foundation's governing board upon the exercise of their free and unencumbered judgment. In other words, the contributed asset has the three essential characteristics described in paragraph 26 of FASB Concepts Statement No. 6 and the foundation has complete discretion in determining how the assets transferred will be used suggesting it would be incorrect to account for this contribution as an agency transaction. In these cases, the contributions should be added to the "Unrestricted net assets" of the foundation.

The frequency with which the variance power is exercised varies from community foundation to community foundation. It would not seem important, however, whether or not that "variance power" is ever used. What is important is that it can be used anytime and that it imposes on the community foundation a supervisory responsibility that is discharged in a serious manner. In other words, in cases where the written instrument establishing the fund does contain precatory language and evidence exists that (1) based on past experiences, the community foundation has exercised its variance power when conditions warranted, or (2) the community foundation does periodically consider the changing needs of the community or periodically perform due diligence reviews of designated charities, thereby indicating that the community foundation has exercised its authority provided by the variance power even if the disbursement of funds is made on a basis consistent with the donor's wishes. It is the existence of this power, not the frequency of the foundation's exercise of power to modify donor-imposed stipulations, which should be determinative. Similar reasoning has been offered by FASB and the AICPA to interpret SFAS No. 117 (paragraph 122 of Statement 117) as providing that where a community foundation is formed as a corporation the mere power of its board of directors under state law to expend net appreciation requires such net appreciation to be reclassified from permanently restricted funds to unrestricted or temporarily restricted funds, whether or not the board actually exercises this power.

I appreciate your attention to my response to the Not-for-Profit Organization Industry Audit Guide exposure draft. Should you have any questions or require further information, please do not hesitate to contact me.

Very truly yours,

PLANTE & MORAN, LLP

Brady J. Pitchman

Central New York Community Foundation, Inc.

Generating resources that enrich our community . . . since 1927.

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Suite 428
500 South Salina Street
Syracuse, NY 13202-3302
(315) 422-9538

August 9, 1995

(87)

AUG 14 1995

Mr. Joel Tannenbaum, Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tannenbaum,

In response to the AICPA's call for comments on its proposed Audit and Accounting Guide for Not-For-Profit Organizations, with specific reference to "variance power and donor-advised provisions," the Central New York Community Foundation offers the following comments:

The Central New York Community Foundation (originally known as The Syracuse Foundation) was established in 1927. Its founders appreciated the flexibility and simplicity of the community foundation model, as it was developed in Cleveland. Especially attractive was the provision for a volunteer Board of Directors, broadly representative of the community and responsible for guiding the use of its funds to meet important community needs.

The founding directors in 1927 could not have anticipated that its assets would provide for grants in the 1990s to address such contemporary issues as AIDS, child care and displaced homemakers. But the founding directors did have the wisdom to provide this flexibility for succeeding boards. In the Articles of Incorporation, written in 1927, it states the Foundation's purpose in part, "...to receive the income or principal from trusts created for the purpose of paying such income or principal to this corporation to be used by it for any of the said purposes, and to apply and distribute the money, securities or other property received for any of said purposes as the same shall have been designated by the grantors or donors thereof, or if no purpose or purposes shall have been designated, or if such designation shall be impossible of fulfillment, to such of the foregoing purposes as the directors of the corporation shall determine, and to do any and all other things deemed necessary or advisable incidental to the above..." It has been under this broad legal charter that the Central New York Community Foundation has been operating for the past 68 years, and will continue to be the guiding principle behind our mission.

From time to time, donors will make charitable contributions to the Community Foundation with the request that the funds be held in perpetuity with the income or a portion of the earnings designated to support another charitable institution, or to be held for donor-advisement. In both cases, the Community Foundation is the legal recipient of the charitable funds and provides the donor with the necessary documentation to claim a charitable income tax deduction per Internal Revenue Service guidelines. The Community Foundation claims complete ownership of these donations, is responsible for investing the funds, and controls any distributions from these funds.

As an example, our community, like many others, has a symphony orchestra which has experienced shaky times. In Spring, 1992, the Syracuse Symphony ceased operations for a short period of time due to insufficient revenues. Some donor-advisors had suggested that gifts be made to the Symphony. The Foundation's Executive Committee met and determined that no gifts should be sent to the Symphony until there was a reasonable expectation that the Symphony would resume its operations. In this particular instance, the integrity of the charitable funds were guarded and the Foundation could act quickly when the Symphony did re-open the fall of 1992.

This situation with the Syracuse Symphony was the impetus for a donor to come to the Foundation shortly thereafter to establish a permanent endowment fund for the benefit of another cultural institution. This donor recognized the experienced and trusted role of the Community Foundation in safeguarding "permanent charitable capital" in this community and for being flexible and responsive in supporting this community's charitable institutions.

In the cases of designated funds or donor-advised funds, the Central New York Community Foundation has not acted as an "agent" but as the "charitable recipient" with full discretion over funds received. In addition to our founding documents, the Foundation's fund agreements reinforce this fact. We believe that the Financial Standards Accounting Board and the AICPA, who is issuing the guidelines, have not fully comprehended the long history of community foundations. Community foundations are not glorified banks or pass-through agents, but have a long and solid history of serving as stewards of the charitable funds entrusted to them. To disregard the institutional integrity of community foundations just to force them into a mold convenient for accountants would be to destroy these vital community assets.

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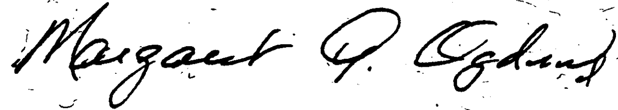
We appreciate your attention to our concerns. We are available to comment further should you require.

Sincerely,



Margaret G. Ogden
President & CEO

cc: Gay M. Pomeroy, Esq.
Council on Foundations, FASB Task Force
Patricia Civil, Coopers & Lybrand, Syracuse

Olivia P. Maynard
9425 HORTON ROAD
GOODRICH, MICHIGAN 48438-9489

(88)

AUG 14 1995

August 9, 1995

Mr. Joel Tannenbaum
Technical Manager, File 3605.AG
Accounting Standards Division, AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tannenbaum:

I serve as the Chairperson of the Community Foundation of Greater Flint. At our August 4th board meeting a great deal of discussion took place about the proposed "Audit and Accounting Guide for Not-for-Profit Organizations". A great deal of concern was expressed by board members about these proposed changes.

The Community Foundation of Greater Flint, as community foundations throughout the country, play a unique role. Not only do we award discretionary grants to non profits to meet the needs of our community but we serve also as a secure place for designated gifts from donors who have particular altruistic interests and as a safe place for non profit organizations' endowment funds. As you well know, these endowment funds are essential to the future health of these non profit organizations and for the population groups they serve.

As trustees of a community foundation, my colleagues and I have a "contract" to make sure the funds given to us continue to fulfill the purposes for which they were given. The issue for the non profits is not to "hide" their funds but to make sure that their commitment to the community is long term. It is the community foundation that has that flexibility to vary its use of its component funds while remaining true to the goals of its contributing organizations. That is why the non profits look to us for this unique assistance.

The Community Foundation of Greater Flint has always worked within AICPA guidelines and has always received unqualified audits. The board is troubled that the proposed AICPA changes will force us, as many other community foundations nationally, to seriously consider changing that tradition. The trust and confidence of our donors is too essential to who we are, not to do otherwise. As proposed the Audit and Accounting Guide, if

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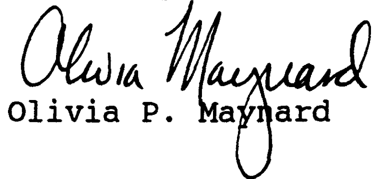
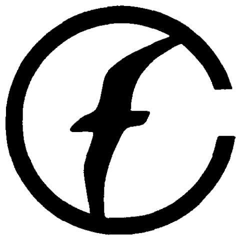
followed, will harm the growth and management of our community foundation as it will many others throughout the country.

Thank you for your attention. It is my hope that the AICPA will respond to the vital issues being raised by many community foundations.

Sincerely,



Olivia P. Maynard



Community Foundation of the Ozarks
901 St. Louis Street, Suite 303
Springfield, MO 65806
Telephone: (417) 864-6199 • Fax: (417) 864-8344

(89)

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August 11, 1995

AUG 14 1995

Joel Tannenbaum, Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tannenbaum:

I am writing today on behalf of the Community Foundation of the Ozarks concerning the audit guide for not-for-profit organizations.

Community foundations have variance power over the funds they administer. Their boards of directors have the right to direct income from the funds where they deem most appropriate. Although, it may be true that most often the distributions from designated funds are directed to the designee, whom the donor has named in the fund's governing document, the fact remains that the control of the fund rests with the community foundation's board of directors. The very fact that this discretion exists, demonstrates that designated funds do not fall under the description explained in Chapter 5, Section 5.02 of the Exposure Draft Proposed Audit and Accounting Guide for Not-For-Profit Organizations, dated April 14, 1995.

The contribution made to establish the designated fund is not an agency transaction. The donor relinquishes control at the time of the gift and the community foundation manages this fund for the good of the community.

Another example of control over the funds administered by community foundations is the spending policy, which has been adopted at Community Foundation of the Ozarks. Upon recommendation from our Investment Committee the board of directors votes on an annual basis to determine the percentage of the fund to be used for the charitable distribution. Neither donors nor agencies have any input in determining this payout percentage.

Our donor-advised funds allow living donors to participate actively in philanthropy. Their recommendations are received and reviewed, but are recommendations only and not directives. Donor advisors, at the time of the gift, relinquish control and legal title of the assets.

It is my hope in writing this letter that your organization will consider the role and responsibilities of community foundations. I would ask that the Financial Accounting Standards Board (FASB) issue a technical bulletin that explains Statement 116 with respect to contributions to community foundations. The interpretation of 116 should be one that is consistent with the tax and legal treatment of community foundations as described here in my letter.

Sincerely,

Susanne Gray

Susanne Gray
Operations Administrator

Marin Community Foundation
17 E. Sir Francis Drake Blvd.
Suite 200
Larkspur, California 94939
415 461 3333
415 461 3386 (Facsimile)

(90)

August 11, 1995

AUG 14 1995

Joel Tanenbaum
Technical Manager
File 3605.AG
Accounting Standards Division, AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

RE: Comments to AICPA's Exposure Draft of Proposed Audit and Accounting Guide: Not-for-Profit Organizations

Dear Mr. Tanenbaum:

Marin Community Foundation (MCF), located in Larkspur, California, is the third largest community foundation in the country. Established in 1986, it currently administers the assets of 55 philanthropic funds, including field of interest, donor-advised, and donor-designated funds and supporting organizations, that total in excess of approximately $600 million.

Patrick McCabe of Morrison & Foerster, the law firm which provides tax and legal counsel to MCF, has prepared comments to the above-referenced audit and accounting guide addressing the issues of whether transfers of assets to donor-designated and donor-advised funds at community foundations should be considered contributions to community foundations. These comments have been sent to you in a letter dated August 11, 1995. MCF's management agrees with all of the points made in the letter, the full text of which is attached hereto. Although I am not planning to repeat all of Mr. McCabe's analysis and comments here, I will take the opportunity to highlight, emphasize, and amplify a few of the key points.

Based on an exhaustive analysis of the Treasury Regulations that apply to community foundations, Mr. McCabe demonstrates how contributions to donor designated funds at community foundations are distinguished from pass-through transactions facilitated by an agent. He states in his letter:

> "These Treasury requirements conclusively establish that contributions to donor designated funds are contributions to the community foundation. A pass-through transaction facilitated by an agent would not be subject to the independent monitoring review prescribed by the regulations. An agent would not be directed to exercise its independent and sole judgment to determine whether the expenditures made in accordance with the restriction have become unnecessary, or inconsistent with the charitable needs of the community. The agent, on completion of the monitoring process, would not have

> the power to completely alter the distribution of the charitable funds trusted to its care to fulfill other charitable purposes. An agent would not be charged with the responsibility inherent in the variance power to conduct investigations into the charitable needs of its community. Finally, an agent would not be subject to loss of its public charity tax status if it failed to exercise its variance power where it had grounds to do so."

In practice, both at the time of establishing a fund and with respect to ongoing fund management, MCF is scrupulous about fulfilling its responsibilities to exercise the required control and discretion over all donor funds, including designated and advised funds. The agreements that establish separate funds at MCF contain provisions that clearly state MCF's variance power. The following is typical language: "The Fund is intended to be and shall be administered as a component part of the Foundation under Treasury Regulation Section 1.170A-9(e)(11), and is specifically subject to the powers of the Trustees as the governing body of a community trust as required therein and as set forth in the Articles of Incorporation and Bylaws of the Foundation. Such powers include the power to unilaterally modify any restriction or condition of the Fund in the event such restriction or condition becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with the needs of the community served by the Foundation." Provisions in the designated and advised fund agreements that refer to distributions clearly set forth the principle that donor recommendations are advisory only and not binding on the Foundation's Trustees.

Indeed it is the fact that control passes to the community foundation that often is a key consideration for prospective donors, both individuals or institutions, in deciding whether to establish funds or make contributions to existing funds at MCF. MCF does not receive some contributions precisely because the potential donor wishes to exert a level of control and discretion which is beyond the scope of the component fund requirements of the community foundation. The attached copy of an article that appeared on the front page of the August 9, 1995 edition of the Marin Independent Journal, Marin County's leading daily newspaper, serves as a dramatic illustration of this point. It reports that the local water district decided not to set up a fund at MCF because "the foundation sent a proposal that district staff said took away too much control over the money's use."

MCF monitors distributions from all of its funds, which occasionally leads to a modification of restrictions and, in one case, to the removal of a designated recipient of grant funds. A

good example is MCF's Fund for Children of Farm Workers. The Fund provided that distributions would be made to the California Human Development Corporation (CHDC) for the benefit of nonprofit daycare centers located in Woodland, Yuba City, and Linda, California. Based on MCF's monitoring of the distributions made from the Fund, the geographic restriction of the fund was broadened significantly. Also, because of MCF's concerns about CHDC's ability to operate in a manner consistent with the purpose of the Fund, Catholic Charities of Sacramento was selected by MCF to replace CHDC as the recipient of grant distributions from the Fund.

MCF encourages donor involvement in community philanthropy, which often entails extensive interaction with MCF donors. We consider this feature of our operations to be a strength in our efforts to address important community needs, both in terms of increasing the amount of philanthropic funds available to meet those needs and heightening awareness of important issues. There is a balance between donor involvement and donor control; we are careful not to cross the line at which the former becomes the latter.

Given the interaction between the Foundation and its donors, it is not surprising that the variance power is not invoked more frequently or that advice from donors is not frequently ignored. Prior to establishing a fund, we have extensive discussions with prospective donors about their charitable interests and how component funds operate. We do not accept funds that are inconsistent with MCF's charitable purposes. Also, our ongoing contact with donors allows for exchange of ideas and information about charitable needs and interests, which informs the recommendations that we receive.

The other point that I want to emphasize is the terrible quandary in which MCF would find itself if the audit and accounting standards are written in such a way that contributions to designated and/or advised funds must be shown as pass-through agency transactions for financial reporting in order to receive an unqualified audit opinion. We believe that such a presentation does not reflect the economic reality nor the tax and legal structure of community foundations. It is fundamentally misleading to current and potential donors and inconsistent with how we describe our management of designated and advised funds to donors. In order to issue statements that we believe are accurate, we would be faced with the prospect of receiving a qualified opinion on those statements.

I believe Mr. McCabe's letter addresses the above concern convincingly in the passage I quote below:

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> "Unless the drafters of the Treasury Department regulations have completely missed their intended purpose, there can be no question that contributions to donor designated and donor advised funds that conform to the prescriptions of the tax regulations should be accounted for as contributions to the community foundation. Any other accounting treatment would be fundamentally at odds with the true nature of such contributions as expressed so thoroughly and without ambiguity in the regulations. The Treasury Department rules therefore provide the substantive tests that determine whether assets transferred to community foundations are "contributions" to the community foundation. Any rules that purport to establish a different set of tests will cause enormous difficulties for community foundations and confuse donors and their advisors. The inevitable effect of this confusion is that fewer charitable endowments will be established to the significant detriment of the communities and charitable beneficiaries served by community foundations. Therefore, because the Treasury Department regulations address the audit and accounting guide's substantive question of when a transfer is a contribution (at least in the community foundation context), AcSEC should adopt the Treasury Department tests to determine the appropriate accounting treatment of such transactions."

Furthermore, if the purpose of the proposed audit and accounting guidelines is to address perceived abuses, those issues are better handled by the federal agencies directed to enforce the regulations they have promulgated.

Thank you for considering our perspective. Please feel free to contact me if clarification or additional information would be helpful.

Sincerely,

Barbara B. Lawson
Vice President
Administration and Finance

Attachments
cc: Stephen Dobbs
President and CEO, Marin Community Foundation

Patrick McCabe
Morrison & Foerster

MORRISON & FOERSTER

LOS ANGELES
SACRAMENTO
ORANGE COUNTY
PALO ALTO
WALNUT CREEK
SEATTLE

ATTORNEYS AT LAW

345 CALIFORNIA STREET
SAN FRANCISCO, CA 94104-2675
TELEPHONE (415) 677-7000
TELEFACSIMILE (415) 677-7522
TELEX 34-0154 MRSN FOERS SFO

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91

Rcv'd 8-14-95

DIRECT DIAL NUMBER
(415) 677-6926

August 11, 1995

VIA UPS

Note - This letter was received both independantly and as an enclosure to letter numbered 90

Joel Tanenbaum
Technical Manager
File 3605.AG
Accounting Standards Division, AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Comments to AICPA's Exposure Draft of Proposed Audit and Accounting Guide: Not-for-Profit Organizations

Dear Mr. Tanenbaum:

On behalf of the Marin Community Foundation, Larkspur, California, we submit the following comments to the above-referenced audit and accounting guide. AcSEC specifically requested comments addressing the following issues:

1. Whether a transfer of resources to a not-for-profit organization with a direction to distribute the income from the resources to another organization, subject to the not-for-profit's ability to modify the direction (the "variance power"), should be considered a contribution to the not-for-profit organization? Furthermore, does the not-for-profit's history of exercising its variance power affect the answer to the question?

2. Whether a transfer of resources to a not-for-profit organization the income from which is distributed to other organizations upon the non-binding advice of the transferor, and also subject to the not-for-profit organization's variance power, should be considered as a contribution to the not-for-profit organization? Does the not-for-profit organization's history of deviating from the

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transferor's advice affect the answer to the question?

3. If the above transfers are subject to the restriction that they be retained in perpetuity, may the transfer be accounted for as a contribution, and the distribution of income from the resources be accounted for as an agency transaction?

Summary of Comments

The purpose of community foundations is to encourage community members to establish charitable endowments[1] that are subject to the control of the community foundation's representative governing body. These endowments are usually too small to operate as free-standing private charitable foundations, but when pooled with a large number of other similar endowments, the costs of administration can be shared. Federal tax law and federal tax policy as expressed in the special community foundation tax regulations directly encourage the establishment of charitable endowments at community foundations. Federal tax policy especially favors community foundation charitable endowments because these charitable gifts would not otherwise be made given the costs associated with administering them in the form of separate private foundations. Federal tax policy also favors charitable gifts that are controlled by a representative governing body which assures that the charitable funds will be applied to meet the community's charitable needs.

From the perspective of community foundations, the audit and accounting guide poses the question of the appropriate accounting treatment for transfers made to donor designated and donor advised funds established as component parts of community foundations. The guide proposes factors to consider when judging whether in reality these transfers are mere agency transactions or are contributions to the community foundation. If the transfers are agency transactions, the community foundation follows the direction of the donors to deliver the transferred assets to one or more third-party charitable organizations designated by the

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1 The term "endowment" is used in this letter to refer to funds established by donors that are intended to be retained in perpetuity and to funds that are fully distributable.

donor. As agent, the community foundation would have little or no discretion concerning the use of the assets transferred.

In complete contrast to the agency hypothesis, the Treasury Department regulations governing all substantive aspects of transactions between donors and community foundations impose significant responsibilities on community foundations and require community foundations to possess significant powers that substantially exceed those of an agent. A community foundation is not a custodian of assets carrying out the directions of donors. Instead, the whole aim of the community foundation regulations is to confirm that ownership, control, and all authority over assets transferred to a community foundation rests solely in the hands of the community foundation's governing body.

The Treasury Department regulations permit community foundations to treat a charitable endowment fund as a component part of the community foundation only if the fund is not subject to a material restriction. A material restriction is one that prevents the community foundation from freely and effectively employing the transferred assets to serve the charitable needs of the community. After it is determined that a transfer is not burdened by a material restriction, the community foundation also must have the power to modify any other restriction that the foundation determines is unnecessary or is inconsistent with the community's charitable needs, i.e., the variance power. In addition, the regulations require the community foundation to direct or to monitor carefully the distributions made from its charitable endowment funds. This monitoring requirement assures that the community foundation will be aware of any necessity to exercise its variance power. Finally, the regulations require the community foundation to commit itself to exercise its variance power when it has grounds to do so. These interrelated requirements are designed to ensure that all transfers to a community foundation are subject to the complete dominion and control of the community foundation's governing body so that the assets are applied to meet the community's charitable needs.

Unless the drafters of the Treasury Department regulations have completely missed their intended purpose, there can be no question that contributions to donor designated and donor advised funds that conform to the prescriptions of the tax regulations should be accounted for as contributions to the community foundation. Any other

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accounting treatment would be fundamentally at odds with the true nature of such contributions as expressed so thoroughly and without ambiguity in the regulations. The Treasury Department rules therefore provide the substantive tests that determine whether assets transferred to a community foundation are "contributions" to the community foundation. Any rules that purport to establish a different set of tests will cause enormous difficulties for community foundations and confuse donors and their advisors. The inevitable effect of this confusion is that fewer charitable endowments will be established to the significant detriment of the communities and charitable beneficiaries served by community foundations. Therefore, because the Treasury Department regulations address the audit and accounting guide's substantive question of when a transfer is a contribution (at least in the community foundation context), AcSEC should adopt the Treasury Department tests to determine the appropriate accounting treatment of such transactions.

Community Foundations

The first two questions listed above describe activities undertaken by community foundations and we will limit our responses to those questions to those types of not-for-profit organizations. To respond fully, it is important to describe the nature and function of community foundations.

The function of community foundations is to encourage the establishment of endowment funds by individuals and organizations to support charitable activities in a particular geographic area. In furtherance of Congressional policy favoring charitable donations, the Treasury Department created a special set of substantive rules that govern the day-to-day activities of community foundations which countenance and promote the creation of these relatively small charitable endowments at community foundations. These substantive rules permit community foundations to pool these separate endowment funds as a single entity and to treat contributions to the funds as contributions to the community foundation.

Community foundations therefore serve a unique function in American philanthropy. They do not normally limit their charitable activities to a specific mission such as operating a school or providing shelter to the homeless. Instead, community foundations typically seek to engage in the broadest possible range of charitable endeavors.

Moreover, rather than provide specific programs or services, community foundations generally support other charitable organizations that carry out programs. For the community served, this broad range of endeavors is given special meaning because community foundations focus their efforts on the charitable needs of a definite geographical area or a single community.

The wide diversity of supported charitable efforts focused on a single community is a key reason for the success of the community foundation concept. Community foundations are institutions that belong to the communities they serve. They are typically administered by leaders of the community who represent the diversity of interests found in a single community. A community foundation will be involved in the support of so many charitable activities that its efforts will touch the lives of almost every community member. Because of its almost unlimited mission, the community foundation is uniquely suited to meet the ever-changing needs of a typical community by drawing on the desire of the community's members to improve the condition of the place they call home.

Community foundations do not compete for funds with operating charitable organizations by organizing mass fund-raising appeals. Instead, community foundations appeal to donors interested in establishing charitable endowments. These charitable endowments are typically too small to operate as independent entities. The administrative costs would render the endowment economically infeasible if it had to bear the costs alone. But, given the ability of community foundations to pool the resources of these small endowments, economies of scale are achieved permitting community foundation endowments to provide cost effective support of local charitable activities.

These small charitable endowments contributed to community foundations are explicitly encouraged by the federal tax law. The Treasury Department recognized that encouraging donors to establish charitable endowments controlled by a representative governing body provided communities charitable resources that otherwise would not be established unless the endowment could be pooled with others to share costs of administration. The Treasury Department promulgated a special set of substantive rules that allow community foundations to meet the public support test that applies to all publicly supported charities. To successfully carry out their mission and satisfy the rules,

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community foundations must encourage donors to establish charitable endowments that are controlled by the community foundation's governing body. These substantive Treasury Department regulations permit community foundations to pool these separate endowment funds as a single entity and to treat contributions to the funds as contributions to the community foundation. The rules also encourage charitable organizations to contribute part or all of their own endowment funds to community foundations to benefit from the experienced and professional management expertise found in the staffs of community foundations.

An additional key aspect of the success of the community foundation concept is the three unique devices available to donors to contribute funds to a community foundation. These three devices permit donors a level of personal involvement, commitment and recognition in the activities of the community foundation that donors find particularly rewarding. These special attributes of community foundations thereby encourage a level of charitable giving that might not otherwise occur. In addition, were it not for community foundations, this form of active, personal philanthropy would be reserved to the few members of the community with the resources needed to establish and administer a private foundation. A community foundation therefore enables charitably-minded community members of relatively modest means to focus their charitable efforts on problems that they may personally identify and be actively involved in resolving.

The three methods used to fulfill the personal philanthropy of donors to community foundations take the form of three basic types of funds; the donor designated fund, the donor advised fund, and the field of interest fund. The donor designated fund corresponds to the activity described in AcSEC's first question outlined above. In the instrument of transfer, the donor designates the charitable organizations that are to benefit from the fund. Donor advised funds correspond to the activity described in the second question. The instrument of transfer does not specify an organization to be benefitted, but instead permits the donor to offer non-binding advice to the community foundation on how best to apply the funds to meet the charitable needs of the community. Finally, a field of interest fund permits a donor to select a particular charitable class to be benefited by the fund, such as higher education, or the arts, and the community foundation uses the fund to support the specified charitable activity.

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If each of these funds were classified as separate legal entities for tax purposes, each individually would need to establish its exemption from taxation and its charitable organization status. Each fund would file a separate tax return and prepare individual financial reports. Each fund would be classified as a public charity or as a private foundation in isolation and such status would depend on the number and source of contributions to each fund. In all likelihood, each fund would be classified as a private foundation. Because most of these funds are relatively small, the added expense of private foundation status would negate the purpose of the gift; the administrative costs would consume most if not all of the income the fund would produce. Therefore, these endowments would not be established if public charity classification were not available to the fund as a component part of a community foundation.

The distinction between classification as a public charity and classification as a private foundation became especially significant to charitable organizations with the passage of the tax reform legislation of 1969 which provided the first definition of private foundations in the Internal Revenue Code. A private foundation essentially is a charitable organization that is funded from a single source (typically an individual, family, or business) that uses its investment income to make grants to other charitable organizations that carry out programs or provide services. Usually, a private foundation is governed by the donor and individuals selected by the donor. Because Congress perceived certain abuses related to the lack of public oversight and accountability of private foundations, the 1969 Tax Reform Act instituted a number of restrictions on private foundation activities. Consequently, private foundations are subject to a 2% excise tax on their annual net investment income under Section 4940(a) of the Internal Revenue Code (the "Code"); the excise tax on acts of self-dealing under Code Section 4941; the excise tax for failing to distribute a certain minimum amount of income under Code Section 4942; the excise tax on retaining excess business holdings under Code Section 4943; the excise tax on investments that jeopardize the foundation's ability to carry out its exempt purposes under Code Section 4944; the excise tax that applies to expenditures for lobbying activities and certain grants under Code Section 4945; and the tax imposed on termination of private foundation status under Code Section 507. In addition, all private foundations, regardless of size, must file annually a

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Form 990-PF reporting in detail its activities and expenditures.

Following passage of the 1969 legislation, the Treasury Department and the Internal Revenue Service spent considerable time discussing the public charity classification of community foundations whose assets are typically held in a large number of separate funds or trusts. The first set of proposed regulations addressing community foundations under the new legislation was issued in the Federal Register at 36 F.R. 19598 on October 8, 1971. After approximately five years of study, comment, and debate, final regulations addressing the public charity status of community foundations were issued in November, 1976 and amended in January, 1977. See Treasury Regulations Sections 1.170A-9(e)(10)-(14) and 1.507-2(a)(8).

The Treasury Department regulations are a detailed interrelated set of provisions that strike a delicate balance between the degree of donor involvement over the disposition of resources contributed to a community foundation and the ultimate control wielded by the community foundation over those same resources. The fundamental question addressed by the community foundation regulations is, at bottom, the same question (in the context of applying FASB principles to community foundations) addressed by AICPA in its proposed audit and accounting guide: When is a transfer to a community foundation to be considered a contribution to the community foundation? Because the Treasury Department regulations completely govern the operation of community foundations and directly address this question, they also should guide the resolution of the questions on which AcSEC seeks comments.

Moreover, since 1977, these detailed regulations have largely shaped the activities most community foundations undertake. The regulations permeate community foundation operations and activities by dictating the language of their governing documents, regulating the composition of their governing bodies, and controlling the type of gifts they can accept.

The Treasury Department regulations permit community foundations to treat all of the separate funds that have been established by community members over the years as component parts of the community foundation itself. If the community foundation and the funds that comprise the community foundation meet certain requirements,

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contributions to the various funds are deemed to be contributions to the community foundation. Given their mission to attract and hold a set of small endowments for the benefit of the community, this result is vital to the community foundation's ability to satisfy the public support test by which its public charity status is determined.

The public support test requires that a public charity receive its financial support from a large group of individuals, organizations, or government entities. Investment income is not treated as a contribution under the public support test. Because the purpose of a community foundation is to build and grow a set of small individual endowments, the larger the community foundation's existing endowment, the more income is produced; which in turn makes the public support more difficult to meet. A successful community foundation must continually attract new contributors who will establish new funds, so that each year a certain minimum portion (10% to 33%) of the community foundation's revenue is attributable to contributions from members of the public, or other publicly supported organizations.

A community foundation and its separate funds must meet the following requirements to be treated as a single, tax-exempt, publicly supported entity for tax purposes:

- It must be commonly known as a "community foundation," "community trust" or similar name conveying the concept of a capital or endowment fund serving a particular area or community.

- All of its funds must be subject to a common governing instrument, such as a common trust agreement.

- It must have a common governing body which directs or, in the case of a donor designated fund, monitors the distribution of funds for charitable purposes.

- Its governing body must have specified powers, including the power to modify any restriction on the distribution of fund assets pursuant to its "variance power," as discussed below.

- Its governing body must ensure that the assets of the community foundation are administered in

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accordance with its governing documents and governing law to produce a reasonable return of net income or appreciation with due regard to safety of principal.

- It must prepare periodic financial reports that treat all of its funds as component parts of a single organization.

- It must file a single informational tax return reporting the activities of the community foundation and its component parts in combination.

<u>See</u> Treasury Regulation Section 1.170A-9(e)(11)

For a fund to qualify as a component part and for assets contributed to that fund to qualify as "contributions" to the community foundation under the federal tax law, the fund and the contribution must meet the substantive requirements set out in the Treasury Department regulations. Foremost among the applicable requirements is the prohibition on contributions subject to a material restriction. Treasury Regulation Section 1.170A-9(e)(11)(ii)(B). The regulations provide that whether a particular restriction is "material" must be determined by all the facts and circumstances. Treasury Regulation Section 1.507-2(a)(8)(i). They also describe some of the more significant facts and circumstances to be considered in making such a determination.

A material restriction is one that prevents the community foundation from "freely and effectively employing the transferred assets, or the income derived therefrom, in furtherance of its exempt purposes." Treasury Regulation Section 1.507-2(a)(8)(i). The presence of a material restriction would mean (in the words of paragraph 53 of FASB Statement No. 116) that the community foundation "has little or no discretion concerning the use of the assets transferred." If a fund established by a donor was subject to a material restriction, the fund would not be treated as a component part of the community foundation. Therefore, community foundations typically will not accept donations that are subject to a material restriction.[2]

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2 The regulations also provide a specific set of rules that govern the operation of a fund that is not treated as a component part of a community foundation. <u>See</u> Treasury Regulation Section 1.170A-9(e)(14).

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The Treasury Department regulations emphasize the composition of a foundation's governing board as a significant circumstance in determining whether a restriction is material. The concern is whether the governing board is organized and operated independently from the donors to a community foundation. The following factors are considered:

- Whether and to what extent members of the governing board are selected by the donors.
- Whether and to what extent board members are selected by public officials.
- The period of time each member of the governing board may serve on the board. A community foundation is deemed to satisfy this factor if a member may not serve more than ten consecutive years, and after completing a term of service, a board member may not serve another term for the lesser of five years or the number of consecutive years the member has immediately completed.

See Treasury Regulation Section 1.507-2(a)(8)(ii).

The Treasury Regulations explicitly provide that the following factors are not considered to be material restrictions:

- The donor may name the component fund.
- The donor may designate the purpose to which the fund is to be used (a field of interest fund) or may designate one or more charities to be benefited by the fund (a donor designated fund). However, donor designated funds may be established to benefit only charitable organizations that are public charities described in Code Sections 509(a)(1), (2), or (3).
- The fund may be administered as an identifiable or separate fund which must satisfy all of the component fund requirements discussed above. The community foundation must be the legal and equitable owner of the fund. The community foundation's governing body must exercise ultimate and direct authority and control over the fund.

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- The fund may specify that some or all of the principal may not be distributed for a specified period.

- The donor may require retention of property contributed to the fund if retaining the property is important to the achievement of charitable purposes in the community due to special features of the property.

See Treasury Regulation Section 1.507-2(a)(8)(iii).

These rules permit the donor a level of involvement in the disposition of his or her charitable contribution to the community foundation. Donors may participate in the resolution of community needs identified by them and receive recognition for their efforts. This donor participation has been a key component of the success of the community foundation concept. The Treasury Department regulations carefully prescribe the level of permitted donor involvement so that the community foundation is not prevented from "freely and effectively employing" the contributed assets.

The Treasury Regulations provide that the following factors are prohibited material restrictions to the community foundation's use of the contributed funds:

- The donor reserves the right, directly or indirectly, to name the persons to which the community foundation makes distributions of the contributed funds or to direct the timing of the distributions. Designating the benefited public charities or limiting principal distributions in the instrument of transfer is specifically exempted from this rule. The rule is intended to prevent post-transfer control by the donor. The special rules applicable to donor advised funds are addressed below.

- The donor requires the community foundation to take or withhold action that would have resulted in assessment of private foundation excise taxes had they been applicable.

- The gift is encumbered with obligations that are inconsistent with the purposes or best interests of the community foundation.

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- The community foundation is required to retain any transferred investment asset.

- The transferred assets are subject to a right of first refusal when and if disposed of by the community foundation.

- The donor requires the community foundation to establish irrevocable relationships with banks, brokerage firms, investment counselors, or other advisors concerning the maintenance or management of the transferred assets.

- Any other condition that prevents the community foundation from exercising ultimate control over the transferred assets for purposes consistent with the community foundation's exempt purposes.

<u>See</u> Treasury Regulation Section 1.507-2(a)(8)(iv).

As is evident, the regulations set out a detailed substantive test distinguishing contributions that meet the requirements of federal tax law and federal tax policy. Specifically, the Treasury Department has designed the regulations to determine what is and what is not a true "contribution" to a community foundation. The rules carefully delineate the spheres over which the donor may exercise influence or control without materially interfering with the community foundation's ability to freely and effectively employ the transferred assets (or the income therefrom) in carrying out its exempt purposes. Transfers to donor designated funds that are not subject to a material restriction are contributions to the community foundation, and the funds transferred are thereafter assets of the foundation; income earned on these funds is income of the community foundation rather than income only to the ultimate recipient. Moreover, the tax regulations require community foundations to issue financial accounting reports that treat all assets of the community foundation, held either directly or in component parts, as assets of the community foundation.

Donor Designated Funds and the
<u>Variance Power -- AcSEC Question 1</u>

The variance power exercisable by community foundations over donor designated funds resolves any

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uncertainty that a transfer to a designated fund is a contribution to the community foundation. There are several aspects of the Treasury Department regulations that compel this conclusion. First, the variance power is extremely broad and is exercisable by the community foundation without the consent of the donor. Second, the community foundation must commit itself to exercise the power where it has grounds to do so. Third, the community foundation is required to monitor the distributions from donor designated funds. This required monitoring will apprise the community foundation of any need to exercise its variance power.

The key issue posed by the audit and accounting guide is whether a contribution to a donor designated fund leaves the community foundation with little or no discretion concerning the use of the assets received. The Treasury Department regulations directly resolve this issue by requiring that each community foundation have the power over each of its component funds to modify any restriction or condition that the foundation determines has become unnecessary, incapable of fulfillment, or inconsistent with the community's charitable needs.[3]

The regulation requires the community foundation to exercise the variance power in its sole judgment without interference or participation by any interested party. A community foundation exercises the variance power solely with an eye towards serving the charitable needs of the community. The community foundation therefore owns the assets of the component fund subject to a modifiable restriction. Together with legal and/or equitable title, the foundation has all the attributes of ownership one could suggest. The only restriction not subject to modification is that the assets may not be used to fulfill a purpose

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3 Treasury Regulation Section 1.170A-9(e)(11)(v)(B)(1) provides that "the governing body must have the power in the governing instrument, the instrument of transfer, the resolutions or by-laws of the governing body, a written agreement or otherwise . . . [t]o modify any restriction or condition on the disposition of funds for any charitable purpose or to specified organizations if in the sole judgment of the governing body (without the necessity of the approval of any participating trustee, custodian, or agent) such restriction or condition becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served."

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inconsistent with the charitable purposes of the community foundation. For example, the assets could not be used for private gain or to provide private benefits.

If the foundation were an agent, it would be required to carry out the directions of its principal. Yet, the tax law specifically prohibits interference with the foundation's exercise of the variance power. The community foundation may not consider the donor's interests. Only the community foundation's judgment of the charitable needs of the community is relevant. In contrast, as agent, a community foundation would have a duty to serve the purposes of its principal.

Not only must the community foundation possess the variance power, the regulations direct the community foundation to commit itself to exercise the power.[4] The community foundation jeopardizes its component fund status if it fails to exercise the power where it has grounds to do so. Loss of this tax status is a powerful incentive for the community foundation to consider vigilantly the necessity of exercising the variance power.

In addition, the regulations require community foundations to direct or monitor the distribution of its charitable funds. In the case of donor designated funds, the community foundation must monitor the distribution of the funds to confirm that they are being expended exclusively for charitable purposes.[5] The monitoring

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4 Treasury Regulation Section 1.170A-9(e)(11)(v)(E) provides that "[t]he governing body (shall by resolution or otherwise) commit itself to exercise the powers described in paragraph (e)(11)(v)(B) [the variance power and the power to replace trustees], (C) and (D) of this section in the best interests of the community trust. The governing body will be considered not to be so committed where it has grounds to exercise such a power and fails to exercise it by taking appropriate action. Such appropriate action may include, for example, consulting with the appropriate State authority prior to taking action to replace a participating trustee."

5 Treasury Regulation Section 1.170A-9(e)(11)(v)(A) provides that "[t]he organization must have a common governing body or distribution committee (herein referred to as the 'governing body') which either directs, or in the case of a fund designated for specified beneficiaries,
FOOTNOTE 5 CONTINUED ON NEXT PAGE

function is a key component of the rules that compels the conclusion that transfers to donor designated funds are contributions "to" the community foundation. Because the community foundation by its very nature is acutely aware of the charitable needs of the community, the monitoring activity will alert it to circumstances that call for the exercise of its variance power. Were that not sufficient, the community foundation risks losing its component fund status if it does not exercise the variance power where it has grounds to do so and fails to take appropriate action.

The interrelated aspects of the Treasury Department regulations that provide the community foundation with effective control over donor designated funds are therefore summarized as follows. The community foundation must regularly monitor the expenditures of designated funds to confirm that they have served exclusively charitable purposes. The community foundation must consider whether its monitoring has revealed any grounds for exercise of its variance power; whether any restriction of the donor designated fund has become unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served. If the foundation concludes that it has grounds for exercise of the variance power, it must do so, otherwise, it will have failed one of the requirements of the component fund Treasury Department regulations. Such failure jeopardizes the community foundation's continued enjoyment of its own status as a public charity. This severe sanction requires the community foundation to take very seriously its obligation to exercise its variance power when called for.

These Treasury Department requirements conclusively establish that contributions to donor designated funds are contributions to the community foundation. A pass-through transaction facilitated by an agent would not be subject to the independent monitoring review prescribed by the regulations. An agent would not be directed to exercise its independent and sole judgment to determine whether the expenditures made in accordance with the restriction have become unnecessary, or inconsistent with the charitable needs of the community. The agent, on completion of the

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FOOTNOTE 5 CONTINUED FROM PREVIOUS PAGE
monitors the distribution of all of the funds exclusively for charitable purposes (within the meaning of section 170(c)(1) or (2)(B))."

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monitoring process, would not have the power to completely alter the distribution of the charitable funds trusted to its care to fulfill other charitable purposes. An agent would not be charged with the responsibility inherent in the variance power to conduct investigations into the charitable needs of its community. Finally, an agent would not be subject to loss of its public charity tax status if it failed to exercise its variance power where it had grounds to do so.

Charitable organizations make expenditures to resolve charitable needs. They monitor the effectiveness of those expenditures. If they find that an expenditure is unnecessary or inconsistent with the charitable need sought to be addressed, they redirect their funds to more suitable uses. Community foundations have all of these responsibilities with respect to donor designated funds. Furthermore, they have specific direction in the tax regulations to take these responsibilities seriously on pain of losing their classification as a public charity. In sum, the whole purpose of the component fund regulations is to direct the operation of community foundations to ensure that all contributions to a community foundation are subject to its control. The regulations not only mandate the powers community foundations have over transferred assets, they also specifically limit the extent to which donors may influence a community foundation's use of the transferred assets. The regulations fully resolve any question that a community foundation has something less than full right and title to freely and effectively employ all assets transferred to it.

Exercise/Non-exercise of the Variance Power

The exercise or non-exercise of the variance power does not affect the conclusion that transfers to donor designated funds are gifts to the community foundation. There are many reasons a community foundation may not have exercised its variance power with frequency or ever. The community foundation as an initial matter may refuse to accept gifts subject to restrictions that the foundation determines are unnecessary, incapable of fulfillment, or inconsistent with the community's charitable needs. Second, the community foundation, as part of its monitoring function, also may provide various forms of assistance to organizations receiving distributions from a donor designated fund to improve the effectiveness of the benefited organization's use of the funds. If the

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assistance is successful, the community foundation would not reach the point where it would have cause to exercise of its variance power.

That the variance power may be exercised infrequently does not alter the legal and economic significance to the community foundation as possessor of the power. Donors are carefully advised of the control they relinquish when establishing a donor designated fund.

Donors learn that contributing assets to a fund established at a community foundation is very different from establishing a restricted trust for charitable purposes. Given the difficulty of successfully prosecuting a cy pres action, donors establishing a restricted charitable trust can be virtually certain that nothing will disturb the charitable expenditures they intend to make. On the other hand, contributions to a donor designated fund of a community foundation carry with them the understanding that the community foundation not only has the power but the duty to remove any restriction on the fund if it determines that failure to do so would be inconsistent with the charitable needs of the community.

The variance power applies no differently to donor designated funds established by charitable organizations that name themselves as the designated charitable beneficiary, i.e., contribute all or a portion of their own endowment to the community foundation. The community foundation still must monitor expenditures from the fund, determine whether its monitoring has revealed any necessity to exercise the variance power, and decide whether to exercise the variance power. Therefore, the impact of the variance power is a direct presence in all transactions the community foundation has with its contributors. Community foundations frequently lose prospective contributions because donors (both individuals and organizations) are not willing to cede their control over the charitable funds to the community foundation. Therefore, the real meaning of the variance power cannot be measured only by reference to the frequency of its exercise. The variance power is most strongly felt in a donor's understanding that any gift means control over the contribution rests in the hands of the community foundation.

Accounting for contributions made to donor designated funds or donor advised funds as agency transactions would be fundamentally at odds with the

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detailed Treasury Department regulations that govern all organizational aspects and operational activities of community foundations. The regulations are designed to require community foundations to use the resources contributed to it in the manner the community foundation independently determines is best for the community. A community foundation acts not as the donor's agent, but as the principal. Therefore the draft audit and accounting guide should adopt the substantive tests of the Treasury Department regulations which sensibly and fully resolve the fundamental issue on which AcSEC seeks comments: What attributes of a transfer from a donor to a donor designated fund of a community foundation signify that the donor has made a contribution to the community foundation. Adoption of a general set of substantive rules that conflict with the specific Treasury Department rules will cause unnecessary and unwelcome confusion and misunderstanding. This confusion will inevitably impact the ability of community foundations to attract new donor designated funds and ultimately harm the charitable beneficiaries which receive support from community foundations.

Donor Advised Funds -- AcSEC Question 2

Donor advised funds are quite different from donor designated funds. Designated funds specify the organizations to be benefited by the fund. Following the transfer, the donor has no authority to select other charitable beneficiaries of the fund and the donors' involvement in the fund terminates upon making the gift. With donor advised funds, donors do not initially suggest the charitable organizations to be benefited. The gift instrument typically provides a mechanism for donors to suggest beneficiaries of the fund from time to time. However, the gift instrument clearly specifies that the ultimate decision to make distributions from the fund rests with the community foundation. The Treasury Department regulations provide specific limitations on the permissible degree of donor participation in distributions from donor advised funds. In practice, the staff of the community foundation often will work with the donor to develop the list of charitable organizations to recommend to the governing body of the community foundation.

The Treasury Department regulations provide several factors that are used to judge whether a right to give advice on the distribution of assets held in a donor advised fund constitutes an indirect right to control those

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distributions. If the donor has retained an indirect right to control distributions from a donor advised fund, the fund will be not treated as a component part of the community foundation. According to the regulations, the following factors indicate that the donor <u>has not retained</u> an indirect right to control distributions:

- The community foundation conducts an independent investigation to confirm that the donor's advice is consistent with the charitable needs of the community most deserving of support.
- The community foundation has prepared guidelines enumerating the specific charitable needs of the community consistent with its charitable purposes and the donor's advice is consistent with the guidelines.
- The community foundation has an educational program directed to donors and others regarding the guidelines described above.
- The community foundation distributes funds in excess of those distributed from the donor advised fund to the same or similar type of charitable organizations or to accomplish a similar charitable purpose.
- The community foundation's solicitations for contributions state that it will not be bound by the donor's advice.

<u>See</u> Treasury Regulation Section 1.507-2(a)(8)(iv)(A)(2).

The following factors indicate that the donor has <u>retained</u> an indirect right to control distributions from a donor advised fund:

- The community foundation's solicitations or pattern of conduct state or imply that the donor's advice will be followed.
- The donor's advice is limited to amounts from the donor advised fund and the first two factors listed above are not present.

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- No procedure is provided for considering advice from other persons other than the donor with respect to the donor advised fund.

- For the community foundation's taxable year and all prior years, the community foundation follows the advice of donors substantially all of the time.

See Treasury Regulation Section 1.507-2(a)(8)(iv)(A)(3).

Contributions to donor advised funds that comply with the limitations of the regulations are clearly contributions to the community foundation. The instrument of transfer for a donor advised fund generally does not impose any restriction limiting the charitable organizations that may be benefited by the fund, although the transfer document may state an obligation to "consider" the advice of the donor regarding recipient organizations. Under the regulations, the transfer document must specify that the community foundation must be free to ignore advice given by donors. Moreover, the community foundation has a duty to ignore donor advice that would cause the foundation to make unnecessary expenditures or expenditures inconsistent with the charitable needs of the community. Therefore, the obligation to consider donor recommendations imposes no impediment on the community foundation's ability to freely make distributions from donor advised funds. The donor's advice may influence its decision, but legal and actual control of the contributed assets and related income rests with the community foundation.

The frequency with which the foundation deviates from a donor's recommendations is a factor the tax regulations consider in determining whether a donor advised fund qualifies as a component part. However, community foundations do not operate in isolation from contributors to donor advised funds. Successful community foundations collaborate with their many donors to meet the community's charitable needs. Because donors work with the staff of the community foundation in developing the list of potential charitable recipients, donors often learn of community needs through the community foundation and there is only a small chance in a well-managed community foundation that the donor would make a recommendation the community foundation would reject. Therefore, the frequency with which a community foundation rejects donors' advice must be considered in tandem with the many other factors identified in the regulations which determine whether a transfer to a donor

advised fund is in fact a contribution to the community foundation.

These Treasury Department regulations fully resolve the substantive issues regarding contributions to donor advised funds sought to be addressed in the draft audit and accounting guide. The regulations provide a detailed and reasonable set of factors specifically designed to determine whether a transfer to a donor advised fund is a contribution to a community foundation. The adoption of a set of rules that adopt conflicting standards is unnecessary and would confuse donors. This confusion would cause significant problems for community foundations in fulfilling their mission of encouraging donors to make charitable gifts in the form of donor advised funds. Because there is no apparent need to adopt a set of substantive rules that conflict with the sensible Treasury Department rules, AcSEC would be well served by adopting those substantive standards.

Separate Accounting Treatment for Donor Designated/Advised Fund Contributions and the Income from the Fund-- AcSEC Question 3

Both the contribution to a donor designated fund or a donor advised fund and the income from such funds are subject to the community foundation's broad variance power. In addition, the distributed income is what the community foundation monitors. The monitoring leads to the evaluation of whether the variance power should be exercised. A donor could not contribute endowment funds with the limitation that the community foundation could not use its variance power with respect to the income of the endowment. The two are part and parcel of a single contribution. Therefore, the income from donor established funds should not be separately accounted for an an agency transaction if the initial transfer is treated as a contribution.

Conclusion

Community foundations provide a valuable service. They possess an expansive awareness of the charitable needs of a community and provide a mechanism for charitably-inclined individuals and organizations to satisfy those needs. The ability to establish donor designated advised, and field of interest funds allows donors a measure of personal involvement and recognition in the charitable work of the community foundation. Community foundations are

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governed according to a complex set of Treasury Department regulations which carefully limit the degree of donor involvement and influence over contributions made to community foundations. The regulations expressly require the community foundation to possess and exercise powers over the assets contributed to it. The regulations require that contributions are to be freely and effectively employed by the community foundation to meet the charitable needs of a community as the community foundation's governing body ultimately determines them, in its sole judgment.

These powers mean that a donor designated fund may be put to uses not anticipated by the donor if the community foundation finds it appropriate to do so. These powers also confirm that the community foundation may ignore a donor's advice regarding distributions from a donor advised fund if the community foundation finds it appropriate to do so.

Therefore, AcSEC need only look to the Treasury Department regulations for the applicable substantive tests regarding the distinction between agency transactions and contributions that the audit and accounting guide proposes to formulate. With respect to the activities of community foundations, it is difficult to imagine a more comprehensive set of rules designed to ensure that contributions to community foundations are subject to its governing body's discretion and control. The adoption of general rules departing from the Treasury Department regulations that purport to establish a set of substantive tests to govern when a transfer to a community foundation is to be accounted for as a contribution can only cause confusion and misunderstanding. Confusion only will discourage donors from establishing funds at community foundations. This will not only cause significant problems for community foundations but will harm organizations and charitable beneficiaries that look to community foundations for support. A contradictory set of substantive accounting rules testing when a transfer is a contribution also would conflict with federal government policy that encourages charitable giving, which policy finds full expression in the detailed rules that apply to charitable contributions made to community foundations. AcSEC should therefore adopt the reasonable and comprehensive substantive tests developed by the Treasury Department. Any separate set of tests can only serve to hinder the federal policy of encouraging the creation of charitable endowments at community foundations and disrupt the ability of community foundations to fulfill their eleemosynary mission.

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Thank you for your consideration of these comments. Please feel free to contact me at the address or telephone number first listed above if you have questions regarding this letter or desire any additional comments.

Very truly yours,

Patrick McCabe

cc: Barbara B. Lawson
Vice President Administration & Finance
Marin Community Foundation

P135

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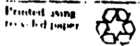
WEATHER: Low clouds and fog tonight and tomorrow, otherwise fair. Lows, 50s. Highs, 60s to 80s. Details, A2. Home delivery 1-800-660-0760 35 cents

Printed using recycled paper 

Marin Independent Journal

August 9, 1995 WEDNESDAY • Marin County, California

MMWD foundation would aid habitat

Donations to benefit watershed lands

■ **MARIN:** Land facts/A5

By John R. Moses

Independent Journal reporter

Marin's newest nonprofit foundation would preserve native plants and animals on the Mount Tamalpais watershed — if the Marin Municipal Water District forms it.

The district's Watershed Committee has been kicking the idea around for months, and lets the water board in on the plan tonight.

Director Jack Gibson of Sleepy Hollow said the idea has never been considered by the whole board, and added he wants to get advice from colleagues before proceeding.

"The watershed is clearly an extremely valuable asset for the district," said Gibson, head of the Watershed Committee. "Many view it as a local treasure."

There are 21,250 acres of watershed providing runoff to district reservoirs.

The foundation is one of several ways the district is studying to find more money for watershed maintenance and habitat restoration.

The Watershed Committee hopes people will feel like donating money, perhaps even naming the foundation in wills, if they know the money will be used solely to preserve the watershed.

The water district would control the watershed land if the foundation incorporates. The foundation would be separate from the district and managed independently by a board of directors.

See MMWD, page A5

Board to meet

The Marin Municipal Water District Board will discuss the nonprofit foundation at its meeting tonight at 7:30 in the district board room, 220 Nellen Ave., Corte Madera.

Facts about parks, open space

Marin land and water

Total land in Marin County: 332,928 acres
Total water area: 55,424 acres
Total land and water acreage: 388,352 acres

Public Use Land: 148,599 acres

■ Federal parks (Point Reyes National Seashore, Marin Headlands): 89,684 acres.
■ State parks (including Mount Tamalpais, China Camp): 13,861
■ Marin County parks (including McNear's Beach): 860 acres
■ Marin Municipal Water District Watershed: 21,250 acres
■ North Marin Water District land: 910 acres
■ Marin Municipal Water District and North Marin Water District (non-watershed) land: 571 acres
■ County Open Space District: 10,440 acres
■ Local parks: 1,023 acres
■ Tidelands, marshlands, mudflats: 10,000 acres

Non-public-use land

■ Active and non-active military sites: 1,100 acres

Taxable land subject to land contract restrictions

■ Agricultural preserve contracts: 93,395 acres
■ Private open space contracts: 4,765 acres
Total: 98,160

All other land in Marin

■ Total: 85,069 acres

MMWD

From page A1

Ideas for the makeup of that board aren't concrete, but Gibson said he expects the water district would have representation on it.

The water district put out feelers to the Marin Community Foundation about administering a watershed fund.

That idea was dashed when the foundation sent a proposal that district staff said took away too much control over the money's use.

One proposal the board will discuss tonight is seating representatives from local environmental groups on the foundation board.

The head of one group named in a water district staff report says no one has mentioned her group might get a seat on the foundation board. News of the proposed foundation was a surprise to Karin Urquhart, executive director of the Marin Conservation League. Urquhart said she was unfamiliar with the proposal.

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August 11. 1995

AUG 14 1995

Mr. Joel Tanenbaum, Technical Mg.
File 3605.AG, Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tanenbaum:

The Assateague Cosatal Trust wishes to comment on the Institute"s Exposure Draft dated April 4, 1995, "Proposed Audit and Accounting Guide for Not-for-Profit Organizations." This document addresses many of our concerns regarding certain provisions of Financial Accounting Standards Board Statements No. 116 and 117; and, we believe, with certain modifications the Guide should be issued.

At the same time, we wish to bring to your attention our concerns relative to two specific issues in the Exposure Draft: (1) the recording of donor-designated funds received by federated fund-raising organizations, and (2) the functional presentation of "fund-raising" and certain other expenses incurred by federated fund-raising organizations as "program" vs. "supporting" services. This would imply that all expenses incurred by the fund-raiser are "expenses"; whereas the bulk of these expenses are currently classified as program expenses (which is reasonable, given the fact that the purpose is to distribute these funds to designated member-recipients such our organization).

Although we agree that fund-raising "expenses" are incurred as part certain in-house programs, we do not believe this should extend to the specific costs of raising funds for the member organizations. Therefore, we urge that the language presently contained within paragraph 13.41 be modified accordingly.

Sincerely.

Thomas J. Patton, Treasurer
Assateague Coastal Trust
105 W. Chesapeake Ave., #413
Baltimore, MD 21204-4739

THE *Saint Paul*
FOUNDATION

Board of Directors
Thomas W. McKeown *Chair*
Ann Huntrods *Vice Chair*
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Paul A. Verret

August 11, 1995

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AUG 14 1995

Mr. Joel Tanenbaum
Technical Manager, File 3605.AG
Accounting Standards Divisions AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

RE: Response to Exposure Draft of Proposed AICPA Audit and Accounting Guide

Dear Mr. Tanenbaum:

The Saint Paul Foundation (the Foundation) appreciates the opportunity to comment on the exposure draft of proposed AICPA Audit and Accounting Guide for Not-for-Profit Organizations, because the guide will significantly affect the Foundation's financial statements.

The Saint Paul Foundation is a community foundation located in St. Paul, Minnesota which administers over 400 separate funds having a total market value of approximately $300,000,000. The purpose of the Foundation is to seek, accept and administer gifts of all kinds to help meet the charitable needs of all mankind and preferably the citizens of the City of St. Paul and its vicinity. The Foundation accomplishes its purpose by making grants to other charitable organizations, by initiating and participating in community programs, and by providing related services to other charitable organizations for the benefit of the community. The governing documents of the Foundation include a variance power which authorizes the Foundation's Board of Directors to modify any conditions on the distribution of assets, if the Board of Directors, in its sole judgment, determines that the condition is unnecessary, incapable of fulfillment, inconsistent with the investment policies adopted by the Foundation from time to time, or inconsistent with the charitable needs of those served by the Foundation.

Jp8.7

600 Norwest Center • Saint Paul, Minnesota 55101-1797 • (612) 224-5463 • FAX (612) 224-8123

Question 1: Does the variance power provide not-for-profit organizations with sufficient discretion to recognize resources received as contributions? Does the not-for-profit organization's history of exercising its variance power affect the answer to the question?

Comments: The variance power authorizes all community foundations to modify donor-imposed restrictions and conditions on the distribution of funds. The variance power, which is included or incorporated by reference in all gift agreements, vests the community foundation with full control and discretion over all distributions. The existence of the variance power is one of the reasons why community foundations have sufficient discretion to recognize resources received as contributions to the community foundation. As a result of the variance power and other factors, the principal and income of designated funds established at a community foundation for the benefit of other charitable organizations are properly reported as assets of the community foundation pursuant to FASB Concepts Statement No. 6.

The variance power is a unique feature of community foundations, which allows community foundations to control the use of fund assets and to modify donor-imposed restrictions to meet the changing needs of the community. As a result of the variance power, the governing body of the community foundation continually reviews the needs of the community and the ability of designated charitable organizations to meet those needs. As the needs of the community change or unusual circumstances occur (such as floods, earthquakes or the discovery of new and deadly diseases), the governing body of the community foundation will consider exercising its variance power to redirect assets to benefit the community. In addition, the governing body of the community foundation will also consider exercising its variance power if a particular need of the community no longer exists or is being adequately addressed by other sources, such as government programs. Similarly, if a designated charity ceases to operate a program which was the primary basis for the donor's designation of that charity, the governing body of the community foundation may exercise its variance power to redirect the distributions from the fund.

To effectively exercise the variance power, the community foundation continually evaluates the needs of the community and performs periodic reviews of each designated charity that receives grants from the community foundation. During these reviews, the community foundation attempts to determine whether the charity is effectively meeting the current needs of the community.

The community foundation has full discretion to exercise the variance power in the best interests of the community. The designated charity cannot compel distributions from a community foundation nor can it control the exercise of the variance power. Since the designated charity does not control the economic benefits of the designated fund nor control the access of others to the fund, neither the principal nor the income of a designated fund constitute assets of the designated charity under FASB Concepts Statement No. 6.

From a legal point of view, the transfer of assets to a designated fund of a community foundation is an unconditional transfer of assets to the community foundation. After the transfer occurs, the community foundation has legal title, full authority and discretion over use of the funds. The existence of the variance power is the critical factor in determining that the community foundation has full discretion over designated funds. The community foundation's history of exercising the power is not determinative or relevant.

The presence of a variance power is one of several reasons why donors create a designated fund to be administered by a community foundation rather than making a contribution directly to the designated charitable organization. Donors establish designated funds at community foundations, because donors want the community foundation to control distributions from the fund and to exercise the variance power, if appropriate. Since the community foundation has full ownership, control and discretion over designated funds, the principal and income of the designated fund should be reported as assets of the community foundation.

<u>Question 2:</u> **Do donor-advised provisions, in combination with variance power, provide not-for-profit organizations with sufficient discretion to recognize resources received as contributions? Does the not-for-profit organization's history of deviating from the resource providers' advice affect the answer to this question?**

<u>Comments:</u> Community foundations have full control and discretion to determine the amount, timing and recipients of all distributions from donor advised funds. Although a community foundation may give the donors the privilege to make recommendations concerning such distributions, the donors' recommendations are purely advisory and are not binding on the community foundation. The community foundation is obligated to review all such recommendations and to determine whether the proposed distributions are appropriate in light of the needs of the community and the foundation's mission. Under these circumstances, the donor-advised provisions, in

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combination with the variance power as discussed above, provide the community foundation with sufficient discretion to recognize resources as contributions received by the community foundation. The community foundation's history of deviating from the donors' recommendations does not affect the answer to this question.

The principal and income of donor-advised funds are assets of the community foundation under FASB Concept Statement No. 6, because the community foundation obtains an economic benefit from the administration of such funds and the community foundation controls all distributions from the funds. Establishment of donor-advised funds furthers the charitable purposes of a community foundation by involving donors in charitable programs for the benefit of the community and providing additional resources to meet those charitable needs.

Comments Related to Chapter 4 - Cash and Cash Equivalents

Paragraph 4.03 and 4.04 - Please distinguish between cash received with donor-stipulations restricting its use to long term purposes and cash received subject to donor restrictions not requiring a separate cash line item. A definition of long term purposes would be helpful. Would cash received subject to donor-imposed stipulations restricting its use to a particular program that will be expended within one year require a separate cash line? Would the amount of restricted cash be disclosed in the notes?

Comments Related to Chapter 5 - Contributions Received And Agency Transactions

Paragraph 5.03 - A definition of the phrase "acting other than as owner" is needed?

Paragraph 5.08 - The more typical scenario is for the fiscal agent to make disbursements to or on behalf of the new entity in accordance with budgetary guidelines. A fiscal agent usually doesn't hold funds until an entity receives its tax exempt status.

Paragraph 5.21 and 5.22 - Transfers of assets from government is a very significant activity and more guidance and examples would be helpful?

Paragraph 5.22 - Is an unexpended government grant which is reflected as an exchange transaction recorded as deferred revenue or unrestricted net assets? It appears to us there isn't a proper matching of revenue and expense.

Paragraph 5.26 - Please clarify what distinguishes this example as a condition rather than a restricted gift for a program? Is the issue that the program is proposed and not an existing program?

Paragraph 5.27 - The use of the phrase "such as certain contributions made by governments" in the last sentence is unclear how this is an example of qualifying costs.

Paragraph 5.35 - Please clarify if this paragraph is creating a hierarchy that restricted contributions are used first before unrestricted assets are used as expenses are incurred?

Paragraph 5.26 - 5.37 - Many foundations will make grants restricted to a particular purpose with a condition that unexpended monies be returned to the foundation. Considering SFAS 116 Paragraph 80 and Chapter 5 please provide further guidance when a refundable advance is recorded and when it is not? Paragraph 10.05 may seek to address this question but needs further clarification.

Comments Related to Chapter 6 - Split Interest Agreements

Paragraph 6.11 Treatment Of The Subsequent Accrual Of The Interest Element In Split Interest Trusts

In reviewing the treatment of the subsequent accrual of the interest element in split interest trusts (Chapter 6, paragraph 6.11), there appears to be inconsistent treatment of the subsequent accruals of the interest element in the case of a promise to give (SFAS No. 116 paragraph 20) and the treatment related to charitable lead trusts, charitable remainder trusts and pooled income funds.

The accounting literature for the subsequent accrual of the interest element is as follows:

> Paragraph 20 of SFAS 116 states, "the present value of estimated future cash flows using a discount rate commensurate with the risks involved in an appropriate measure of fair value of unconditional promises to give cash. Subsequent accruals of the interest element shall be accounted for as contribution income by donees."
>
> Paragraph 6.21 of AICPA Proposed Audit and Accounting Guide states, "Accretion of the discount and revaluations of expected future cash flows based on revisions in investment returns and in the donor's life expectancy should be recognized as adjustments to the receivable and as changes in the value of split-interest agreements in the statement of activities in the temporarily restricted net asset class."

The following examples illustrate this inconsistency by comparing the case of a charitable lead annuity trust where the NPO is not trustee (AICPA Paragraph 6.21) and the case where the NPO receives a comparable irrevocable promise to give. In

our opinion, the NPO's economic benefit is the same under both cases, however, based on the current accounting literature, the accounting treatment of both cases is quite different due to the form of the gift.

Promise to Give Example. Donor A makes an irrevocable, unconditional promise to give of $1 million payable to NPO X. The promise to give is payable $100,000 per year for ten years.

- At the time of the promise to give, contribution revenue is recognized equal to the present value of estimated cash flows.
- In subsequent years the accruals of the interest element shall be accounted for as contribution income.
- The Cumulative Statement of Activity for ten years would reflect the following:

Contribution Revenue	$1,000,000
Changes in Value	0
Total Received by NPO X	$1,000,000

Charitable Lead Annuity Trust Example. Donor B establishes a Charitable Lead Annuity Trust which will pay an annuity to NPO X of $100,000 per year for ten years. NPO X is not trustee.

- At the time that the charitable lead trust is created, contribution revenue is recognized equal to the present value of estimated cash flows.
- In subsequent years, the accretion of discount and changes in actuarial assumptions are recorded as "Changes in Value of Split Interest Agreements."
- The Cumulative Statement of Activity for ten years would reflect the following:

Contribution Revenue	Initial Amount
Changes in Value	Subsequent Amount
Total Received by NPO X	$1,000,000

The above examples illustrate that at the time of the gift, NPO X would record the same contribution amount regardless of the form of gift, promise to gift or lead trust. However, in subsequent years, the accounting treatment diverges based on the form

of the gift. Under both examples, economically NPO X is in the same position, however, the amount recognized as contribution revenue is quite different.

It appears the intent of paragraph 20 of SFAS 116 is to recognize contribution revenue equal to the total amount received from the donor. While under the proposed AICPA Audit and Accounting Guide, split-interest gifts would recognize contribution revenue equal to the present value at the time of the gift which is not equal to the total amount received by the NPO. The accounting for split-interest gifts appears consistent with the exposure draft related to SFAS No. 116. But SFAS No. 116 was changed to recognize subsequent accruals of the interest element as contribution revenue rather than as interest income.

In addition, it appears the proposed audit guide applies the same accounting approach employed for charitable gift annuities to charitable trusts. We believe receipt of a beneficial interest in a charitable trust is a very different transaction than a charitable gift annuity. Accordingly, the accounting treatment should be different.

It is our recommendation that the change in the value of split interest trusts, excluding charitable gift annuities, be recorded as contribution revenue to be consistent with paragraph 20 of FASB 116.

Paragraph 6.02, 6.05, etc. - Use of the Term Fiscal Agent

We recommend the deletion of the term "fiscal agent" as used in this context because it is not clearly defined, it is confusing and does not meet a technical, legal definition.

In the case of charitable lead trusts, charitable remainder trusts, and pooled income funds, the trust agreement generally provides for a trustee, income beneficiaries and remainder beneficiaries. Rarely does it provide for a fiscal agent. A trustee may hire various service providers to provide all or part of the services necessary to administer a trust such as investment managers, tax return preparers, etc. The trustee remains responsible for the administration of the trust and supervises these third-party service providers.

In the case of a charitable gift annuity as described in Paragraph 6.30 a fiscal agent does not exist. The transaction involves the donor, the NPO and an annuitant. The NPO may self administer or contract with other organizations to provide all or part of the services necessary to administer the gift annuities.

Paragraph 6.09 AND 6.10 Trustee Vs Not Trustee Accounting Approach

The AICPA Proposed Audit and Accounting Guide requires different accounting treatment for a charitable trust depending on whether the NPO is trustee. We recommend that in either case, regardless of whether the NPO serves as trustee or not, that the accounting for the non-trustee approach be adopted. Under this approach, the NPO's future interest is recorded as a receivable. Additional disclosures if warranted could be disclosed in the notes to the financial statements. This approach is recommended for the following reasons:

1. As stated in Paragraph 6.25 of the AICPA Proposed Audit and Accounting Guide, obligations to the beneficiaries are limited to the assets of the trust. If the trust goes bankrupt, the NPO does not have an obligation or liability. Only in the case of a charitable gift annuity does an NPO have an obligation.

2. Recording the assets and liabilities of the trust on the books of the NPO, result in an apparent overstatement of the assets and liabilities of the NPO.

3. Using the proposed methods of accounting, depending on whether the NPO is trustee or not, could be confusing to the users of the financial statements. If the user of the financial statements wants to know the value of the contribution receivable for split-interest gifts, the user must:

    A. Calculate the difference between assets held in trust and their corresponding liability (for those funds held in trust where the NPO is trustee) and

    B. Add the results to contribution receivable from trusts (for those funds under a non-trustee agreement).

4. Regardless of whether the NPO is trustee or not, the sole interest of the NPO is the same, which is the future income stream from the contribution element of the split interest gift. However, the accounting treatment for both cases related to the statement of position is quite different.

Paragraph 6.07 - 6.13 - Present Value Methodology and Factors

As you are aware there are more than one mortality table and different organizations can use different investment return and discount assumptions. We suggest that further guidance and illustrations on the present value methodology and the disclosures in the footnotes be provided.

Paragraph 6.11 Cost/Benefit Analysis of Proposed Split Interest Accounting

Has a cost/benefit analysis of these proposed accounting rules been performed? These additional requirements will increase the cost of administration of these gifts and reduce the net benefit to the NPO. In addition some gifts, which are currently accepted, will be refused due to these requirements.

Other Comments

1. Paragraph 6.17 states, "A charitable lead trust is an arrangement in which a donor establishes and funds a trust with specific distributions to be made to a designated not-for-profit organization **over a specified period.**" (Emphasis added). Paragraph 6.20, 6.21, 6A.40, 6A.41 speak of discounting over the donor's life rather than the specified period. We don't believe the donor's life is a factor.

2. Paragraph 6.02. This paragraph is very general and confusing. For example the last sentence of the first paragraph is not technically true with respect to a gift annuity. In most states the NPO can legally spend the entire amount gifted in the first year. An alternative approach is to provide a brief overview of the three general cases:

   - Charitable Gift Annuities.
   - Remainder Interests.
   - Lead Interests.

3. Paragraph 6.15. Recognizing that many NPO's will have all the various kinds of split interest agreements, some of which they are trustee and some of which they are not trustee, it would be useful to prepare illustrative disclosures as done in chapter five.

4. Paragraph 6.22 - 6.24. Perpetual Trusts Held by a Third Party

   A review of the Colleges and University Audit Guide, pages 10 and 11, includes the following comments related to perpetual trusts:

"Only if the institution has legally enforceable rights or claims, including those as to income, such funds may be reported as assets, properly described, in the financial statements."

"If the funds were established under revocable trusts, or if the trustees have discretion as to the amounts to be distributed to the beneficiaries, the discretionary amounts of income are tantamounts to gifts and should be so reported with disclosure of the amounts."

We recommend that the proposed accounting for perpetual trusts reflect these distinctions and only allow an institution to record assets when the institution has a legally enforceable right and the trustee does not have any discretion as to the amounts and timing of distributions from the trust.

5. Paragraph 6.25. Charitable Remainder Trust

The audit guide cites annuity trusts and unitrusts, but there is a third frequently used type of a charitable remainder trust, a net income unitrust. The net income unitrust operates somewhat similarly to a pooled income fund with the beneficiary receiving income only. Please clarify the proper accounting treatment. Would the net income unitrust accounting be similar to a pooled income fund or a charitable remainder trust?

Comments Related to Chapter 8 - Investments

Paragraph 8.22 requires a not-for-profit organization to disclose the organization's investment objectives, and policies, etc. It should be noted that many not-for-profit organizations have multiple investment strategies such as assets held for the following purposes:

1. Operating Reserve.
2. Replacement of fixed assets, buildings and capital items.
3. Endowment.
4. Charitable Trusts for which the organization is Trustee. For example, a Net Income Charitable Remainder Unitrust that has a high payout rate such as 8%.
5. Charitable gift annuity pool which may be invested subject to state insurance regulations. For example, the State of New York limits investment in equities to 10% of the reserve amount.

Many not-for-profits would have different investment strategies (investment objectives, asset allocation strategies, permitted asset classes, etc.) for each of these purposes. In

reality, for many not-for-profits total investments is just a compilation of multiple investment strategies.

It would not be accurate to disclose a single (or primary) investment objective and the aggregate carrying value of investments by major type under paragraph 8.24. The asset allocation of investments disclosed would not be consistent with the stated investment objective. The not-for-profit would need to disclose multiple investment objectives and groupings of investments by major type. We question how useful this would be to the reader.

We recommend that paragraph 8.22 not require disclosure of the organizations investment objectives but permit organizations to disclose this voluntarily.

Paragraph 8.24 - Many not-for-profit organizations have investments in mutual funds, common trust funds, and other commingled vehicles. We request additional guidance regarding the following questions:

1. Are fixed income mutual funds classified as equities or fixed income?

2. Some mutual funds have different types of securities, such as:

   a. Balanced mutual funds which include equities and fixed income.
   b. Global balanced mutual funds which include foreign and U.S. equities, corporate bonds and government bonds.
   c. Fixed income funds which may have corporate, U.S. Government and foreign bonds.

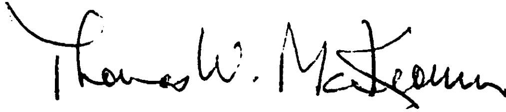
   How should these investments be classified for major type purposes?

Paragraph 8.23 - We don't understand the relevance of an aging of debt securities if they are recorded at fair value? We recommend this disclosure be dropped. If retained, how would fixed income portions of mutual funds be aged? Would they be treated like mortgage backed securities?

If you have any questions, or if you would like for us to provide additional information, please feel free to contact us.

Thank you for your consideration.

Sincerely,



Thomas W. McKeown
Chair

Paul A. Verret
President

TWM/PAV:aes

Indiana University Foundation

Bloomington

August 10,1995 (94)

AUG 14 1995

Mr. Joel Tanenbaum, Technical Manager
File 3605.AG
American Institute of Certified Public Accountants
Accounting Standards Division
1211 Avenue of the Americas
New York, NY 10036-8775

Mr. Tanenbaum:

We, at Indiana University Foundation (IUF), would like to specifically address the issue of Agency or Intermediary transactions as stated in *The Proposed Audit and Accounting Guide, Not-For-Profit-Organizations*, Chapter 5, pars. 5.05 through 5.13, (*Statement of Financial Accounting Standards No. 116, Accounting for Contributions Received and Made*, (SFAS 116) pars. 53 and 54).

Our concerns are as follows:

The Audit Guide or SFAS 116 does not distinguish between Captive, Federated, and Independent fundraisers (see Attachment 1). It merely refers to "intermediaries." There is only a reference made to community foundation fund-raising organizations when referring to "variance power" and a brief description of federated fundraising organizations (and similar organizations) in paragraph 5.09.

1. Has FASB considered the differences between the different fundraising organizations and the difference in the kinds of independence and control they exercise?

2. Variance power as stated in the Audit Guide, "Exhibit - Specific Issues for Comment", relates very specifically to community foundations. Have you considered variance power as it exists in any other not-for-profit fund-raising organizations? The IUF has "variance power" whereby our organization receives donations for the benefit of Indiana University through instruments which give the IUF the power to withhold disbursement or modify the original intended purpose of a gift to the extent necessary to enable those funds to be used. Any such alternative use determined shall be for a purpose which most

Showalter House, Post Office Box 500, Bloomington, Indiana 47402 · 812 855-8311 · FAX: 812 855-6956
Conference Center 241, 850 West Michigan Street, Indianapolis, Indiana 46223 · 317 274-3711 · FAX: 317 274-8818
625 North Michigan Avenue, Suite 500, Chicago, Illinois 60611 · 312 751-5407 · FAX: 312 751-2731

closely coincides with the donor's primary original intent. Not only does IUF have this power but it has been exercised in the past.

3. Has FASB considered how independence and control have an effect on variance power and its use and vice versa?

4. IUF is the fund-raiser for Indiana University (IU). The IUF is not a public but a private institution with tax exempt status under 501(c)(3) of the Internal Revenue Code. The State of Indiana prohibits certain types of expenditures from public institutions. This includes the payment of certain types of foreign travel, lobbying, etc. IU has certain discretionary accounts held at the IUF which it uses for these types of expenditures. If the IUF is considered an intermediary and deposits are considered revenue to IU, then IU would not legally be able to incur the types of expenditures referred to above. Have these types of legal prohibitions been considered by FASB?

5. The audit guide provides for college and universities but not their related foundations. There are numerous institutionally related foundation' where the institution is governed by GASB and the related foundation is a 501(c)(3). The guide should specifically address these types of entities. Collectively, these foundations manage a large percentage of college and university endowments.

Comments - Issue 1: Variance Power and Donor-Advised Provisions

We believe that the determination of whether a receipt is a contribution or an agency transaction depends on the independence and control of each not-for-profit organization. Specifically the not-for-profit should:

(a) be in all material respects organizationally, administratively, and operationally independent of all entities for which they are raising funds, and to which funds are distributed;

(b) not be controlled by persons (including close relatives and entities under their control) or entities which are major donors to the reporting organization, or to the organizations supported by the reporting organization; and

(c) present themselves to the public that they have as their principal purpose the solicitation of funds for distribution to one or more unaffiliated (independent) not-for-profit organizations.

In addition, through its origination (community foundations) or its independence and control, not-for-profit organizations may explicitly or implicitly establish variance power. The extent of variance power of each not-for-profit organization needs to be closely reviewed to determine the effects on reporting of resources received. Those organizations with little or no independence and/or control will probably not be empowered or have the responsibility to use variance power; therefore, resources received would more than likely be recorded as agency transactions. On the other hand, those organizations which are independent and have control or have certain aspects of independence and control, may or may not have the legal and/or operational authority or responsibility to exercise variance power.

The variance power that is exercised as opposed to what is available should not affect the determination of whether receipts are reported as contributions or agency transactions. If the power exists, either implicitly or explicitly, then it can be exercised.

There is an additional dimension to this subject found mostly with those foundations which distinguish between the corpus and the income earned on donor-restricted endowments. A donor may give the corpus of an endowment fund to the foundation with stipulations:

- that the corpus must remain intact as permanent endowment, and

- that the income earned by the fund be used in perpetuity for a specific purpose.

As for the corpus the foundation acts as the sole trustee; as to the income, the foundation is in much the same position as a United Way and other organizations who ultimately provide the funds received (income in this case) to the intended recipient. Normally the organizations which hold endowments and distribute its income in accordance with donor designation perform such functions as a service to donors and to the not-for-profit designee and/or community in their area.

- If the not-for-profit, through variance power, has power to redirect both the corpus and income from that fund, then the entire amount should be recorded as revenue.

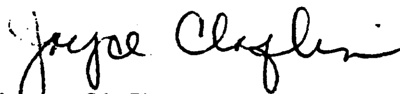
- If the variance power exists related only to the income to be disbursed, then only the income should be recorded as revenue, whereas the original donation would be recorded as an agency transaction.

Donor-advised provisions are not legally binding and allow the not-for-profit the discretion to change the donor's designation of the gift. This coupled with variance power, provides the not-for-profit organization with sufficient discretion to redirect the donor's restrictions, thus, enabling the not-for-profit organization to recognize resources received as revenues.

We feel the audit guide should address all matters which we have listed as concerns above, specifically variance power.

We appreciate the opportunity to respond to this audit guide exposure draft and are available to answer any questions or comments that you may have.

Sincerely,



Joyce Claflin
Senior Vice President
Finance and Administration

Gina M. Reel
Director Financial Reporting

Attachment

Attachment 1

We believe the audit guide should define the various types of intermediaries. Intermediary organizations come in three basic types:

1. Captive Fund-Raising Organizations

Organizations which exist solely for the purpose of raising and/or holding money for one or a small group of related organizations (sometimes referred to as the "parent" organization). Such groups are often named "The Friends of the [Museum]," "The [Hospital] Foundation," "The [Opera] Guild," "The [College] Alumni Association," "The [College/University] Foundation," or similar terms;

2. Federated Fund-Raising Organizations

Organizations which raise and/or hold money for many different organizations, usually in a particular geographic area. In many cases the federated fundraiser publishes a list or organizations for which it is soliciting funds. The organizations for which money is raised are always legally and operationally independent of the fundraiser. Despite the publishing of a list of supported organizations, gifts to federated organizations are presumed to be unrestricted unless the donor explicitly imposes a specific restriction as to use; They are in turn three types of federated fund-raisers. They are as follows:

(a). United Ways and similar community-based independent federated fund-raising organizations (including organizations which raise money for groups of organizations of a similar type - e.g. community arts funds, combined health appeals, Black United Funds, United Jewish Appeal, etc.);

(b). Combined Federal Campaigns (operate within the federal government in a manner similar to United Ways, and are often administered by the local United Way);

(c). Community foundations, as defined by the Internal Revenue Service (Reg.1.170A-9(e)(11)).

Attachment 1 (Continued)

3. Independent Fund-Raising Organizations

These are community-based organizations, which exist to raise money for other organizations, but are independent of any supported organizations. They typically announce that one or a few named not-for-profit organizations will be beneficiaries of amounts raised, but they retain discretion to change the named beneficiaries in the future. These organizations act somewhat like grant-making foundations. Many clubs, so-called "Service" organizations, Junior Leagues, and Thrift Shops perform this kind of fundraising, as part or all of their activities.

The Oregon Community Foundation

621 S.W. Morrison St., Suite 725 Portland, Oregon 97205
(503) 227-6846 Fax (503) 274-7771

(95) AUG 14 1995

A Tradition of Community Caring

August 14, 1995

Mr. Joel Tanenbaum
Technical Manager
File 3605.AG
Accounting Standard Division
AICPA
1211 Avenue of Americas
New York, New York 10036-8775

Subject: AICPA Exposure Draft "Not-for-Profit Organizations"

Dear Mr. Tanenbaum:

We are writing to support the position taken by the FASB Task Force for Community Foundations with respect to the proposed Audit and Accounting Guide for implementation of FASB Statement No. 116, paragraphs 53 and 54. We are aware that you have received a detailed response from the Task Force and want you to know that we participated in its development and support it completely.

Further, we have discussed your questions with respect to variance power with our legal counsel and have carefully reviewed our fund agreements with donors, our correspondence with donors, and our annual evaluations of all organizations that receive grants from our various charitable funds (including advised funds, designated funds, and non-profit endowments).

It is clear to us from a legal and a practical standpoint that The Oregon Community Foundation owns and is in charge of its funds. We do not serve merely as an "agent or intermediary" for other non-profit entities. First, we make clear to all donors and their legal and financial agents that the Foundation's board of directors is vested with and will use variance power in appropriate circumstances. We share specific instances when this has occurred. Second, the Foundation requires all grantees, regardless of fund source, to submit an annual evaluation reporting on use of funds and relevance of services for the community. Future distributions are dependent upon continued relevance of the services for the community and effectiveness of the organization.

Given the manner in which we educate our donors, structure our legal agreements, communicate with our grantees, require board approval for all grant

PRESIDENT
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Donna P. Woolley

distributions from all funds, and require annual reporting by all grantees on the use of funds, we do not believe it is appropriate or accurate for AICPA to suggest or direct auditors to treat funds held by community foundations as simply agents for other organizations. We know that most community foundations in America operate in a very similar manner as we do.

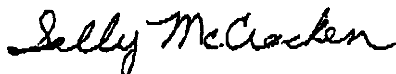
With respect to AsSEC's specific questions, we have one answer:

-variance power provides no discretion to a non-profit to allow it to treat funds held by the community foundation as a contribution until it is actually received. The fact that variance power exists is sufficient to reach this conclusion. We are prepared to exercise variance power when justified. We collect information annually to determine if exercising this power is needed. Our position applies to all of our funds, discretionary, advised, designated, and endowments.

We have no doubt from a legal standpoint that ownership and control of assets held by The Oregon Community Foundation rests with the foundation. Our policies, procedures, and practice make this clear, as do Treasury Department regulations and the Internal Revenue Service Code.

Thank you for your interest in receiving comments from the field. We feel the field is very well represented by our FASB Task Force. Hopefully, our comments have helped you to clarify how community foundations operate. We would be happy to provide you with specific documentation of our agreements and procedures.

Sincerely,



Sally McCracken
Chair, Board of Director

Gregory A. Chaillé
President

United Way
of America

701 North Fairfax Street
Alexandria, Virginia 22314-2045
Phone: (703) 836-7100

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AUG 15 1995

August 14, 1995

Mr. Joel Tannenbaum, Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tannenbaum:

On behalf of the Financial Issues Committee (FIC) of the 1400 member United Way organizations, as well as on behalf of United Way of America (UWA), which is the national membership organization for United Way organizations, we hereby submit our comments on the AICPA exposure draft of "Proposed Audit and Accounting Guide - Not-for-Profit Organizations" (the Audit Guide) dated April 14, 1995.

The FIC is a group of nineteen Chief Financial Officers of local United Way organizations from all areas of the United States. The views expressed in this letter are those of the FIC and UWA. When the letter uses words such as "we", "us" or "our", the reader should assume that these pronouns refer collectively to the FIC and UWA. Our comments are meant to supplement any comments you may receive separately from any local United Way.

We present our comments in order of importance with the most important being presented first. In our comments, we refer to the paragraph number of the Audit Guide with the symbol (¶).

Federated Fund-Raising Organizations

<u>Display of agency transactions on statements of activities (¶ 5.10)</u>

Previous UWA correspondence to the AICPA Not-for-Profit Organizations Committee (the Committee) expressed our strong views and rationale for preserving as true "revenue" contributions raised by local United Way organizations but designated by donors for other charitable organizations. We argued that the full amount raised, whether designated or undesignated, was important for donors and the public to know, and was part of communicating a complete picture of the "organization as a whole" (SFAS 117, ¶18).

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However, the decision has been made that designated donations are "agency transactions". We continue to have concerns with this decision; however, given the decision, we are pleased to see the inclusion of Method 3 in ¶5.10 as one means of communicating to the public the full campaign results for United Way organizations. In showing the full campaign results, Method 3 better illustrates the total impact on the community of the United Way Campaign than either Method 1 or 2, and therefore more accurately presents the activities of United Way organizations than either Method 1 or 2. Method 3 also allows for a more accurate understanding of fund-raising and administrative expenses in relation to the total amount raised.

It is our view that most federated fund-raising organizations will elect to use Method 3. We, therefore, suggest that Method 3 be shown first in the Audit Guide (i.e., Method 3 should become Method 1).

Caption for the amounts retained from designated contributions (¶ 5.10)

All three methods in ¶5.10 use the term "Administrative fees for raising amounts on behalf of others" to describe the amount withheld from designated contributions. As ¶5.10 is an illustration, we presume that this language is illustrative only - not prescriptive. We believe that in the case of United Way organizations, other language in the caption might be more descriptive. Further, the language used in the illustration might give the reader the impression that the United Way has charged additional fees other than its normal withholding to cover fund-raising and processing costs. We, therefore, request that the illustration make it clear that not-for-profit organizations should use language which is most reflective of the particular organization's situation, and that the language used in the illustration is not mandatory.

Numbers used in the illustrations (¶5.10)

We found that using the same amounts ($5,000) in the illustration for both contributions and amounts raised on behalf of others makes the illustration somewhat difficult to follow. We suggest using different amounts; for example $5,000 for contributions and $3,000 for amounts raised on behalf of others. The federated fund-raiser could be shown to pay out $2,700 of the $3,000 amount and withhold $300.

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Use of the word "remitted" in Method 2 (¶5.10)

We believe that the word "remitted" used in Method 2 implies that the Statement of Activities is on a cash basis. We request that this caption be reworded as: "Less: Net amounts raised on behalf of others".

Other terminology in the illustration (¶5.10)

All three methods use the terminology "Total public support and revenue" to describe the final revenue amount. This implies that public support is not revenue. We suggest that the word "other" be placed before the word "revenue" so that the caption reads "Total public support and other revenue".

Discussion of uncollectibles (¶5.09)

The second to last sentence in ¶5.09 reads "Amounts retained by federated fund-raisers as fees (such as administrative fees for obtaining assets or for estimated uncollectible accounts) should be classified as revenue other than from contributions."

We believe that the reference to "... estimated uncollectible accounts..." is misleading. Estimated uncollectible contributions, whether they are designated or undesignated, should be recorded as contra revenue (the debit) and a reserve against contributions receivable (the credit). The estimated uncollectible amount is not recorded as revenue. We, therefore, request that the reference to "estimated uncollectible accounts" be deleted from ¶5.09.

The consideration of uncollectibles leads to another point which, while not covered by ¶5.09, is relevant to the presentation of estimated uncollectible undesignated pledges.

SFAS 116 and 117 are unclear concerning whether estimates of uncollectible undesignated pledges should be shown as a contra amount to contributions or as an expense. We strongly suggest that either method of presentation be allowed.

Our logic for presenting estimated uncollectible undesignated pledges as a contra amount to contributions is that a United Way largely has no control over such uncollectibles. As United Way campaigns take place largely in the work place, when an employee terminates, it becomes very difficult to follow the individual to request that he/she continue payments on his/her pledge. We believe that presenting estimated uncollectibles as contra to contributions more accurately describes this situation than presenting estimated uncollectibles as an expense.

Donor-Imposed Restrictions

Payments dues in future periods (¶5.30)

We believe that ¶15 of SFAS 116 and the last example in ¶5.30 of the Audit Guide are intended to address multiple year contributions. The pledges obtained in annual United Way campaigns are generally not multiple year contributions. Generally, donors make the pledges for a one year period. However, because of timing considerations unique to each different United Way, the normal cash receipts cycle of pledges may extend for up to eighteen months after pledges are made, and the collection of pledges may straddle fiscal years of a United Way. We believe that the eighteen month period might well fall, from the donor's perspective, within the span of "the current period" as referred to in SFAS 116.

Functional Classifications of Expenses

Fund-raising activities (¶13.32)

This paragraph states that "Fund-raising activities involve inducing potential donors to contribute ... time." A donor who donates time is a volunteer.

We maintain that the functional classification of expenses associated with the solicitation of volunteers should depend upon the purpose of the volunteer solicited. For example, if a paid United Way professional staff employee solicits volunteers who will, in turn, solicit contributions to the United Way, then the appropriate portion of the staff employee's salary and related costs should be recorded as fund-raising expense. However, if the paid United Way staff employee solicits volunteers to work in a United Way program, then the appropriate portion of the employee's salary and related costs should be allocated to program expense.

We believe that our proposed treatment of expenses associated with soliciting volunteers is especially important to United Way funded agencies. For example, imagine a United Way funded agency whose purpose is to provide tutors to elementary school children. Under ¶13.32 as written, that agency's expenditures in soliciting volunteers to tutor would be classified as fund-raising expenses. This would distort the agency's Statement of Activities in that the statement would appear to show more fund-raising expenses, when in fact, the agency is just attempting to find volunteers to conduct its programs. The distortion could be significant if solicitation of volunteers is the main duty of the agency's staff.

For this agency, a more accurate characterization of the expenses associated with soliciting volunteers is program expenses because the purpose of the paid staff is to solicit volunteers, and the volunteers are being solicited to carry out the agency's program.

Promises to Give

Legal enforceability of promises to give (¶5.38)

The intent of this paragraph is unclear, and we request it to be reworded.

The paragraph states that a not-for-profit organization can record an unconditional promise to give even if "... the promise is not legally enforceable."

Our first reaction to this paragraph is that a United Way organization would probably never record an unconditional promise which was not legally enforceable. However, we have subsequently interpreted the paragraph to mean that a formal test of a promise's legal enforceability is not required before recording the promise. That is, if a not-for-profit organization believes that an unconditional promise to give is legally enforceable, it may record it without obtaining a legal opinion of the promise's legal enforceability.

If it is, in fact, the AICPA's intent in ¶5.38 to not require a legal opinion before recording an unconditional promise to give as contribution revenue, we request that the paragraph be rewritten to more clearly communicate this.

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Valuation of bequests (¶5.41)

This paragraph states that a not-for-profit organization should record a bequest as contribution revenue when a will is declared valid.

United Way organizations are increasingly becoming the remainderman beneficiaries of wills and trusts. In these situations, even when the timing of the gift is known, the value of the gift is not always known because the estate or trust has not been fully distributed. United Way organizations would typically not record contribution revenue in these situations until the remainder of the estate or trust is actually received. We, therefore, request that ¶5.41 be slightly revised to state that a bequest not be recorded until both the timing and the value of the bequest are known with reasonable certainty.

Statement of Financial Position

Footnote 3 to ¶3.03 and ¶3.06

We understand that net assets are presented as unrestricted, temporarily restricted or permanently restricted, though it is not necessary, nor does the AICPA encourage, to classify specific assets by class. However, we believe that footnote 3 to ¶3.03, as well as the wording of ¶3.06 can lead a person to believe that a donor can place a restriction on net assets. A donor does, in fact, restrict the use of a specific asset when he contributes it which, in turn, leads to a restriction in net assets. We think that the Audit Guide should make it clear that a donor can restrict only the use of his/her contributed asset, not the net assets of the organization.

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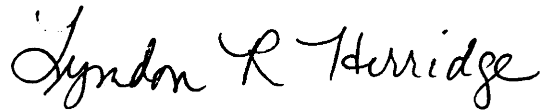
Thank you very much for your consideration of our comments. If you have any questions about any of our comments, please feel free to telephone either Kate L. Moore at (703)683-7805 or Jeff Galginaitis at (703)683-7838.

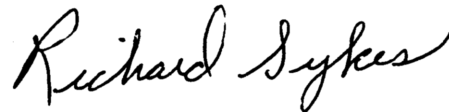
Sincerely,

Kate L. Moore
Chief Financial Officer
United Way of America

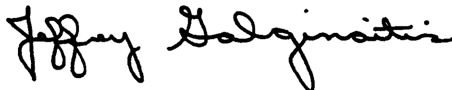


Lyndon R. Herridge
Chair, Financial Issues Committee

Dale DePoy
Chair
FIC Subcommittee on SFAS 116 & 117



Richard Sykes
Vice-Chair
FIC Subcommittee on SFAS 116 & 117



Jeffrey Galginaitis
Controller, United Way of America
Facilitator, Financial Issues Committee

THE UNIVERSITY OF CHICAGO
OFFICE OF THE COMPTROLLER
1225 EAST 60TH STREET
CHICAGO, ILLINOIS 60637

August 14, 1995

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AUG 15 1995

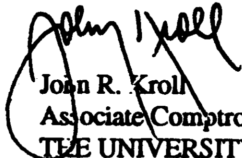
Mr. Joel Tanenbaum
Technical Manager
File 3605, AG
Accounting Standards Division, AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tanenbaum:

Thank you for the opportunity to respond to the AICPA's invitation to comment on their Exposure Draft "Proposed Audit and Accounting Guide, Not-for-Profit Organizations." My comments consist of the attached copy of an E-Mail sent to the National Association of College and University Business Officers (NACUBO) for consideration in their response to the Draft Audit Guide. These comments are my personal views on the Draft Audit Guide and do not represent the views of the University of Chicago.

Please call me at 312/702-1941 if you have any questions or would like to discuss.

Sincerely,



John R. Kroll
Associate Comptroller
THE UNIVERSITY OF CHICAGO

Attachment
K993kw

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Kroll, John

From: Kroll, John
To: Blythe,Joe-Denver
Cc: Blythe,Joe-NACUBO
Subject: FW: NFP Proposed Audit Guide
Date: Friday, August 11, 1995 4:52PM
Priority: High

Thanks for the opportunity to throw in my two cents regarding the NACUBO response to the AICPA " Proposed Audit and Accounting Guide.....Not -For -Profit Organizations". Following are my comments organized by paragraph #......

* PREFACE page xvi.....I think it's to late in the process to make the effective date the 1995-96 fiscal year. A more reasonable date might be 6/30/97, the same date the proposed SFAS for Investments becomes effective.

* 3.03.....I disagree that a separate line item is needed to display the amount of $$$ that have been accumulated through gifts awaiting expenditure on capital projects. If this amount is material, explain what needs to be explained in a footnote.

* 3.24.....SOP 94-3 provides guidance on "Reporting of Related Entities by Not-for -Profit Organizations" and becomes effective for most NFP's in fiscal 1995-96..... FASB's "Preliminary Views on major issues related to Consolidation Policy" gives a bit different guidance to NFP's on reporting of related entities......and now the draft audit guide gives yet one more example how an NFP might determine if an affiliated entity is related for reporting purposes. A reconciliation between the ultimate FASB position and the AICPA statement of position will most likely be made after FASB makes up its mind, therefore, why does the AICPA at this time feel they need to add further clarification to a document they issued less than a year ago which will most likely change or be modified in the not to distant future. I say leave well enough alone and get rid of 3.24

* 5.07 and 3.17.....I can testify first hand that the inclusion of anything to do with the old "Agency Fund" balance sheet type information has driven our Trustees (the primary users of our financial statements) NUTS. They don't understand it and care even less about it. To require the cash inflow and out flows from agency transactions be included in the statement of cash flow will further confuse them and add nothing to their oversight of our institution. I vote this NEW requirement be removed from the Audit Guide.

* 5.20 and 5.21.....Paragraph 56. of SFAS # 116 states "The Board believes that whether a grant is from a government agency, private foundation, or corporation, the difficulties in determining whether a transfer is an exchange transaction or a contribution are substantially the same" The Board acknowledges that to apply the provisions of their Statement "requires a careful assessment of the characteristics of the transfers...." Paragraph 5.21 of the draft audit guide pretty much follows the same line of thinking for the classification of government transfers, however, paragraph 5.20 does not follow this line of thinking for $'s received from foundations and other types of business organizations. As a matter of fact, the AICPA draft audit guide goes to far by prejudging that "a research grant made by a foundation to a university would likely be a contribution if the research program is to planned and carried out by the university and the university had the right to publish the results." In fact. the situation described in their example is the case in most federal awards. I think 5.20 should be written in the same cautious tone that appears in SFAS # 116 and in paragraph 5.21, and like paragraph 5.21, the reader should be referred to the evaluation Table 5.2.

* 5.31.....It took me a while, but I am comfortable that a donor can change the character of unrestricted net assets and this fact should be handled via " a reclassification of unrestricted net assets to restricted net assets." With this type of possible transaction in mind, I think the wording in 11.06, 11.08, 11.09, 11.10, and 16.05 need to modified to encompass this type of financial activity.

* 5.35.....The example in this paragraph does a great job in clarifying the confusing sentence in paragraph 17 of SFAS # 116.

* 5.39.....I feel the general tone of this paragraph is at odds with the general direction of Paragraph 15 of SFAS # 116 which states "...receipts of unconditional promises to give cash in future years generally increase temporarily restricted net assets." At a minimum the phrase I referred to from SFAS # 116 should be included in 5.39

* 5.41.....This paragraph includes the words "Solicitations for donations that include wording such as "information to be used for budget purposes only" or that explicitly allow resource providers the ability to rescind their indications that they will give are intentions to give rather than promised to give and should not be reported as contributions." Based on a presentation I gave this past fall to about 200 development officers on SFAS # 116 and the implications this standard might have on their relationship with business officers, I can assure you that there is plenty of creative juices flowing looking for ways to NOT record promised to give (pledges).....I don't think NFP's need any encouragement or ideas from the AICPA in this regard. I suggest this sentence be left out.

* 5.56.....Why did the AICPA chose to be more prescriptive with the reporting of contributions??? Doesn't seem this line item is any more or less important than say endowment income or tuition.

* 5.62.....I would replace the words "though the auditor may nevertheless decide to request confirmation of contributions receivable." with the words...."and would not necessarily have to be confirmed unless the auditor is not satisfied with other audit procedures discussed in the Audit Considerations on pages 52 through 56." I just don't want the auditors to feel they need to confirm unless they really have to.

* 6.15.....Why do we have to display the assets and liabilities separately for split-interest agreements ??? These are relatively small $$'s for higher ed., so why make this more prescriptive than SFAS # 117.

* 6.25 to 6.29 and 6.34 to 6.37.....By their very nature, charitable remainder trusts and pooled life income funds are fundamentally designed to "periodically pay the income earned on the assets to designated beneficiaries." I can understand the logic and need to discount the estimated time period between the receipt of the gift and the estimated death of the donor and subsequently recognize the discount as income as described in 6.36 and 6.37. What I don't understand is why we have to go through all the trouble for the charitable remainder trust funds as described in 6.25 to 6.29. What a pain it will be to set up a liability for the estimated payments to the beneficiaries and then adjust this liability each year, especially for the unitrusts where there are so many moving parts. In my opinion, the pain we will have to go through is not worth the theoretical accuracy !!!! Since unitrusts are basically set up to have the income be equal to the amount paid out to the beneficiaries, why not just let us book a discounted value of the gift and credit deferred revenue much the same way it has been outlined for the pooled income funds. It sure would make things a lot easier and would produce a result that would be very close to the method outlined in 6.27 to 6.29. ABSENT A CHANGE IN THE AUDIT GUIDE DIRECTION, I KNOW WE WILL ARGUE FOR THIS SHORT CUT WITH OUR EXTERNAL AUDITORS AND PASS ON ANY DIFFERENCE BETWEEN THE SHORT CUT VERSION AND THE AUDIT GUIDE DICTATE.

* Appendix on Pages 68, 69,70, 71, 72, and 73.....example journal entries are GREAT. They would be even better if they were put in a story problem format with real #'s.

* 8.02.....This is a GREAT move by the AICPA to allow NFP's the ability to put all their investments on market value. !!!! I do have one suggestion.....create an appendix that lists out all the provisions from the old audit guides that will carry forward to this audit guide.

* 8.16.....Refer this paragraph to the FASB exposure draft dealing with this similar to the way it was done in paragraph 8.02.

* 8.22 to 8.25.....Is the AICPA sure they haven't missed any disclosure ???? I feel they have gone a bit overboard with this and have definitely taken it beyond what for-profits have to do. I think the disclosure requirements should be no more onerous than they are for other entities.

* 9.04.....Great clarification.

* Chapter 11.....Paragraph 5.31 opens up the possibility to make unrestricted $$'s something other that unrestricted. This chapter should be looked at again with this in mind and expanded.

* 12.05....Thirty Eight simple bold face words have set off a flurry of discussion and debate within the higher education industry and has prompted NACUBO to come up with a slew of specific situations and examples that may or may not meet the criteria of a discount. More clarification and specific guidance is needed here before this paragraph goes live. Without this, I think there will be mass confusion. I suggest the AICPA look to NACUBO and the survey they have taken for help in constructing guidance.

* 13.07.....The word "induce" conjures up all kinds of negative images. I suggest the word "elicit" be used.

* 13.28.....The words in this paragraph do not match the words in paragraph 26. of SFAS # 117. Specifically SFAS # 117 uses the words "such as".......not "should be". The words in SFAS # 117 should be used.

* 13.34.....I don't necessarily disagree that certain expenses need to be allocated for purposes of SFAS # 117, but what a pain this will be !!!! If allocation were just done for SFAS # 117 it wouldn't be so bad.....add to this the different cuts and allocations we have to make for A-21, HEGIS reports, the old AICPA format for certain rating agencies, the Form 990, etc. and it becomes a real problem that is both time consuming and costly. I question whether the added information is worth the cost.

Joe, these are my comments on the AICPA exposure draft. Please call me at 312-702-1941 (work) or 708-986-8154 (home) if you wish to discuss or need further clarification. Again, THANKYOU for the opportunity to add my comments.

JOHN KROLL

P.O. BOX 969, WHEATON, ILLINOIS 60189-0969 • (708) 653-5300

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AUG 15 1995

August 14, 1995

Joel Tanenbaum
Technical Manager
File 3606.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

RE: Comments on the April 14, 1995, *Exposure Draft of Proposed Audit and Audit Guide--Not-for-Profit Organizations*

Dear Mr. Tanenbaum:

Thank you for the opportunity to comment on the Not-for-Profit Organizations Committee's *Exposure Draft of Proposed Audit and Audit Guide--Not-for-Profit Organizations* (ED).

Measurement Principles for Contributions:

Paragraph 5.51
I agree that unconditional promises to give cash that are expected to be collected more than one year after the financial statement date should be measured at the present value of estimated future cash flows. However, I believe that revenue should be recognized if the fair value of the contributed asset <u>increases</u>, as well as if its value decreases, between the date the unconditional promise to give is recognized and the date the asset is received. The "lower-of-cost-or-market" method proposed in paragraph 5.51 is not even-handed. The Financial Accounting Standard Board's March 31, 1995, Exposure Draft, *Accounting for Certain Investments Held by Not-for-Profit Organizations* (FASB NFP Investments ED) eliminates lower-of-cost-or-market and establishes fair value as the required measure of the value of most investments. I believe fair value (estimated present value of future cash flows) should also be used to measure unconditional promises to give.

Paragraph 5.52
Use of the term "bad debt expense" to describe uncollectible unconditional promises to give implies that this decrease in net assets should be recorded in the expenses section of the statement of activities. I believe that the amount of unconditional promises to give which is expected to be uncollectible should be recorded as an offset to contribution revenue in the revenue section of the statement of activities, because (1) bad debt expense is not appropriately includable in any functional expense category and (2) recording bad debt expense in the expense section would inappropriately "gross-up" the revenue and expense

sections of the statement of activity.

Paragraph 5.54
I applaud the use of a risk-free rate of return to measure the present value of future cash flows from unconditional promises to give because I believe that decrements for uncollectibility are appropriately accounted for by the allowance described in paragraph 5.52. However, I believe that the discount rate should be revised as market rates change. A fixed discount rate results in the asset being reported at amortized cost; a revised discount rate market adjusts the asset to fair value. Because the FASB NFP Investments ED prescribes fair value as the appropriate measure for most investments, I believe fair value is also an appropriate measure for unconditional promises to give. In practice, many organizations will find that the small amount or short discount period of unconditional promises to give will allow them to use a discount rate determined at the time the unconditional promise to give is recognized without obtaining a value that is materially different from the value computed by adjusting the discount rate to a market rate.

Chapter 6 SPLIT-INTEREST AGREEMENTS

I believe that the liabilities and net assets associated with split-interest agreements should be periodically revalued in a manner consistent with the FASB Investments ED. Paragraph 47 of that exposure draft reads in part: "The Board explored relationships of investment assets and related liabilities of not-for-profit organizations, including relationships identified by its task force members. In some of the identified relationships, the liability is measured and periodically remeasured at the present value of estimated future cash flows using a discount rate commensurate with risks involved. For example, the obligation to the beneficiaries of an annuity agreement is measured at the present value of the payments to be made, and the obligation to employees covered by a funded postretirement benefit plan is measured at the actuarial present value of the expected benefits attributed to periods of employee service...." (emphasis mine)

Paragraph 6.07
If paragraph 5.54 were changed to require that discount rates be revised for market changes at each financial statement date, the cross-reference by paragraph 6.07 to paragraph 5.54 would provide for the periodic remeasurement described in FASB NFP Investments ED paragraph 47 quoted above. The result of using revised discount rates, changes in life expectancy of the beneficiaries and change in fair value of assets (to the extent recognized) would result in the split-interest agreement's assets, liabilities and net assets being adjusted at each financial statement date to the amounts that would have been computed if the agreement had been initiated on the financial statement date, except to the extent that certain assets are not required to be adjusted to fair value.

Paragraph 6.11
One of the transactions to be recognized during the term of the agreement is "(a) accretion of the discounted amount of the contribution". If split-interest agreements are permitted or required to be revalued to fair value at each financial statement date, it would become

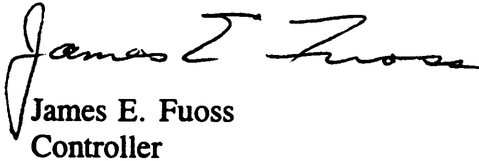
unnecessary to isolate and separately record the "cost-basis" transaction described in the previous sentence.

Paragraphs 6.20, 6.21, 6.24, 6.28, 6.29, 6.33 and 6.37, and Appendix - journal entries
In each of these paragraphs and in the corresponding journal entries, I believe the references to "accretion of discount" could be eliminated, and "the effect of changes in discount rates" could be added or could be (expressly or implicitly) included in the expression "changes in actuarial assumptions".

* * * * * *

I appreciate the opportunity to comment on these matters and would be pleased to discuss them further.

Sincerely,



James E. Fuoss
Controller

Dollinger Smith & Co.
Certified Public Accountants

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AUG 15 1995

August 9, 1995

Mr. Joel Tanenbaum
Technical Manager
File 3605.AG
Accounting Standards Division
American Institute Of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Tanenbaum:

We submit the following comments on the Exposure Draft, Proposed Audit And Accounting Guide, Not-For-Profit Organizations.

Issue No. 1

In SFAS 117, a not-for-profit organizations is defined as follows:

> An entity that possesses the following characteristics that distinguish it from a business enterprise: (a) contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return, (b) operating purposes other than to provide goods or services at a profit, and (c) absence of ownership interests like those of business enterprises.

Regarding (a) above, we would request that the audit guide provide further guidance on what constitutes significant amounts of resources. For instance, would an organization that has 10% or 20% of its revenues as contributions be a significant amount of resources? We would request that some threshold be given in the guide. In another instance, many 501(c)(3) organizations provide services for clientele such as the developmentally disabled. Many of these organizations receive contracts from local, state and/or federal governments for the funding of these services. If these governmental contracts are deemed to be exchange transactions, and this is the only funding the organization receives, technically the organization would not meet the definition of a not-for-profit organization because they receive no contributions, even though such organizations are surely considered as such. It would appear that the definition of a not-for-profit organization in FASB Statement No. 117 is not sufficiently broad to include all not-for-profit organizations as defined by conventional thinking and practice. We would request that the guide provide additional guidance in this area.

1777 South Harrison, Suite 310
Denver, Colorado 80210
(303) 753-6507

262 Hawthorn Commons, Suite 164
Vernon Hills, Illinois 60061
(708) 549-7074

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Issue No. 2

Paragraph 3.15 states:

> Except as discussed in the following sentence, however, this Guide does not extend to those organizations the requirements in paragraph 26 of FASB Statement No. 117 for reporting (a) information about expenses reported by their functional classification and (b) information about expenses by both functional and natural classifications in a matrix format in a separate financial statement.

This statement might be construed as somewhat ambiguous. In practice, many of these types of organizations believe they are required to provide functional reporting of expenses. We would request that this sentence be rewritten to state that for these organizations, reporting natural classification of expenses is permitted.

Paragraph 3.15 also states:

> For organizations that do not meet the FASB Statement No. 117 definition of a not-for-profit organization but that normally receive significant amounts of contributions from the general public, this Guide - ...

We would request clarification on this comment. Would not "receive significant amounts of contributions from the general public" automatically meet the definition of a not-for-profit organization in FASB Statement No. 117? If this comment is to pertain to certain types of organizations, we would request examples of such organizations be included in the comment to clarify the issue.

Issue No. 3

Paragraph 7.04 states:

> Not-for-profit organizations may incur costs that relate to future rather than to current-period activities. Except as discussed elsewhere in this chapter, the recognition and measurement principles for those costs are similar to those used by business organizations.

Many organizations like associations have annual meetings or other events where significant costs are accumulated for the event. Great variability exists in the accounting for these costs. This occurs when the event takes place after the organization's fiscal year end. Many organizations defer these costs, including period-type costs, until the event has occurred. For

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certain types of cost this treatment is certainly proper, for instance, the down payment on a facility to hold the event. Transactions of this nature generally are considered prepayments and are properly deferred to the balance sheet.

Many organizations also defer period costs. Examples of these costs would include travel to the site for facilities arrangement, salaries of meeting planning personnel while working on the event, etc.. Other organizations record these costs as period expenses in the statement of activity.

Differences in the deferral of these costs can a have a material impact on net assets. In practice, great variability exists regarding the deferral of these period costs. Regarding the guide, we propose that "the recognition and measurement principles for those costs are similar to those used by business organizations" is not enough guidance. We request that the guide specifically address this issue and provide guidance in the accounting treatment and deferral of these period costs.

Issue No. 4

Paragraph 12.05 states:

> If the organization regularly provides discounts (such as some types of financial aid for students, reduced fees for services, or free services) to certain recipients of its goods or services, revenues should be reported net of those discounts.

We are confused by "some types of financial aid" used above, specifically the word "some". Is student financial aid reported net? We request clarification. If certain types of aid are reported net and others are reported gross, could the types of aid and their accounting treatment be delineated or given as an example?

Issue No. 5

Many associations have sponsorship arrangements for their annual meetings or other various events. Not-for-profit organizations have these arrangements as well. These arrangements typically involve a sponsor providing money relating to the support of a specific event. In return, the sponsor can receive exchange value of a negligible amount, such as signage visibility, or substantial exchange value such as advertising or promotion arrangements.

We realize the guide covers part exchange/part contribution transactions generally. However, great confusion exists in the association community regarding these transactions. Although

discussed in general terms elsewhere, we would request that the guide specifically address sponsorship arrangements in relation to contribution/exchange transactions and the recording of such amounts as revenues or reductions in cost.

Issue No. 6

The guide generally addresses functional reporting of expenses and certain expense classifications. However, we submit that a great problem exists in practice regarding functional reporting of costs. We have seen great variability in practice regarding the classification of functional costs dependent on the recovery of such costs by a resource provider. Specifically, the problem occurs when a resource provider allows for reimbursement of indirect or general and administrative costs. Many organizations account for these costs as program costs if in fact the resource provider allows for reimbursement in accordance with contract or grant agreements. The FASB addressed this issue in the following literature:

Paragraph 31 of FASB Statement of Financial Accounting Concept No. 6 states:

> Some users have specialized needs but also have the power to obtain the information they need. For example, donors and grantors who restrict the use of resources they provide often stipulate that they be apprised periodically of the organization's compliance with the terms and conditions of the gift or grant. Creditors also may be able to stipulate that certain specialized types of information be provided. Special-purpose reports directed at those kinds of needs are beyond the scope of this Statement.

Paragraph 34 of FASB Statement of Financial Accounting Concept No. 6 states:

> The objectives are those of financial reporting rather than goals for resource providers or others who use the information or for the economy or society as a whole. The role of financial reporting in the economy and society is to provide information that is useful in making decisions about allocating scarce resources, not to determine what those decisions should be. For example, information that tries to indicate that a relatively inefficient user of resources is efficient or information that is directed toward a particular goal, such as encouraging the reallocation of resources in favor of certain programs or activities of nonbusiness organizations, is likely to fail to serve the broader objectives that financial reporting is intended to serve. The role of financial reporting requires it to provide neutral information.

We strongly concur with the opinion of the FASB in the above paragraphs. The FASB has been clear that specialized reporting requirements from resource providers should not unduly influence presentation of external financial statements. The audit guide is silent on this point. We request that the guide include a discussion of this issue and provide guidance with regard to classification of functional expenses.

<u>Issue No. 7</u>

Paragraph 7.02 states:

> Not-for-profit organizations may acquire merchandise inventory for resale, for example, items held for sale by a bookstore, dining service, kitchen, or thrift shop. Merchandise inventory may be acquired by not-for-profit organizations in exchange transactions or from contributions.

Paragraph 7.03 states:

> Contributions of inventory should be reported in the period received and should be measured at fair value. Estimates of fair value may be obtained from published catalogs, vendors, independent appraisals, and other sources. If the gifts have no value, as might be the case for certain clothing and furniture that cannot be sold by the not-for-profit organization, the item received should not be recognized.

The requirement to value inventories such as thrift shop inventory is problematic for the following reasons:

1. These goods generally are difficult to value. Most not-for-profit organizations receive these goods as contributions. Generally these goods are used and have no established market value. The goods have value only if the thrift shop sells a particular good to a particular customer on a particular day. This is vastly different from a commercial retail operation which pays to stock its inventory and realizes its margin upon sale of the items. Therefore, although we concede that value of the inventory may be substantial, it is extraordinarily difficult to determine such value.

2. Most thrift shop operations are staffed primarily by volunteers. Such volunteers generally have limited accounting knowledge or expertise. These volunteers are generally incapable of inventory procedures to maintain value for inventory. This requires that these operations pay outside fees to maintain inventory values. This cost could not be absorbed by most of these organizations.

3. Most thrift shops use sales proceeds to fund other programs, usually human services related. Valuation of inventory for thrift shops provides no financial benefit either to the management or the external reader of the financial statements.

Generally, we submit that the requirement to value inventory for thrift shops and other like organizations is burdensome. The cost would greatly outweigh any benefit derived therefrom. We submit that the guide be changed to not require valuation of inventory for thrift shop operations.

Issue No. 8

Paragraph 9 of FASB Statement No. 116 states:

> Contributions of services shall be recognized if the services received (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. Services requiring specialized skills are provided by accountants, architects, carpenters, doctors, electricians, lawyers, nurses, plumbers, teachers, and other professionals and craftsmen. Contributed services and promises to give services that do not meet the above criteria shall not be recognized.

We submit that services requiring "specialized skills" is too narrow of a criteria. Many not-for-profit organizations enlist vast numbers of volunteers to carry out program goals. Many of these volunteer donations are not recognized under the narrow criteria as noted above. This results in significant under-reporting in the statement of activity of these organizations. We request that the committee address this issue and consider broadening the criteria for recording of donated services.

Issue No. 9

No illustrative financial statements are included in the audit guide. We would appreciate such statements in the guide or in a subsequent document.

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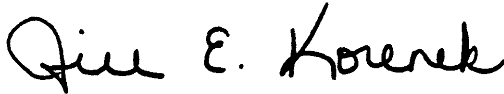
Other

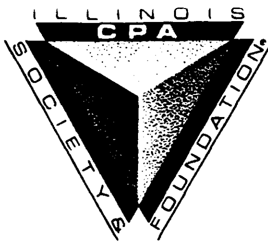
Generally, we regard this audit guide as an excellent document. We applaud the superb work of the committee.

Yours truly,

DOLLINGER, SMITH & CO.



Jill E. Korenek



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AUG 15 1995

August 11, 1995

Mr. Joel Tanenbaum, Technical Manager
File 3605.AG, Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tanenbaum:

The Committees on Accounting Principles and Auditing Services of the Illinois CPA Society ("Committees"), assisted by the Nonprofit Organizations Committee, are pleased to have the opportunity to comment on the exposure draft of the Proposed Audit and Accounting Guide, Not-for-Profit Organizations ("Exposure Draft") of the American Institute of Certified Public Accountants ("AICPA"). The organization and operating procedures of the Committees are described in the appendices to this letter. These recommendations and comments represent the position of the Illinois CPA Society rather than any of the Committee and of the organizations with which they are associated.

The Committees support the issuance of the Audit Guide and urge its issuance at an early date to provide guidance for CPA's that audit not-for-profit organizations. However, we do have some suggestions for revision we hope you will consider seriously before issuance. Our major issues are contained in the body of this letter. Supplemental Schedule I contains certain specific issues that should also be addressed. Supplemental Schedule II contains some other editorial comments. The following are our major concerns.

1. We note that governmental not-for-profit organizations are not included in this guide, as they are in the healthcare guide. Will there be guidance from the AICPA for governmental not-for-profits, and where will that guidance come from? It also seems that, for some borderline cases, guidance will be needed at some point regarding "what is a government?, especially if guidance is different for governmental and nongovernmental not-for-profits. We note that OMB Circular A-128 will be merging into Circular A-133 in the near future, so some issues will be the same.

2. It would be very helpful to members if guidance were provided in the form of illustrative financial statements. These statements were very useful in SOP 78-10. We note that illustrative financial statements were provided in the healthcare guide ED.

3. There seems to be some confusion regarding functional reporting. The Guide ED goes to great length describing what should be included as program, management and general, fund raising, and membership development. Yet, neither FASB 117 nor this document requires that this specific breakdown be required. It appears that colleges will not use this breakdown, if materials from NACUBO are to be followed. If this is the case, can auditors require this breakdown for voluntary health and welfare organizations and other not-for-profit organizations? If not, does the controversy about joint costs mean anything? It would seem that the AICPA would have to take a position on this issue. (We note that the healthcare guide ED seems to discourage these

SOUTH RIVER-
SIDE PLAZA
SUITE 1600
CHICAGO, IL.
60606 - 6098
FAX: 312-993-9954
TEL: 312-993-0407 or
800-993-0407 (Illinois only)

functions and illustrates only two.)

4. It would be helpful if a table or grid were prepared, showing the new and the old accounting principles (major) that should be followed by organizations subject to this guide.

5. As noted in the Guide ED, there are certain organizations, not subject to FASB 116 and 117, that are subject to this Guide. It would be helpful if the Guide were specific about this and listed some of these organizations. It would additionally be helpful to include illustrations of major instances where GAAP is different for these organizations and organizations subject to FASB 116 and 117.

6. The following is offered in response to Issue 1 on page v. of the ED. Items (a), (b), and (c) are responses to the three questions.

   (a) We believe that organizations having variance power should record the resources received as contributions because there is an element of discretion. It should be treated no differently than a temporarily restricted contribution to be used on Program A -- the organization has discretion on exactly how the money will be used (i.e. supplies, salaries, printing, etc.). The organization's prior history of exercising variance power should not have any bearing on how the transaction is recorded -- the availability to use discretion is still present. Using this logic also provides for a simpler and more consistent analysis of how to account for these types of transactions. If an organization has variance power the income should be accounted for as temporarily restricted and the subsequent granting of the money to the other organization should be a contribution expense.

   (b) We believe that donor-advised provisions do not constitute binding restrictions that the organization must follow. If any organization has donor-advised provisions and variance power, the resources received should be accounted for as a contribution -- the organization does not have to abide by the donor's wishes. If there are only donor-advised provisions and it is determined that the organization should record the contribution, should the revenue be recorded as temporarily restricted or unrestricted (the organization does not HAVE to follow the wishes of the donor)? Prior history of deviating from the advice should not affect if the contribution should be recorded or not. Once again, the organization has the ability to NOT follow the donor's wishes and this logic provides for a simpler and more consistent analysis of the transaction.

   (c) The receipt of resources that must be retained in perpetuity could be accounted for as a contribution with the related income accounted for as an agency transaction (with footnote disclosure); however, a few issues need to be addressed. How would this accounting treatment tie into the proposed new investment rules on accounting for holding gains/losses on endowment funds? If there is a holding loss and the value of the investment is reduced, what is the debit side to the entry if you do not record income related to the investment? Do you create a receivable due from the ultimate recipient? It may be simpler to assume that since the organization has control over the assets, it should also record the investment income and then record the contribution expense.

7. In response to Issue 2 and in response to the ED language, we are concerned that guidance be provided more specifically regarding which type of student aid is a revenue deduction and which is an expense. In other words, when should tuition be recorded net and when should tuition be recorded gross and offset by tuition revenue. We believe that you should lean, when possible,

to the reporting of tuition gross and reporting student aid expense. For example, a work-study program should result in a expense being reported. The same should be true for the expenditure of restricted contributions for student aid. For example, when a CPA firm makes a contribution for a student scholarship, that contribution should be reported as a revenue, with the expenditure being reported as an expense. We further urge you, for those items that you decide should be reported as revenue deductions, that you require disclosure of the nature and amounts of those revenue deductions.

8. On page 46, you suggest that bad debt expense be reported in the appropriate net asset class. However, Statement 117 requires all expenses to be reported as unrestricted. The FASB does allow "losses" to be reported as restricted. We agree that bad debt charges should be displayed in the appropriate net asset class; perhaps the solution is to report bad debt charges as a loss.

9. Your ED, as well as the new FASB guidance, allows undepreciated plant to be recorded as either unrestricted or restricted, depending upon organization policy. We note that the healthcare ED requires that all undepreciated plant be reported as unrestricted. We agree with the healthcare guidance and urge you to require that plant be recorded as unrestricted when it is placed in service. Flexibility should be provided that would allow separate reporting of the balance relating to undepreciated plant in net assets.

10. Footnote #5 related to paragraph 2.32 defines the dollar threshold of $100,000 for federal assistance. Since this threshold is subject to change by regulatory authorities, we suggest a reference to A-133 thresholds for guidance, without including a dollar amount.

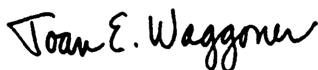
11. The distinction drawn in the ED between contributions and exchange transactions for membership dues of a not-for-profit organization would be difficult to audit. Tables 5.2 and 5.3 left this area very subjective. We question if the revenue distinction is sufficiently important to justify the audit cost. For example, how would a value be put on the technical assistance we receive from the AICPA for our dues?

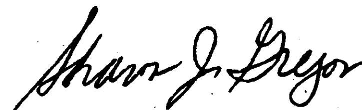
12. Paragraph 5.52 regarding the allowance for doubtful accounts could produce auditing problems, especially if a pledge campaign is new or not run on a regular basis (i.e., no history of collections). We suggest that some examples of scope limitation paragraphs be added to the Guide for situations in which the allowance for doubtful accounts cannot be satisfactorily audited.

13. We suggest that the guide include guidance on the classification of capital assets when purchased with federal assistance and with a reversionary interest at disposition, as outlined in OMB Circular A-110 and A-122.

We would be pleased to discuss our comments and recommendations with you at any time.

Very truly yours,





Joan E. Waggoner
Chair of Committee on Accounting Principles

Sharon J. Gregor
Chair of Committee on Auditing Services

SUPPLEMENTAL SCHEDULE I

Specific Issues

We suggest that the AICPA also address the following specific issues:

Paragraph 5.09 (pages 32-33)

Assume an organization has a fundraising event (i.e. a walkathon) to be carried out at many different sites throughout the country. It forms agreements with site sponsors whereby 50% of the net money raised (after expenses) will be kept by the organization and 50% will go to the charitable entity represented by the sponsor (i.e. a hospital). Based on this paragraph, would the organization only report 50% of the contributions received as revenue and 50% of total expenses incurred or would it show total contribution revenue and total expenses which would include the distributions to the various site charities. The donors to this walkathon may or may not know that the net proceeds are being split 50/50; they may think that they are giving money to support a specific cause, i.e. cancer research. Can guidance be provided on this type of situation?

Footnote 13 (page 42)

This footnote should clearly indicate if the nonprofit intermediary should record an asset and a liability if it has evidence that it will be receiving assets from another entity which it will pass through to another entity or if no entry should be made and if no entry is made, if there should be any disclosures required.

Paragraph 6.33 (page 64)

This paragraph and the related appendix example do not discuss how to account for the income earned on the charitable gift annuity.

Paragraph 8.03 (pages 86-87)

It makes reference to split-interest gifts being discussed in Chapter 6 where there wasn't a discussion on how to value the assets. Can further guidance be provided on how to value split-interest gifts?

"Significant Contributions"

Can this guide clarify or give guidance on what the interpretation of "significant" contributions are in the FASB 117's definition of not-for-profit?

Specific Issues (Continued)

"Related Entities"

Does SOP 94-3 (Reporting of Related Entities by Not-for-Profit Organizations) use the FASB 117 definition of not-for-profit or must all organizations required to follow this guide follow SOP 94-3?

Entity A is a not-for-profit organization that meets the definition of not-for-profit included in FASB 117. This entity has a related nonprofit organization, entity B, that it should consolidate, but that related entity

does not meet FASB 117's definition of not-for-profit. How are the investments and disclosures related to the investments that entity B owns shown in the consolidated financial statements -- using FASB 115 rules or using not-for-profit investment accounting rules?

Assume the same facts as above, except entity B is a for-profit subsidiary. How are B's investments shown in the consolidated financial statements?

A nonprofit organization, Entity A, must follow the provisions of this guide, but it does not meet the FASB 116 definition of not-for-profit. It has a related foundation, Entity B, that it controls and consolidates. This entity B meets the FASB's definition of not-for-profit. How are the foundation's (entity B) investments reported in the consolidated financial statements -- using for-profit or not-for-profit rules? Or is entity A considered to be a FASB 117 not-for-profit because you have to look at it on a consolidated basis which would include the foundation. However, what if this foundation is not significant overall to entity A?

SUPPLEMENTAL SCHEDULE II

Other Editorial Comments

We suggest that the following editorial comments be addressed:

Table 5.2 (page 36)

Under the "Contribution" column there are two typesetting errors in the narrative that corresponds to the "Method of Determining Payment" indicator. The second line only has one word on it ("providing") and there is an unnecessary blank line between the 4th and 5th lines of the narrative.

Paragraph 5.22 (page 38)

The fourth line says "restrictions or contributions." It should say "restrictions on contributions."

Paragraph 5.33 (page 40-41)

The last line on page 41 should have the word "and" after "follows such a policy" instead of a comma (or it was intended to add another phrase after "discloses its policy in notes to the financial statements?").

Paragraph 5.41 (pages 41-42)

On page 42 there is an explanation regarding wills in parentheses. It should be added that the contribution should also not be recorded if that amount can not be reasonably estimated.

Paragraph 7.07 (page 75)

The 5th line says "can be best be measured"; one of the "be's" needs to be removed.

Paragraph 7.14 (pages 76-78)

The last line on page 76 under "Note X" is not right-aligned.

Paragraph 13.26 (pages 116-117)

On page 117 the underlines in the middle section of the note example are not all long enough or of the same length as the underlines above and below them (also have some of this same problem on examples on page 116).

Paragraph 15.10 (page 129)

The indication of membership organizations that are required to make complex disclosures to their members or pay a proxy tax should be 501(c))(6) organizations, not 501 (c)(3).

STATE OF MICHIGAN
DEPARTMENT OF ATTORNEY GENERAL

101

AUG 15 1995

STANLEY D. STEINBORN
Chief Assistant Attorney General

FRANK J. KELLEY
ATTORNEY GENERAL

LANSING

P. O. Box 30214
Lansing, MI 48909

August 10, 1995

Joel Tanenbaum, Technical Manager
File 3605.AG
Accounting Standards Division AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tanenbaum:

Re: Proposed Audit and Accounting Guide, Not-for-Profit Organizations

Please accept these comments regarding the proposed audit and accounting guide for not-for-profit organizations. The opinions expressed do not necessarily reflect the views of the Attorney General, but do reflect positions of the Charitable Trust Section.

EXCHANGE TRANSACTIONS AND SPECIAL FUND-RAISING EVENTS

Paragraphs 12.05 (and its related footnote 3) and 13.15-13.20, primarily discuss the issue of display related to special events and sale activities. We believe that the wording of paragraphs 13.19 and 13.20 is unclear as to the required display, especially taken in light of footnote 3 to paragraph 12.05. In our opinion, the proposed guide should be clarified to require that all all expenses related to these events and transactions, other than direct benefit costs, should be required to be displayed on the statement of functional expenses. We also believe that the definition of direct costs for these events should not include payroll and payroll-related costs. These issues are discussed below.

Lack of Clarity

We understand the appropriate definitions to be as follows:

> Direct benefit costs - The costs of articles and services furnished as inducements directly to event participants or purchasers of tickets or items. (Taken primarily from Standards of Accounting and Financial Reporting, Third Edition.)
>
> Direct costs - The incremental costs incurred in transactions with independent third parties and the payroll and payroll-related costs for the activities of employees who are directly associated with, and devote time to, special events or other fund-raising activities. (Taken from paragraph 13.19)

Footnote 3 to paragraph 12.05 indicates that direct costs of special events may be displayed sequentially with the related gross revenues. Paragraph 13.18, however, does not refer to direct costs, but instead specifies that the cost of directly related goods and services (which we interpret as direct benefit costs) may be displayed as a line item deduction or included in the area we shall call the statement of functional expenses. Then paragraph 13.19, in giving an example, indicates costs of direct benefits and other direct costs of the event are to be reported separately but with no indication where on the statements. Sequentially with gross revenues, or on the statement of functional expenses?

We believe that these areas should be clarified and made consistent with the following positions.

Display of Other Direct Costs

We believe all costs other than direct benefit costs in these transactions and events should be required to be displayed in the statement of functional expenses. Perhaps the need for this is more apparent in situations where organizations incur substantial promotional costs beyond the direct benefit costs.

It is our experience that many organizations hire professional fund raisers to sell tickets or obtain sponsors, primarily through telemarketing, for special events. The gross revenues frequently include contributions, but these may also be exchange transactions. The cost of this promotional activity can typically exceed 50% of the event's gross revenues while the organization nets 5-20%. Because the organizations holding these events are usually relatively small, and because they may hold more than one and sometimes several events in a year, this usually constitutes a major activity for the organization.

The public which purchases tickets or provides sponsorship for the event does not usually have access to the organization's financial statements. They most often must rely on the thumbnail sketch provided by the functional classification of expenses which can be furnished by government regulating agencies or other "watchdog" organizations. Even if financial statements are available, the presentation on the statement of functional expenses attracts the most attention. Allowing organizations to remove expenses other than direct benefit costs from the statement of functional expenses would, we believe, diminish the usefulness of that statement.

It should also be noted that the practice of deducting only direct benefit costs is consistent with current accounting literature, including Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations; Accounting & Financial Reporting, A Guide for United Ways and Not-for-Profit Human-Service Organizations; and the IRS booklet, Instructions for Form 990.

Therefore, in our opinion, only direct benefit costs of a special event should be permitted to be displayed sequentially as a deduction from the event revenues. All other costs should be required to be presented on the organization's statement of functional expenses.

Payroll as Direct Costs

Paragraph 13.19, in the definition of direct costs, includes payroll and payroll-related costs of employees who are directly associated with the event. Regardless of where the direct expenses are displayed, we do not believe payroll or payroll-related costs should be permitted to be included. If direct costs are permitted to be shown sequentially with gross revenues, this would allow organizations to shift costs from the statement of functional expenses, effectively watering down the usefulness of this statement. In addition, employee salaries are an item of interest to the public. This definition would seem to make it acceptable to shift costs from "salaries" into a line item simply called "other direct event expenses".

We believe that payroll and payroll-related costs should not be includable as a special event direct cost.

Suggested Changes

We suggest the following changes to the proposed audit and accounting guide:

-- Paragraph 12.05 should be changed to indicate that if the primary purpose of the exchange transaction is to raise funds even though contributions are not received above the fair value of the goods sold, it should be accounted for as a special fund raising event.

-- Footnote 3 to paragraph 12.05 should be changed to indicate that only direct benefit costs may be displayed sequentially with the related gross revenues.

-- Paragraph 13.18 already indicates that direct benefit costs may be displayed either as a direct deduction from gross revenues or included in the statement of functional expenses. It should also clarify that other direct expenses must be included in the statement of functional expenses.

-- Paragraph 13.19 should clarify specifically where the items mentioned in the example should be reported.

-- Payroll and payroll-related costs should be removed from the definition of direct costs in paragraph 13.19.

ACCOUNTING FOR JOINT COSTS

While the period for comment on the September, 1993 proposed SOP has passed, the proposed audit and accounting guide states that, when it is issued, it will supersede whichever SOP is in effect. Therefore, we are taking this opportunity to provide a brief comment and a different approach to this controversial area. We are presenting an idea for discussion and not necessarily advocating its adoption because its feasibility is unknown.

As a state regulating agency, our perspective is on behalf of the potential donor. Our desire is that prospective donors simply be given useful information on which their decision to donate may be based. The most sought after information is usually related to the question: how will the contribution be used? Unless the organization is carrying on a restricted purpose campaign, such as a capital campaign, the donor frequently will look at the prior years functional expenses and the amount or percentage spent on program services to help make the decision. However, unbeknownst to most donors, those program services expenses may include significant costs of joint informational and fund raising campaigns.

When has a bona fide program service been conducted in these campaigns? Of course, that is the nub of the controversy over accounting for joint costs. Not-for-profit organizations say that there is an intrinsic educational or program value in all mailings and communications. State regulators and other watchdog agencies do not agree, at least not to the extent claimed by the not-for-profit organizations. However, even if the the non-profit sector, the regulators, IRS, and accountants are ever able to reach an accord as to what is a program service, will the resultant definition agree with what the donor/member thinks?

Rather than arguing over how joint costs of communications should be allocated, perhaps a new functional classification should be used. Because mailings and telecommunications are an ever increasing segment of many organization's activities, perhaps this area should simply be set aside in its own function. This function could be called "donor/member communications" for example. If a donor/member receives useful, informative communications from the organization, the donor/member will realize that this is an important function of the organization. If the donor/member believes that the communication factor is not that important, he or she may look to the program services function to determine if there is activity he or she wishes to support.

GIFTS IN KIND

Paragraph 5.12 specifies that gifts in kinds should be measured at fair value. Because an earlier draft of this audit and accounting guide did not take this straight-forward position, we are writing in support of the current position. It is our belief that current accounting for thrift stores and sheltered workshops is widely inconsistent, revenues and expenses are frequently misclassified, and inventory assets are usually understated due to the previous lack of clarity on this point.

Based on our review of financial statements of thrift stores and sheltered workshops soliciting in Michigan, contributed merchandise is a significant, and often the largest, revenue generator for these operations. Other than the consistency that few organizations account for donated merchandise as contributions, there is wide disparity in the methods used to account for these operations. Some organizations record the sales transactions as sales, others as program service revenue. We have seen all costs related to the solicitation, transportation, sorting and selling of the goods capitalized and deducted as cost of goods sold, while others may itemize many of these costs on the statement of functional expenses and allocate them to program services. Contributed inventory is usually carried at a nominal value of $1.

The stated reason in most organization's financial statements for this method of accounting for contributed merchandise is that the value of the goods cannot be determined. However, we do not understand why the donated merchandise is not considered valued as it is sorted and graded by the organization's employees. It would seem that the donated goods must have a price before it is displayed for sale.

It is also our opinion that the method of accounting currently in use by thrift stores and sheltered workshops leads to questionable conclusions in other areas. Although store and salvage sales were over 60% of one organization's operations, I was informed that the organization no longer considered itself a voluntary health and welfare organization because it did not derive its revenue primarily from voluntary contributions.

Further, we believe that this overlooking of the contribution nature of revenues leads the organizations to also overlook the fund raising aspect of the costs associated with generating these significant contributed resources. Despite having established large mechanisms, such as attended donation centers or telemarketing programs, to solicit and receive these millions of dollars worth of donated goods, very few thrift shops and sheltered

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workshops allocate any of these costs to fund raising. We understand the program aspect of the hiring and training of these organizations' employees. However, we likewise believe that the thrift stores and sheltered workshops should not deny that there is a fund raising aspect as well in the generation of these donated resources upon which they depend.

Therefore, we believe that the approach taken by FASB Statement No. 116 and reiterated by the proposed audit and accounting guide will lead to more accurate, complete, and consistent statements of activities and financial position of thrift stores and sheltered workshops.

Very truly yours,

Joseph J. Kylman
Auditor
Charitable Trust Section
(517) 373-1152

JJK/mjc

m/8-aicpa.8-aicpa1.8-aicpa2.8-aicpa3.
8-aicpa4.8-aicpa5.8-aicpa6

Fighting 40 Neuromuscular Diseases

NATIONAL HEADQUARTERS
3300 East Sunrise Drive, Tucson, AZ 85718-3208
Telephone (602) 529-2000 • Fax (602) 529-5300

... a non-United Way independent voluntary health agency operating without either government funding or fees from those it serves.

August 10, 1995

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AUG 15 1995

Mr. Joel Tanenbaum, Technical Manager
File 3605.AG, Accounting Standards Division
American Institute of Certified
Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tanenbaum:

On behalf of the Association, I'm writing this letter to comment on the AICPA's Exposure Draft, "Proposed Audit and Accounting Guide - Not-for-Profit Organizations." We believe the final pronouncement should incorporate the revisions set forth below.

(1) In addition to paragraphs 2.36 and 2.37 (Planning Stage Materiality), the PREFACE OR INTRODUCTION should contain a section briefly discussing materiality somewhat along the lines of the "Audit and Accounting Guide - Audits of Certain Nonprofit Organization."

(2) Paragraph 13.07 (Fund-Raising Costs) should be expanded to include the situation where fund-raising costs are incurred immediately prior to a fiscal year end but the resulting revenue is reasonably anticipated to exceed such expenses and be received substantially in the subsequent fiscal year.

For example, a calendar year agency incurs postage, printing and other expenses in the beginning of December in connection with a coordinated mail program to accomplish a portion of its program objectives, recruit volunteers and raise funds to support future programs. Recipients will receive the mailing in late December or early January. It's reasonably anticipated that substantially all contributions will be received in January and thereafter and will exceed expenses for the mailing. Based on the foregoing, we believe it's appropriate to treat the direct costs associated with the mailing as prepaid expenses (see paragraph 7.04), thereby recognizing in the subsequent calendar year both the expenses and the related revenues.

(3) Paragraphs 13.22 (Investment Revenues, Expenses, Gains, and Losses) and 13.24 (Presentation of Expenses by Function) should be revised to <u>prohibit</u> expenses shown in the statement of activities which are subtracted from revenues or gains (and therefore not included in "expenses and losses") from being regrouped via a footnote into a program or supporting functional category. To permit such regrouping distorts the amounts included in such functional categories and would, therefore, be confusing and misleading to the reader of the financial statements.

Muscular Dystrophy Association
JERRY LEWIS, National Chairman • LOIS R. WEST, President • ROBERT ROSS, Senior Vice President & Executive Director
ROBERT M. BENNETT, Treasurer • TIMMI MASTERS, Secretary

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For example, to include the direct costs of special events within the Fund Raising functional category (even though they are subsequently "backed out") redefines and, in our opinion, misstates the traditional definition of the Fund Raising category. In this regard, Paragraph 93 of Statement of Position 78-10 ("Accounting Principles and Reporting Practices for Certain Nonprofit Organizations") states the cost of direct benefits" are not considered fund-raising costs."

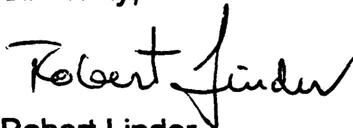
Also, the current AICPA Industry Audit Guide "Audits of Voluntary Health and Welfare Organizations" as well as the "Standards of Accounting & Financial Reporting for Voluntary Health and Welfare Organizations" ("Black Book") indicate that the statement of functional expenses articulates to the total of functional expenses in the statement of support, revenue, and expenses and changes in fund balances <u>without</u> any reconciliation to expenses that have been traditionally netted against revenue.

Additionally, paragraphs 13.14, 13.25 13.26, 13.29 and 13.32 would also require revision.

Furthermore, the aforementioned current AICPA Industry Audit Guide and Black Book include a financial statement illustration whereby estimated fund-raising expenses from federated and nonfederated campaigns are shown parenthetically. The Proposed Audit Guide appears to be silent on this topic. In light of the last sentence of paragraph 13.22 which states that "The financial statements should disclose the total fund-raising expenses," it's not clear whether these estimated expenses are intended to be shown (gross or parenthetically) in the statement of activities or are to be a part of the reconciliation suggested in paragraphs 13.24-13.26. It's also not clear why the sentence is included in the text; and similarly, for the section of paragraph 13.29 which states "an organization should disclose its total program costs."

We strongly recommend that the Exposure Draft be revised along the lines set forth above to further improve a quality document.

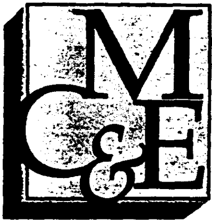
Sincerely,



Robert Linder
Director of Finance

RL/dp

RL-AICPA



Maner,
Costerisan
& Ellis, P.C.
Certified Public Accountants

Jack E. Powers
Lawrence C. Kowalk
Gary W. Brya
Lamonte T. Lator
Bruce J. Dunn
Daniel L. Popoff
James E. Nyquist
Jeffrey C. Stevens

Walter P. Maner, Jr.
Floyd L. Costerisan
Leon A. Ellis (1933-1988)

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AUG 15 1995

August 9, 1995

Joel Tanenbaum, Technical Manager
File 3605, AG
Accounting Standards Division
AICPA
1211 Avenue of Americas
New York, New York 10036-8775

Re: Comment on Not-For-Profit Audit and Accounting Guides

Dear Mr. Tanenbaum:

My comments related to the guide is from the perspective of a large local firm (60 total staff) located in a capital city which serves a large number of trade association and union clients. I am immediate past chairman of the MACPA not-for-profit committee and have attended all three of the AICPA not-for-profit conferences.

I strongly encourage the exclusion of functional reporting of expenses for trade associations, unions and social clubs. The type of entities that do not need functional reporting should be highlighted and defined in the guide to avoid confusion by both the public and CPAs.

The functional reporting of expenses by many in the association and union community is viewed as not useful information and, as a consequence, functional allocations are often made using estimates versus more supportable methods. As a consequence, such information becomes misinformation because of lack of emphasis placed on it by the organization. In addition, CPAs have, in practice, not placed high importance on audit evidence to support these allocations. The public who rely on functional allocations, therefore place a higher degree of value on these allocations than they deserve.

6105 W. St. Joseph Highway • Suite 202 • Lansing, Michigan 48917-4848 • (517) 323-7500 • Fax (517) 323-6346

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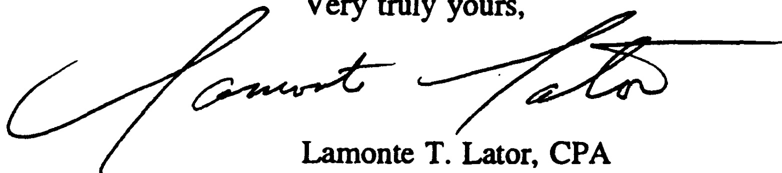
In summary, I don't believe functional reporting should be required for non voluntary health and welfare organizations. If functional reporting is expanded beyond those organizations, definitions and examples should be provided in the guide of organizations either covered or exempted to avoid confusion by the public and CPAs.

Best of luck in this project and if you would like further input, do not hesitate to call.

Very truly yours,



Lamonte T. Lator, CPA

The Oregon Society of CPAs

10206 S.W. Laurel Street
Beaverton, Oregon 97005-320
Telephone 503/641-7200
Oregon 1-800-255-1470
FAX: (503) 626-2942

August 8, 1995

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AUG 15 1995

Joel Tanenbaum, Technical Manager
File 3605.AG
Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

RE: Exposure Draft
Proposed Audit and Accounting Guide
Not-For-Profit Organization
Dated April 14, 1995

Dear Mr. Tanenbaum:

The following comments concerning the above referenced exposure draft are from the Not-For-Profit Committee of the Oregon Society of Certified Public Accountants.

After careful review of the exposure draft, it is the committee's view that the following issues should be reconsidered.

Gifts in Kind

Paragraph 5.13

"Not-for-profit organizations may also receive items, such as tickets, gift certificates, works of art, and merchandise, that are to be used for fund-raising purposes by transferring them to other resource providers (the ultimate resource provider or recipient) during fund-rasing events. Such gifts in kind...should be reported as contributions and measured at fair value when received by a not-for-profit organization."

The proposed Guide suggests a two-step process in recording the sale of gifts-in-kind. The first step is to record the fair market value of the item received as inventory and as contributed revenue. The second step is to record the resulting gain or loss on the sale of said gift-in-kind.

The committee's belief is that for any given year, the gains and losses would likely offset each other. Even if gains and losses do not offset one another, we question the benefit and reliability of this information in light of the cost of obtaining it.

Secondly, the committee believes that the best determinate of the fair market value of gifts-in-kind that are to be exchanged for money is what the organization eventually receives for the item once it is sold.

Therefore, it is the subcommittee's contention that the revenue cycle for items donated that will later be sold is not complete until said items are indeed sold and such items should not be recorded until the actual sale has occurred.

Other Assets

Paragraph 7.03

"Contributions of inventory should be reported in the period received and should be measured at fair value."

From a guidance standpoint, the committee suggests reminding practitioners that this issue applies to inventory *if it is material.*

Definition of Permanently Restricted Net Assets

From our reading of the definition of permanently restricted net assets, it is our general understanding that once an asset has been defined as permanently restricted, it cannot be reclassified (except for very unusual situations). In the chapter concerning split-interest agreements, specifically charitable remainder trusts, it appears that this concept does not apply. If a split-interest agreement expires, the Guide states that the asset should be reclassified from permanently restricted to one of the other two classifications. It is our contention that under the current definition of permanently restricted net assets the contribution should have been classified as temporarily restricted if the passage of time could remove a restriction.

It is suggested that either the definition of permanently restricted net assets be clarified or expanded to include the concept of lack of organization control and that examples of allowed reclassification from permanently restricted net assets to one of the other two classification be shown, or that the recording of particular split-interest agreements be modified as to which net asset classification is applicable (ie, from permanently restricted to temporarily restricted).

Source of Generally Accepted Accounting Principles (GAAP) for Change in Accounting Principle

"Effective Date and Transition", as explained in the preface of the exposure draft, states that the effect of initially applying this Guide should be reported as the effect in change of accounting principle.

We have always looked to AICPA Audit and Accounting Guides for implementation guidance and for presentation and disclosure clarification. AICPA's Statement on Auditing Standards (SAS) No. 69 restated the hierarchy of GAAP, placing AICPA Audit and Accounting Guides (Guide) in Category B, the second level of GAAP. SAS No. 69 places FASB Pronouncements in Category A, the first level of GAAP.

For entities covered by Financial Accounting Standards Board Statement Nos. 116 and 117 and the Guide, we are not aware of any new theoretical issues brought up in the Guide that are not already effective in SFAS Nos. 116 and 117. For some entities not covered by SFAS Nos. 116 and 117, the Guide will apply and be the source of GAAP for reporting a change in accounting principle.

Our best interpretation is that for entities covered by SFAS Nos. 116 and 117 and the Guide, SFAS Nos. 116 and 117 will be the source of GAAP for reporting a change in accounting principle. For entities not covered by SFAS Nos. 116 and 117, but covered by the Guide only, the Guide will be the source of GAAP for reporting a change in accounting principle.

We hereby request that a clarification be made in the final draft concerning this issue.

Effective Date and Transition

Given the impact on not-for-profit organizations due to the implementation of this pronouncement, an effective date of periods beginning after June 15, 1995 seems rather unrealistic and impractical, especially since this pronouncement probably will not even be released until halfway through the year in which it supposedly should be implemented. For many organizations, they may not have the systems in place to effectively track the information necessary to fulfill the requirements outlined in this exposure draft, if all new items are implemented. We suggest that the implementation date be extended based upon what requirements are ultimately retained in the final copy.

*****

We appreciate the opportunity to respond to this exposure draft and thank you in advance for your consideration of our concerns. Should you have any questions regarding the committee's comments, please feel free to call the chair of the Not-for-Profit Audit Guide Exposure Draft Subcommittee, Tara Sims, at (503)239-8000.

Sincerely Yours,

Rob Rambo, Chairman
Not-For-Profit Committee

Subcommittee Members

David Bruns
Neil Erickson
John Gamiles
Carol Jones
Rob Rambo
Tara Sims
Mark Sleasman

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AUG 15 1995

American Red Cross

National Headquarters
Washington, DC 20006

August 4, 1995

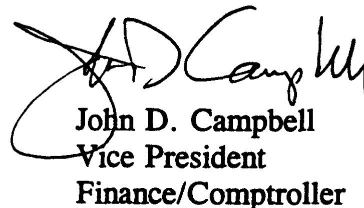
Mr. Joel Tanenbaum
Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tanenbaum:

Enclosed are comments from the American Red Cross in response to your April 14, 1995 Exposure Draft - Proposed Audit and Accounting Guide, Not-for-Profit Organizations.

We hope you reflect favorably on our recommendations and appreciate the opportunity to respond.

Very truly yours,



John D. Campbell
Vice President
Finance/Comptroller

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¶5.10 - Agency Transactions

The three methods of displaying agency transactions for Federated Fund-Raising Organizations produce the same end result but are vastly different. In an effort to structure a compromise due to objections raised by United Way, the proper treatment of agency transactions is diluted and is reduced to an exercise in semantics in Method 3. By trying to distinguish between "amounts raised" and "contributions" a reader or user would be justifiably confused. "Amounts raised" sounds and looks like a contribution, and is really much different than method 1, which is the purist, and correct approach. Method 3 opens the door for a multitude of "funds raised on behalf of others" and provides a gross-up mechanism that really depicts agency receipts as just another type of contribution.

Recommendation

Methods 1 and 2 should be retained, and Method 3 should be deleted.

¶5.52 - Bad Debt Expense

It appears that the exposure draft recommends that bad debt expense be reported as an expense, not as a contra-revenue. The exposure draft also recommends that the expense be reported in the net asset class in which the contribution revenue is reported. There are several issues and concerns:

1. If an allowance for bad debts is established for promises-to-give recognized as revenue in the current year, such allowance (expense) should be treated as a contra-revenue, not an expense, since it is likely that the revenue will not be completely realized. Grossing up revenue and expense for the estimated uncollectible simply overstates revenue and expense with no associated display benefit.

2. The recommendation to report provisions for uncollectibles as an expense brings into question the treatment on the Statement of Functional Expenses. Clearly, this would be a type of expense which likely could not be associated with any program or supporting service. Accordingly, it couldn't be allocated or charged directly so must be presented separately, similar to payments to affiliated organizations. Again, treatment as a contra-revenue would solve this dilemma.

3. The recommendation that the bad debt expense be reported in the net asset class in which the contribution revenue is reported conflicts with the FAS 117 position that all expenses be reported as unrestricted. This guidance is not clear at all.

Recommendation

All bad debt expense should be reported as a contra-revenue, with disclosure of such amount on the face of the Statement of Activities or in the notes.

¶5.56 - Contribution Revenue Category

The exposure draft prescribes that contribution revenue be disclosed in the notes or as a separate line item "Contribution Revenue." FAS 117 provides more flexibility, and alternative illustrative financial statement presentations.

Recommendation

Avoid requiring specific reporting requirements beyond that prescribed in FAS 117 or FAS 116. Instead, provide several illustrative options similar to FAS 117.

¶7.04 and ¶13.07 - Deferral of Fund Raising Costs

Paragraph 7.04 provides for capitalization of direct-response advertising that is expected to result in future benefits. However, paragraph 13.07 precludes capitalization of fund raising costs that will result in future contribution streams. This is inconsistent and unrealistic. It is generally understood that inventoriable fund raising costs, i.e., mail materials, can be capitalized. The same should be true of materials and mail distribution costs of a mailing that occurs just prior to the end of the fiscal year, if historical trends can justify and support association (matching) of contribution revenue and direct mail costs.

Recommendation

Allow capitalization or deferral of fund raising costs pertaining to a direct mail or other fund raising initiative, if such costs can be associated with a near term revenue stream, supported by previous historical trends.

¶13.24 - Presentation of Expenses by Function

The additional clarification included in this paragraph creates both burden and confusion in the preparation of the functional expense presentation. The requirement to include all expenses in this statement, regardless of placement in the Statement of Activities, creates a reconciliation and presentation dilemma. In fact, it converts a relatively straightforward statement into a confusing reconciliation. The fact that certain costs may be grossed up as a revenue offset in the Statement of Activities is not sufficient reason to force-fit those expenses into the functional presentation. In fact, it could be argued that expenses like direct benefit costs associated with special events are non-program related expenses that represent exchange transactions which do not conveniently fit into any functional class, and appropriately belong as offsets to revenue.

Recommendation

Promote reporting all expenses in the functional presentation as an option. Require, at a minimum, that the functional presentation agree with the expense section of the Statement of Activities.

August 9, 1995

COMMUNITY
FOUNDATION OF
GREATER FLINT

/06

AUG 15 1995

Joel Tannenbaum, Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of Americas
New York, NY 10036-8775

Dear Mr. Tannenbaum:

Please consider my responses to the Proposed Audit and Accounting Guide for Not-For-Profit Organizations. The Community Foundation of Greater Flint is a relatively young foundation created in 1988. We have worked diligently to educate the donors and agencies of our geographic area as to the mission and purpose of our organization. This education process includes the concept that the Community Foundations Board has the final decision, or variance power, over all distributions made from each fund. This holds true for agency endowments, designated funds and donor advised funds to the same extent as it does with our unrestricted funds. We have no examples of variance power being exercised, but much of that can be attributed to one of two things. The first being the age of the foundation, we have not experienced the changes that can occur over time that would necessitate the Board exercising its variance power. The agencies that have been designated continue to exist and carry out the purpose for which the contributions were intended and remain consistent with the mission of the Community Foundation. The second reason is that we do ongoing education of our donors that have established donor advised funds, so that they are cognizant of the requirements our Board has placed on distributions. Our staff has dismissed any and all requests that would in fact be denied prior to them reaching the Board level. This dismissal is usually done through conversations with a donor prior to them expressing a written request for the Board to consider.

The issue of donor advised funds being recognized as contributions by Community Foundations should be answered in the affirmative. The donors are joining with the Community Foundation over an issue that will strengthen the area we serve. If in fact the Community Foundation was not in the forefront aggressively assisting the non-profit agencies in our area, the donor would be making gifts directly to the agency that they desire to help. The donor's confidence in the fact that the Community Foundation has the expertise to manage the endowments for the agencies, or the gifts of donor advised fund is one of the premier reasons why the gifts come to the Community Foundation. Secondly, the donors are confident that our Board and staff will monitor the agencies in a manner that would be inappropriate for an individual donor.

OLIVIA P. MAYNARD
Chairperson
EDWARD J. KURTZ
Vice Chairperson
ARTHUR L. TUURI, M. D.
President Emeritus

DOROTHY M. REYNOLDS
President
DAVID K. SWENSON
Vice President for Program
LAURA B. FROATS
Vice President for Finance

502 CHURCH STREET
FLINT, MICHIGAN
48502 - 1206
(810) 767 - 8270
FAX (810) 767-0496

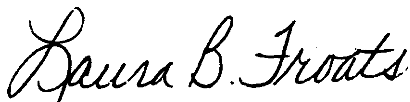
The classification of assets according to your proposed guidelines seems to contradict exactly what the Accounting Standards are attempting to do, which is to clarify financial statements for not-for-profit agencies. If in fact we are required to account for income earned on assets held in perpetuity as agency transactions, our financial statements will be misleading to the general public, and will cause much undue concern by our donors and grantees. Again, if we are unable to show assets that we clearly have legal title to, and have the ability to exercise our variance power over, then we will be misleading our readers as to the real dollar value of the Foundation.

The fact still exists that a Community Foundation is a rare form of 501(c)(3). Our purpose is to raise endowment funds that will in turn benefit the area that we serve. We do not provide direct services to the community except for our support of the nonprofit philanthropic community in general. If we appear to those that are potential donors that we are not increasing this endowment base, then we will indeed lose our strength to convene groups from all areas to address the issues of our community.

A final issue I would like considered is the fact that the non-profit agencies that we serve, either through an agency endowment that we administer, or through grants directly from our unrestricted or designated funds, will find the new guidelines confusing and ambiguous. If Community Foundations are not allowed to show assets on their balance sheet and the agencies are responsible for the display of the same, mass confusion will exist. The result will be financial statements that will ill reflect the entire financial picture of any non-profit in town. I fear that the staff at the local non-profit agencies will spend an inordinate amount of time attempting to comprehend the new guidelines and how they will impact their organization. This time spent will undoubtedly interfere with the much needed services that the agency staff members were hired to provide. These small agencies cannot afford to have sophisticated financial staff, let alone the availability of a CPA more often than during their yearly audit. This again, clarifies my position of why the agencies establish funds within the Community Foundation and why donors choose to contribute to agency endowments rather than directly to the designated agency.

We have consistently, during the lifetime of this Foundation, maintained our financial records according to generally accepted accounting principles and would like to continue in the same manner. Our donors are pleased with the fact that we have received an unqualified opinion from our auditors each year. To vary from this practice would lend itself to questioning by the public, our donors. Please consider the effect the guidelines will have on our community, which is just like any other, and allow Community Foundations to function in a manner that is conducive to growth of our asset base.

Sincerely,



Laura B. Froats
Vice President for Finance

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The First Church of Christ, Scientist in Boston Massachusetts

Office of the Treasurer

August 14, 1995

/07

AUG 15 1995

Mr. Joel Tanenbaum
Technical Manager, File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tanenbaum:

Re: Exposure Draft of Proposed Audit and Accounting Guide for Not-for-Profit Organizations

We would like to comment regarding the exposure draft. Our comments relate mostly to the accounting for split-interest agreements contained in Chapter 6 of the Guide, and to FASB's Statement No. 116 which underlies the accounting requirements addressed by that chapter.

For several months now, we have been putting a lot of time and effort into developing a plan to implement the changes called for by SFAS 116. In late February, we were able to obtain a rough draft of (what was then) chapter 5 of the proposed Audit Guide, addressing the accounting treatment of split-interest agreements. Since then, we have spent untold amounts of time in studying and diagramming that chapter, attending seminars about SFAS 116, and holding discussions with our outside auditors, with FASB personnel, and with other NPOs -- trying to understand all this and lay out an implementation plan, as well as the design for a computer system to actually do the accounting as prescribed by the two publications.

While Chapter 6 of the proposed Audit Guide is quite detailed, we have found that even after all our study, diagramming, and discussions, several things are still not clear and we remain confused on several key issues. These are as follows:

<u>Re computations of present values of income and remainder interests</u>

The guidelines in Chapter 6 speak about three factors that should be considered in determining the value of the respective interests: (1) the rate of return on investment, (2) the rate of pay-out to the income beneficiary, and (3) the discount rate [Para. 6.07].

THE FIRST CHURCH OF CHRIST, SCIENTIST, 175 HUNTINGTON AVENUE, BOSTON, MA, U.S.A. 02115-3187 • (617) 450-2000

We thought that using the valuation tables under Sec 7520 of the Internal Revenue Code might be an efficient way to arrive at the requisite values. However, the tables do not accomodate the proposed AICPA Guide's requirement that the discount rate should never be revised [Para 5.54] since the rate of return and the discount rate are the same. Since the discount rate is not revised, we are confused as to how we might "revalue" (as required by Para.6.11 of the Guide) the liability for payments to others, and our own economic interest, for revisions to the expected rate of return on investment. In other words, we do not understand the theoretical basis for having a fixed discount rate and its relationship to a changing rate of return.

Additional confusion is introduced by the fact that some of the models for the various types of trusts call for the computation of the income interest first, while others call for the computation of the remainder interest first. Since the sum of these two always must equal one hundred percent (of the fair value of the assets), a different result is obtained depending on which one is calculated first and then subtracted from the whole to deduce the other; this doesn't seem to make sense.

For example: in the case of a charitable remainder trust in which the NPO is trustee, the present value of the income interest is first computed and then subtracted from one to arrive at the present value of the NPO's remainder interest (see para. 6.27 and 6A.43); but in the case of a charitable remainder trust with an outside trustee, the present value of the NPO's remainder interest is calculated directly (see para. 6.29 and 6A.44); and in the case of a pooled income fund where the NPO is the trustee, the present value of the NPO's remainder interest is calculated directly as it is in the case with the outside trustee (see para. 6.36 and 6A.46). Bear in mind that the present value of a remainder interest, if computed directly, can be greater or less than the value for the remainder that would be obtained if one first computed the present value of the income interest and then subtracted from one to derive the value of the remainder. (Please see the attached illustrative example.) Why should the value of a remainder interest in a charitable remainder trust be different simply because of a different trustee?

<u>Difficulty in obtaining certain information</u>

One of the most critical pieces of data needed for the calculation of the present value of future interests is the birthdates of life tenants or others having economic interests in the various trusts. We have experienced great difficulty in trying to obtain this information, e.g., some "outside" trustees don't have the information or feel ethically bound not to disclose confidential information about beneficiaries without obtaining their permission first - which they refuse

to do, and our own Board of Directors and Trustees also refuse to inquire of a donor or beneficiary about his birthdate.

Beneficiaries' birthdates are a very sensitive question, and one that is a significant consideration in our relationships with donors, beneficiaries, and outside trustees. It is totally unrealistic to think that we can obtain them all (or even a majority of them), and impractical to require them for the basis of accounting entries. Also, other information is needed from outside trustees, such as fair value and critical provisions of trust agreements. We do not believe there is any basis on which we can legally require our donors or outside trustees to supply the necessary information if they choose not to.

Further, it's of primary importance to us to maintain a good relationship with our donors. Clearly, administrative requirements which would jeopardize this relationship are secondary.

Carrying value of trust assets

It would make a lot of sense to us to carry the trust assets at their current fair market values. The banks and trust companies acting as administrative agents for these trusts account for them at market values. If we account for them at fair value, it will enable us to maintain our general ledger in accordance with the subsidiary detail trust ledgers maintained by the bank.

We are not clear if interests in trusts must be considered part of "other investments" for determining basis of valuation, or if they can be considered a class by themselves. The asset composition in most trusts is primarily equities with readily ascertainable market values, and debt securities . The accounting reports furnished to us by the bank which is handling the trust accounts for which we are trustee, as well as many of the outside trustees' reports, include a current valuation of trust assets. We will be accounting for investments in equity securities with readily determinable fair values and all investments in debt securities at fair value in accordance with FASB's March 31, 1995 Exposure Draft re Accounting for Certain Investments Held by Not-for-Profit Organizations. It makes a lot of sense to us to account for our interests in trusts at fair value too; since it's commonly done by trustees, our general ledger and subsidiary records would then agree, and the underlying asset composition is so similar to the "certain investments".

Chapter 8, Para. 8.02, of the Proposed Audit Guide discusses the valuation of "certain investments" addressed in the FASB's Exposure Draft, and the valuation of "other investments" which might include "real estate, mortgage

notes, venture capital funds, partnership interests, oil and gas interests...". We have many of these types of investments, and it would be difficult to obtain market values for many of them; so, we would prefer to retain the lower of cost or market method of accounting for these assets. We understand that whatever method of accounting is elected for "other investments" must be applied consistently to ALL "other investments". We are not clear if the trusts have to be considered part of the other investment category; it almost sounds as if interest in trusts can be considered separately, i.e., (Para 8.03) "This chapter discusses the accounting recognition, measurement, and disclosure requirements for investments in (a) debt securities, (b) equity securities with a readily determinable fair value not accounted for under the equity method and not required to be consolidated, and (c) other investments. Split-interest gifts, including investments held by others, are discussed in chaper 6, 'Split-Interest Agreements,' of this Guide." FASB's Proposed Accounting for Certain Investments Held by Not-for-Profit Organizations, however, defines "other investments" as including "interest in trusts, joint-venture agreements, oil and gas properties, real estate, and investments in closely held companies and partnerships" (Para. 33).

<u>General objections to SFAS 116</u>

1. Overnight improvement in financial position

We have substantial beneficial interests in trusts, i.e., split-interest agreements, most of which will not be realized until several years in the future. The change in accounting method required by SFAS 116 to recognize the present value of such future interests will make a dramatic improvement in our financial position overnight. We feel strongly that this dramatic improvement will be misleading to readers of our financial statements and that the explanations offered in lengthy footnotes will not sufficiently clarify it for them.

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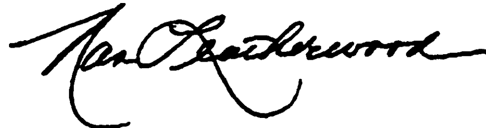
2. Implementation - a huge task

Our organization, like so many others today, has been downsizing for the past several years. It is a huge task to study SFAS 116 and the Proposed Audit and Accounting Guide and gain a sufficient understanding of them to be able to design a system to acheive the prescribed accounting results. Then, it is another equally-huge task to program that computer system, modify and enhance existing systems, and create needed interfaces to carry out that design. The devotion of thought and effort to such a large project is extremely difficult.

We trustee approximately 1500 trusts and have a beneficial interest in 600 other trusts. The burden and cost of management and consulting time required to study and implement these accounting changes seems like a terrible imposition on a non-profit organization and a significant diversion of its resources from its charitable purpose.

Thank you for your consideration of these matters. We will be very interested in the responses to the Exposure Draft; please put us on a mailing list to receive any information.

Sincerely,



Nan Leatherwood
Audit and Tax Services Manager

Re FAS 116 -- Present value Nan 8/3/95

Illustration of present value concepts

Principal	Return	Distribution	Term	
$100,000	8%	8%	20 years	Term certain OR age 65

Year	Beginning prin balance	Return on investmt(8%)	Distribution (8%)	Payout of Remainder
1	100,000	8,000	8,000	0
2	100,000	8,000	8,000	0
3	100,000	8,000	8,000	0
4	100,000	8,000	8,000	0
5	100,000	8,000	8,000	0
6	100,000	8,000	8,000	0
7	100,000	8,000	8,000	0
8	100,000	8,000	8,000	0
9	100,000	8,000	8,000	0
10	100,000	8,000	8,000	0
11	100,000	8,000	8,000	0
12	100,000	8,000	8,000	0
13	100,000	8,000	8,000	0
14	100,000	8,000	8,000	0
15	100,000	8,000	8,000	0
16	100,000	8,000	8,000	0
17	100,000	8,000	8,000	0
18	100,000	8,000	8,000	0
19	100,000	8,000	8,000	0
20	100,000	8,000	8,000	100,000
	100,000	160,000	160,000	100,000

	...........Present values re cash flows.........			..Present values per IRS Tables..		
	Total	Income	Remainder	Income	Remainder	
@ 6% discount	122,940	91,759	31,180	68,820	31,180	B
	100,000	91,759	8,241	70,989	29,011	D
	100,000	68,820	31,180	56,599	43,401	S
				59,500	40,500	U1
@ 8% discount	100,000	78,545	21,455	78,545	21,455	B
				81,131	18,869	D
				65,088	34,912	S
				67,440	32,560	U1
@ 10% discount	82,973	68,109	14,864	85,136	14,864	B
	100,000	68,109	31,891	87,842	12,158	D
	100,000	85,136	14,864	71,213	28,787	S
				73,892	26,108	U1

Re FAS 116 -- Present value Nan 8/3/95
Illustration of present value concepts 107

Principal	Return	Distribution	Term
$100,000	6%	6%	20 years Term certain OR age 65

	Beginning prin balance	Return on investmt(6%)	Distribution (6%)	Payout of Remainder
1	100,000	6,000	6,000	0
2	100,000	6,000	6,000	0
3	100,000	6,000	6,000	0
4	100,000	6,000	6,000	0
5	100,000	6,000	6,000	0
6	100,000	6,000	6,000	0
7	100,000	6,000	6,000	0
8	100,000	6,000	6,000	0
9	100,000	6,000	6,000	0
10	100,000	6,000	6,000	0
11	100,000	6,000	6,000	0
12	100,000	6,000	6,000	0
13	100,000	6,000	6,000	0
14	100,000	6,000	6,000	0
15	100,000	6,000	6,000	0
16	100,000	6,000	6,000	0
17	100,000	6,000	6,000	0
18	100,000	6,000	6,000	0
19	100,000	6,000	6,000	0
20	100,000	6,000	6,000	100,000
	100,000	120,000	120000	100,000

	............Present values re cash flows........			..Present values per IRS Tables..		
	Total	Income	Remainder	Income	Remainder	
@ 6% discount	100,000	68,820	31,180	68,820	31,180	B
				70,989	29,011	D
				56,599	43,401	S
				59,500	40,500	U1
@ 8% discount	80,364	58,909	21,455	78,545	21,455	B
	100,000	58,909	41,091	81,131	18,869	D
	100,000	78,545	21,455	65,088	34,912	S
				67,440	32,560	U1
@10% discount	65,946	51,081	14,864	85,136	14,864	B
	100,000	51,081	48,919	87,842	12,158	D
	100,000	85,136	14,864	71,213	28,787	S
				73,892	26,108	U1

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Re FAS 116 -- Present value
Illustration of present value concepts

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Nan 8/3/95

Principal	Return	Distribution	Term	
$100,000	8%	6%	20 years	Term certain OR age 65

	Beginning prin balance	Return on investmt(8%)	Distribution (6%)	Payout of Remainder
1	100,000	8,000	6,000	0
2	102,000	8,160	6,120	0
3	104,040	8,323	6,242	0
4	106,121	8,490	6,367	0
5	108,243	8,659	6,495	0
6	110,408	8,833	6,624	0
7	112,616	9,009	6,757	0
8	114,869	9,189	6,892	0
9	117,166	9,373	7,030	0
10	119,509	9,561	7,171	0
11	121,899	9,752	7,314	0
12	124,337	9,947	7,460	0
13	126,824	10,146	7,609	0
14	129,361	10,349	7,762	0
15	131,948	10,556	7,917	0
16	134,587	10,767	8,075	0
17	137,279	10,982	8,237	0
18	140,024	11,202	8,401	0
19	142,825	11,426	8,569	0
20	145,681	11,654	8,741	148,595
	148,595	194,379	145,784	148,595

	...........Present values re cash flows.......			..Present values per IRS Tables...		
	Total	Income	Remainder			
@ 6% discount	126,834	80,501	46,333	68,820	31,180	B
	100,000	80,501	19,499	70,989	29,011	D
	100,000	53,667	46,333	56,599	43,401	S
				59,500	40,500	U1
@ 8% discount	100,000	68,119	31,881	78,545	21,455	B
				81,131	18,869	D
				65,088	34,912	S
				67,440	32,560	U1
@10%discount	80,522	58,434	22,088	85,136	14,864	B
	100,000	58,434	41,566	87,842	12,158	D
	100,000	77,912	22,088	71,213	28,787	S
				73,892	26,108	U1

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Re FAS 116 -- Present value
Illustration of present value concepts

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Nan 8/3/95

Principal	Return	Distribution	Term
$100,000	6%	8%	20 years Term certain OR age 65

Year	Beginning prin balance	Return on investmt(6%)	Distribution (8%)	Payout of Remainder
1	100,000	6,000	8,000	0
2	98,000	5,880	7,840	0
3	96,040	5,762	7,683	0
4	94,119	5,647	7,530	0
5	92,237	5,534	7,379	0
6	90,392	5,424	7,231	0
7	88,584	5,315	7,087	0
8	86,813	5,209	6,945	0
9	85,076	5,105	6,806	0
10	83,375	5,002	6,670	0
11	81,707	4,902	6,537	0
12	80,073	4,804	6,406	0
13	78,472	4,708	6,278	0
14	76,902	4,614	6,152	0
15	75,364	4,522	6,029	0
16	73,857	4,431	5,909	0
17	72,380	4,343	5,790	0
18	70,932	4,256	5,675	0
19	69,514	4,171	5,561	0
20	68,123	4,087	5,450	66,761
	66,761	99,718	132,957	66,761

	...........Present values re cash flows.....			..Present values per IRS Tables..		
	Total	Income	Remainder	Income	Remainder	
@6% discount	100,000	79,184	20,816	68,820	31,180	B
				70,989	29,011	D
				56,599	43,401	S
				59,500	40,500	U1
@ 8% discount	82,865	68,541	14,323	78,545	21,455	B
	100,000	68,541	31,459	81,131	18,869	D
	100,000	85,677	14,323	65,088	34,912	S
				67,440	32,560	U1
@ 10% dsicount	60,109	53,188	6,921	85,136	14,864	B
	100,000	53,188	46,812	87,842	12,158	D
	100,000	93,079	6,921	71,213	28,787	S
				73,892	26,108	U1

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F&Co. FEDDEMAN & COMPANY, P.C.
CONSULTANTS & CERTIFIED PUBLIC ACCOUNTANTS

1700 DIAGONAL ROAD • SUITE 300
ALEXANDRIA, VIRGINIA 22314
(703) 684-7775 Tel. • (703) 684-7789 Fax

MEMBERS OF
PRIVATE COMPANIES PRACTICE
SECTION OF THE
AMERICAN INSTITUTE OF
CERTIFIED PUBLIC ACCOUNTANTS

W. KENT FEDDEMAN, CPA
JOSEPH M. KOTWICKI, CPA
CHERYL L. JORDAN, CPA
J. ANDREW SMITH, CPA
NATHANIEL T. BARTHOLOMEW, CPA

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AUG 15 1995

August 11, 1995

Joel Tanenbaum
Technical Manager
File 3605.AG
Accounting Standards Division
American Institute of
  Certified Public Accountants
1121 Avenue of the Americas
New York, NY 10036-8774

Dear Mr. Tanenbaum

Feddeman & Company is pleased to provide comments on the "Proposed Audit and Accounting Guide: Not-for-Profit Organizations." Feddeman & Company is a firm providing auditing and other financial services exclusively to associations and other not-for-profit organizations. The firm is the largest and oldest organization specializing in services exclusively for these organizations in the Washington, DC area. An organization affiliated with the firm, Association Information Management Service, Inc. (AIMS), has participated in preparation of these comments. AIMS provides financial analysis for associations from throughout the United States and is the only organization in the country that is regularly studying financial reporting practices of associations. Associations are a major industry group that will follow this new guide. We believe the combined perspectives of our organizations have identified some key issues that should be considered as work on the audit guide is completed.

<u>Distinction between classes of not-for-profit organizations is unclear.</u> SFAS No. 117 introduced a definition of not-for-profit organizations different from that in SFAC No 4. SFAC No. 4 refers to "repayment or economic benefits" while SFAS No. 117 refers to "pecuniary return." The attributes of ownership that distinguish a not-for-for profit organization are also different between the two FASB documents. The distinction between types of organizations that FASB attempted to establish by SFAC No. 4 is further muddied by the different criteria FASB introduces in SFAS

No. 117. We realize that this confusion is established by FASB and not AICPA but the guide needs to do a better job of defining the organizations to which it is applicable to overcome the confusion introduced by FASB.

Page xv introduces the fact that the guide is applicable to two classes of entities; those included in SFAS No. 117 and other not-for-profit organizations--the 117 group and the "gap" group. Paragraph 103 makes it clear that trade associations (companies are members) and professional societies (individuals are members) are included in the scope of the guide but does not identify the group to which associations belong. Footnote 2 and paragraph 2.11 say that rules for the 117 group and the gap group are different. Various places in the guide identify how these differences affect accounting and financial reporting, such as in valuation of investments and in functional classification of expenses.

We believe it is unfortunate that FASB has created this confusion. Having rules that require the same transactions to be handled differently by different types of organizations adds complexity without benefit. However, since FASB has created this confusion, AICPA needs to do a better job of sorting it out. The distinction between classes of organizations must be much more clearly defined and the sections of the guide that apply differently to each class must make that distinction more clear.

<u>Uncollectible pledges should be a reduction of contributions, not a bad debt expense.</u> Paragraph 5.51 discusses unconditional promises to give (pledges), specifying that the amount recorded when the pledge is received is net of an allowance for uncollectibles and the portion that is expected to be collectible is discounted to the present value of expected cash flows. Paragraph 5.55 states that amortization of the discount is recognized as contributions. Like the discount to present value, the allowance for uncollectibles should be a reduction of contributions, not a bad debt expense as specified in paragraph 5.52. For pledges with values that may change for reasons other than collectibility and the discount to present value, paragraph 5.51 specifies that increases are not recognized but decreases are recognized in the period the decrease occurs. All changes in value should be recognized, both increases and decreases. Recognition of increases in the value of a pledge is consistent with recognizing the increase in value of investments. In addition, paragraph 5.51 should specify that a decrease in value is a reduction of contributions. All adjustments to the amount originally recorded should be recognized as an adjustment of contributions in the period when the adjustment is made.

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Recognizing bad debt expense is appropriate in connection with exchange transactions but not for the type relationship that exists between a donor and donee.

Guidelines for reporting contributions made and distributions of agency receipts need to be clarified. An association related foundation may receive funds that are distributed to the association. If the receipts are properly classified by the foundation as contributions, the distributions are "contributions made." Guidelines for reporting contributions made are unclear. Paragraph 5.02 says Chapter 13 discusses reporting of contributions made by not-for-profit organizations. The only references in Chapter 13 related to contributions made are in paragraph 13.11 (which simply refers to paragraph 10.06), in paragraph 13.27 which implies that only federated fund-raising organizations may make contributions, and in paragraphs 13.39 and 13.40 which addresses the functional classification of certain distributions. Paragraph 10.06 does not deal with contributions made but rather deals with promises to give. Therefore, this subject is not adequately addressed. The best coverage of this subject is in paragraph 3.14 which says "awards and grants to others" are a natural expense classification. The various references to this subject should be coordinated and the content of 3.14 should be the theme of all conclusions on this subject.

If an association related foundation receives funds when acting as agent for its affiliated association, the results of its solicitation effort should be reflected in its financial statement. One of the 3 methods of display shown on page 33 would appropriately be used by a foundation that receives agency funds. We favor a display such as the following for this type transaction:

Total contributed funds received	$10,000
Less amounts remitted to XYZ Association in accordance with donor restrictions	4,500
Net unrestricted support	5,500
Other sources of revenues and gains	100
Total revenues, gains, and other support	$ 5,600

Paragraph 5.09 and 5.10, including the display alternatives, indicate that they are applicable only to federated fund-raising

organizations[1] but the issues discussed are more broadly applicable and should not have this limitation.

The nature of the organization's activities and its purpose should be the only basis for distinguishing between revenues and gains Paragraphs 12.02 and 12.03 provide the appropriate distinction between revenues and gains in conformity with paragraph 79 of SFAC No. 6; that is, revenue is derived from the organization's ongoing major or central operations and gains arise from peripheral or incidental transactions. Paragraph 13.21 adds an additional, inappropriate criteria concerning special events and other fund-raising activities. This paragraph says that if "revenues or expenses are significant in relation to the organization's annual budget," the event or activity is not "peripheral or incidental." An example will help illustrate why this additional criteria is inappropriate. An association may conduct a capital campaign once every 20 years. In the year of the campaign, the revenues and expenses are significant in relation to the association's annual budget in that year but looking at the budget for the 20 year span between campaigns, it is not significant to the organization's budget. This capital campaign is NOT part of ongoing major or central operations of the association and therefore should not be reported as revenues and expenses. It would be reasonable for the guide to require that gains and losses of amounts that are significant in relation to the organization's annual budget be reported gross rather than net but such a requirement should not relate only to fund-raising activities.

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[1] It is undesirable to establish rules that are applicable only to federated fund-raising organizations. If such selectively applicable rules are deemed essential, it is necessary to clearly define a federated fund-raising organization. It is possible, for example, for a charitable foundation to encourage and facilitate contributions to a number of associations; would such a foundation be a federated fund-raising organization?

As discussed in the first section of this letter, we believe the not-for-profit organizations proposed audit guide is already filled with examples of the complexity and confusion that results from efforts to apply rules to only certain types of organizations but not to other organizations that have identical transactions. We urge AICPA to avoid adding to the confusion. Rules that are applicable only to federated fund-raising organizations should be avoided.

The source of funds, not their use, should control classification Paragraph 5.09 states that contributed funds equal to the amount used to fund solicitation expenses and administer the organization should be classified as revenues other than from contributions[2]. This provision allows the use of funds to dictate their classification rather than reflecting the intent of the donor. Some of the amounts contributed may be used for program, some for administration and solicitation, and some may be added to reserves of the fund-raising organization. The amounts should be classified as contributions regardless of how the funds are used.

The effective date should be for fiscal years beginning after December 15, 1995 The proposed effective date is for fiscal years beginning after June 15, 1995 (with a delay to December 15, 1995 for small organizations). There is no basis for the June 15 date and it is prior to the end of the comment period for the proposed guide. SFAS No. 116 and No. 117 are effective for fiscal years starting after December 15, 1994 (with a delay to December 15, 1995 for small organizations). There was no better guidance available on June 15, 1995 than there was on December 15, 1994, so an effective date before a new guide is issued makes no sense. There should be a commitment to complete the guide by December 15, 1995 and make it effective on that date. Large associations will be operating without specific guidance for a year but the June 15 date does not correct that problem and simply adds confusion about when action must be taken.

Flexibility in language and financial statement format allowed by the guide is desirable Footnote 1 on page 18 specifies that terms such as "Statement of Financial Position...serve as possible titles... Other appropriately descriptive titles may also be used ... (such as) balance sheet..." Similarly, paragraph 3.08 and footnote 1 on page 105 say the term "equity" is an acceptable synonym for "net assets." Footnote 2 on page 105 also mentions flexibility in terminology. Paragraphs 3.12 and 13.03 say revenues and expenses can be differentiated between "operating and nonoperating" and in other ways, "such as by business segments." Paragraph 3.13 allows "an intermediate measure of operations" within the statement that reports all changes in unrestricted equity which would seem to allow a

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[2] This provision is in a section of the guide specified for federated fund-raising organizations but this provision seems inappropriate, even for these organizations. As noted elsewhere in this letter, we oppose rules that are applicable only to one type of organization.

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measure such as "Profit/loss from member services" (SFAS No. 117 mentions such terms as "operating profit" and "results of operations"). These provisions are desirable, allowing associations to follow business style financial reporting if they choose, thus portraying their business-like operations.

*****

The above comments reflect our views on the major issues raised by this proposed audit guide. In addition, an appendix provides our response to the specific issues identified in the proposal and make a number of additional suggestions.

We will be pleased to discuss these comments with you and members of the Not-for-Profit Organizations Committee.

Sincerely,

W. Kent Feddeman, CPA
Managing Director
Feddeman & Company, P.C.

Ronald R. Kovener, CAE
President
Association Information
Management Service, Inc.

RRK8:guide-as.cpa

APPENDIX

Response to the specific issues for comment

With respect to the questions on Issue 1:

- -- Variance power transfers discretion over funds from the donor to the donee, thus making the receipt a contribution, not an agency transaction. Paragraph 5.02 and 5.04 properly state that the recipient of agency funds has little or no discretion concerning their use. Variance power gives the donee sufficient discretion to classify the amount as a contribution. The action of the donor establishes the classification of the receipt, not the action of the donee, therefore the donee's history with respect to exercising the discretion granted does not influence the classification.

- -- The existence of variance power is a sufficient transfer of discretion from the donor to the donee to warrant recognition of the receipt as a contribution as noted in the previous point. A donor's action to "advise" rather than "direct" further underscores the transfer of discretion to the donee. As with the previous example, the history of action by the donee is irrelevant.

- -- There is authority in the proposed guide for handling the principal of a gift differently from the earnings on that gift. For example, paragraph 8.08 specifies that when a donor contributes to an endowment, "the initial gift creates permanently restricted net assets; the investment income is temporarily restricted..." It is reasonable to recognize each aspect of this transaction consistent with the direction of the donor, even if one aspect is an agency transaction rather than being a contribution.

With respect to Issue 2, it seems reasonable to differentiate between a discount and an exchange transaction. The example in the issue description is reasonable. Something of value is provided and received and it is reasonable that the financial records should reflect this transaction.

Other comments

The last sentence of paragraph 1.08 overstates the use of fund accounting by not-for-profit organizations in the past. Consistent with the first sentence, the last sentence should say "... some not-for-profit organizations used fund accounting...:

Paragraph 3.08 says "Revenues, expenses, gains, and losses should be classified by (equity) class." The word "expenses" should not

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be included in this list, because paragraphs 3.10 and 13.03 properly specify that expenses may only affect unrestricted equity.

SFAS No. 117, paragraph 26 deals with functional and natural classification of expenses, specifying only that voluntary health and welfare organizations must use a matrix format to display both classifications of expenses. For other organizations that choose to report the natural classification of expenses, two separate listings, possibly one on the face of the statement of activities, the other in the notes, should be sufficient. The second bullet of paragraph 3.15 of the guide seems to require the matrix format for certain organizations if they choose to present both functional and natural classification of expenses. All associations should be permitted to use two separate lists of expenses if they choose to report both classifications. This alternative can be more clearly allowed by removing the words "in a matrix format in a separate financial statement."

In table 5.2, the resource provider's records, if available, could serve as an additional indicator for distinguishing contributions from exchange transactions. Resource provider records that classify a transaction as a contribution or as a purchase are clear indications of intent. Similarly, the resource provider's records could help distinguish a promise to give from an intention to give. SFAS No. 116 requires a donor to recognize expenses when making a promise to give. Failure of a resource provider to record a contribution payable in the future is an indication that the communication represents a intention, not a promise.

Section (a) of paragraph 5.39 seems to contain an error or is unclear. The use of the temporarily restricted classification is not limited to the situation described. A pledge may be restricted as to its time of use in many ways, not simply to the time when the pledge is paid.

It might be helpful for paragraph 5.43 to begin by saying "The fair value of contributed services..."

In example 2 on page 48, the sentence at the bottom of the page probably should say "Discount rates ranged from..."

The first sentence of paragraph 6.04 should be expanded to refer to "... part-contribution <u>and</u> part-exchange <u>or part-agency</u> transactions."

Paragraph 8.01 adopts the guidance of the exposure draft of a proposal that differs from SFAS No. 115 concerning valuation of investments. While we understand that the final guide must incorporate such guidelines when they become final, we wish to note that we disagree with the proposal to apply different valuation standards to not-for-profit organizations than to other organizations. The provisions of paragraph 8.06 underscore the confusion that results from different rules for different organizations.

Footnote 1 on page 111 says SOP 87-2 is "<u>the</u>" AICPA statement applicable to allocation of costs among functions. SOP 87-2 discusses one specific allocation issue, not the subject of allocation generally. Paragraph 13.34 of the proposed guide discusses the many types of expenses that must be allocated. Footnote 1 on page 111 should be modified.

13.36 says subsequent paragraphs provide information about cost allocation. Paragraph 13.37 is the only one that discusses this subject, so the reference in 13.36 might be clarified.

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AUG 15 1995

August 14, 1995

Mr. Joel Tanenbaum
Technical Manager
Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

File Reference: 3605.AG--Exposure Draft, Proposed Audit and Accounting Guide, Non-for-Profit Organizations

Dear Mr. Tanenbaum:

We are pleased to comment on the above referenced Exposure Draft (ED). As more fully described in the enclosed 1994 Annual Report, Second Harvest helps to feed the nation's hungry by soliciting, on behalf of member food banks, donations of food and grocery products from a variety of sources for distribution by our member food banks to their agencies who in turn feed the hungry. Our member food banks will be impacted in a variety of ways by the recent issuance of Statements of Financial Accounting Standards No. 116 and 117. Likewise, they will be impacted by the issuance of the above referenced Audit and Accounting Guide. For your information, a copy of the 1993 Annual Report of the Food Bank of the Rockies is included as representative of the operations of our member food banks.

Second Harvest will be less impacted than our member food banks since it will not be required to record, as contributions, the product donations that it solicits for the food banks as they are by definition agency transactions. It appears, however, that our member food banks will be required to record, as contributions, the product donations that we provide to them, as well as the product donations that they solicit directly. Accordingly, Second Harvest is commenting on the ED on behalf of our member food banks.

Furthermore, Second Harvest has in recent years calculated and published in promotional materials a value for the product donations that we successfully solicit. The purpose of such disclosure is to provide our various constituencies with a better understanding of the impact of our efforts than can be determined from a reading of our financial statements, which primarily reflects cash-settled transactions. Our valuation procedures are described later in this letter. Second Harvest would like to propose that our valuation procedures be considered a reasonable methodology to

116 SOUTH MICHIGAN AVENUE, SUITE 4
CHICAGO, ILLINOIS 60603-6001
(312) 263-2303
FAX: (312) 263-5626

value product donations and therefore could be adopted by our member food banks for financial statement preparation. In this way, our valuation procedures can serve our separate promotional purposes as well as the financial statement purposes of our member food banks, to the extent possible. Our principal concerns and those of our member food banks relate to valuation of the donated product. We are concerned that the ED does not provide sufficient guidance in measuring the value of product donations to organizations such as our food banks. Second Harvest expects other non-profit organizations that receive donations of used clothing, furniture, etc. may face similar difficulties as described below.

There are a variety of product donors including food manufactures/processors, wholesalers, distributors, retailers, restaurants and food service firms. Product donations received by our member food banks are typically products that are unsaleable by the donor through normal "first line" channels and frequently even through secondary channels. Although the products are wholesome, they are off-spec in some marketing sense such as color, size, appearance, packaging problems, etc. In the normal course of minimizing their costs, our donors typically select the most economically attractive option to dispose of such product. Frequently, such products can be and are sold to secondary markets if the "problem" is not that significant. Often, however, the only other disposal option for product donated to food banks is to physically waste the product since it has no use. In salvage or reclamation operations food banks sort through a mixture of unsaleable and unusable product to "glean" wholesome useable product. Occasionally, however, even first line product will be donated by individuals and other donors in connection with food drives as well as in connection with promotional activities of the food bank sponsored by donors.

SFAS No. 116 describes in paragraph 19 to 21 acceptable valuation approaches and the ED elaborates on such guidance in paragraphs 5.48 to 5.56. Given the nature of the product, as described above, it is obvious that there is no relevant quoted market value information available. Due to the varied donor sources, the donors' value is not consistent across similar products. Appraisals are clearly not practical. Present value techniques do not apply to these circumstances as the food banks do not sell the product. Food banks do not have access to information to develop replacement cost information. The discussion that follows describes aspects of valuation specifically related to donated off-spec products.

Assuming that donors typically handle such off-spec product in the most economically attractive manner, it would seem the fair value of the donated product would approximate the lesser of (to be conservative) i) the reduction in income taxes that the donor receives by donating the product or ii) the favorable economic impact, net of income tax effect, of the avoided cost to waste the product. Calculating the

income tax effects of such values could be unreasonably burdensome for the donors and not developed timely enough for the reporting purposes of the food banks. Another relevant value might be the income tax basis cost of the item since, if the donor could sell the product and recover at least its cost it would typically pursue such a course rather than donate the product. Donors are not likely to be willing to disclose confidential cost information to food banks. The income tax deduction that the donor receives by contributing the product would not seem to provide any relevant valuation information since the deduction equates to income tax basis cost plus 50% of the gross margin on such product.

As implied above, the donor's reason for donating a particular "load" of product is most indicative of the level of value. It is not practical, however, for food banks to learn this reason; they are not in a position to insist that donors disclose this information. Furthermore, Second Harvest and its member food banks are very concerned that the imposition of any level of additional effort on donors to allow food banks to accept the donated product will likely have a negative impact on the level of product donations. This must be avoided, if at all possible. Even without this problem the food banks are likewise not in a position to insist that donors provide a calculation of any of the values described above. Another alternative might be for donors to provide food banks a valuation consistent with their reason for donating. The donors' reasons for donating each "load" of product clearly vary due to the precise "problem" with each such "load" and there maybe overall different reasons or classes of reasons for donating among different donor groups. Theoretically, the different reasons or "problems" should dictate different valuation techniques, virtually on a "load by load" basis. As discussed above, however, not only is it impractical to resolve many of the fundamental valuation problems overall, it would be even more impractical to apply different valuation techniques from "load to load". Accordingly, guidance in developing a straight forward, cost effective standard valuation methodology to be applied to all donated product irrespective of the type of and the donor's reasons for donating, must be developed and included in the final Guide. Again, food banks are not in a position to insist that donors provide such information; frequently, there may not be a formal valuation other than the information used to calculate the income tax driven values described above, anyway.

Given the previously described difficulties in developing a value, it may seem appropriate to turn to the guidance in SFAS No. 116 in the first sentence of paragraph 19, "A major uncertainty about the existence (emphasis added) of value may indicate that an item received or given should not be recognized." and the first sentence of paragraph 5.49 of the ED, "Major uncertainties about the value of a contributed asset may indicate that a contribution should not be recognized.". The footnote to the SFAS No. 116 paragraph cited above and the balance of paragraph

5.49 of the ED do not provide useful guidance since the circumstances referred to therein are not present here. We question the reason of the absence of the word "existence" in the cite from the ED. It is clear that the donated product received by food banks has value; insurance coverage is frequently carried on such inventory, agencies of food banks are occasionally found to be selling such products at flea markets (which results in termination of the agency's relationship with their host food bank), etc. Furthermore, there are not necessarily uncertainties about the existence of value, but rather unusual difficulties in determining such value. Clearly, to opt to exclude any value for this donated product in the financial statements of the food banks because of the measurement difficulties dramatically understates the scope of their operations and is at variance with one of the key objectives of SFAS No. 116. Unfortunately, however, the valuation issue is extremely difficult, and as discussed above, neither SFAS No. 116 nor the ED provide sufficient guidance for food banks and other organizations similarly situated.

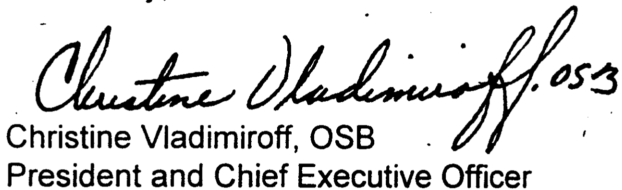
Lastly, let me describe briefly the valuation methodology that Second Harvest has used for promotional purposes. Prior to 1994, a retail value was calculated based on a statistical sample of retail values, weighted among approximately 30 categories of food and grocery product accordingly the poundage of different products Second Harvest solicited in that year. Note that product donation and distributions in the food banking industry are consistently measured in pounds regardless of the product involved. Beginning in 1994, it was determined that retail value was not appropriate and a wholesale value was developed in much the same manner as the above procedures except that the retail values were reduced through the application of a wholesale to retail markup factor obtained from grocery industry sources. Wholesale pricing seemed more appropriate as it measures the useability of the product whereas retail measures the marketability of the product Currently, Second Harvest is calculating a 1995 value and is contemplating a similar approach as for 1994 except that a combination of wholesale and "generic" whole pricing may be used where available. It would appear that "generic" pricing gets even closer to the useability issue since such products tend to avoid the marketing issues of branded product which add to cost. There are many problems associated with this effort including possible geographic differences in cost, donor units of measure versus food bank units since food banks only track poundage where as the grocery industry uses a variety of units of measure, gross versus net weight due to varying packaging types, donation assortments which are difficult to specifically identify, etc. Nevertheless, Second Harvest is committed to resolving these issues and is hopeful that its outside auditors will attest to a list of approximately 30 different product categories of value which will be used for promotional purposes. In addition, Second Harvest is in the process of reviewing the practicality of our outside auditors attesting to the methodology used at arriving at the valuation such that member food banks can use such values in the recording of product contributions received and

made. None of our member food banks have the resources to develop anything other than very rough values on their own.

Please consider the above discussion as you finalize the ED and consider adding guidance covering circumstances such as those faced by our member food banks. If you believe the approach outlined above that Second Harvest is planning to follow for 1995 is reasonable, please include appropriate language in the final Guide. If your believe there are other practical approaches that are also acceptable or better, please include appropriate descriptive language in the final Guide. If is it not considered necessary to address the concerns described in this letter in the final Guide, we respectfully request, at a minimum, a response from your staff providing us with some guidance or explanation of how the guidance in the ED should be applied in our circumstances.

We would be pleased to discuss this matter, at your convenience, if you wish. You may contact me directly or Beth Saks, Director of Finance & Information Systems.

Yours truly,



Christine Vladimiroff, OSB
President and Chief Executive Officer

Enclosures

Attachment 1

Letter #109 Re: NPO Audit Guide

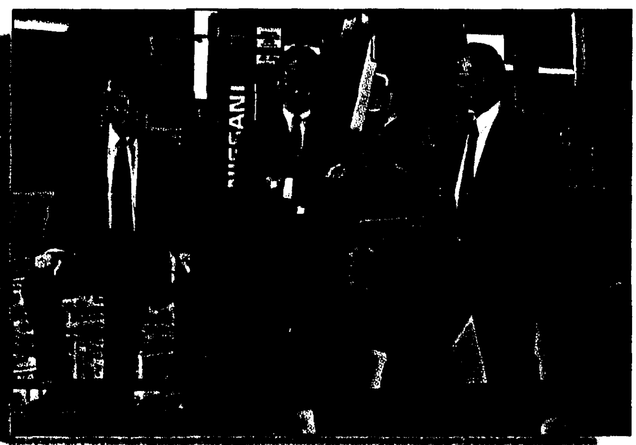
1993 Annual Report

Letter 109
Attachment 1

The Food Bank of the Rockies exists to create an efficient means of channeling food to participating agencies that count on us to meet the needs of the hungry. We do this by seeking, collecting and distributing vital sustenance that enriches the lives of the citizens of metropolitan Denver, northern Colorado and Wyoming.

Dear Friends,

The Food Bank of the Rockies continued to make progress in alleviating hunger in 1993, even though national statistics on hunger remain staggering and seemingly insurmountable. According to the *1993 Second Harvest National Hunger Study*, nearly 26 million Americans received help from our network alone. And sadly, 42.9 percent of those in need were children. The fact that Colorado's economy is purportedly *rebounding* caused an influx of unemployed persons from other states during the year, seeking work. This resulted in an additional burden on pantries and soup kitchens.



The Food Bank met these challenges by handling a record 8.8 million pounds of food and household items. This is especially notable since our goals were far more modest in light of the construction and remodeling in progress. In fact, many goals were met and exceeded throughout the year—most noteworthy was the successful completion of the Capital Campaign. This provided the funds for the purchase of our building and related expenditures which will enhance the efficiency, cost effectiveness and safety of our facilities and allow us to better serve our agencies.

None of this is possible without the consideration and generosity of people like you. Feeding the hungry is an all important first step which enables food recipients to once again become productive members of society. On behalf of the Board and Staff of the Food Bank, and those who depend on us, thank you.

Sincerely,

Bob Slosky, *Chairman of the Board, 1993*
Seth Patterson, *Chairman of the Board, 1994*
Rick Rank, *President and CEO*

Operating Expenses

What have we done lately?

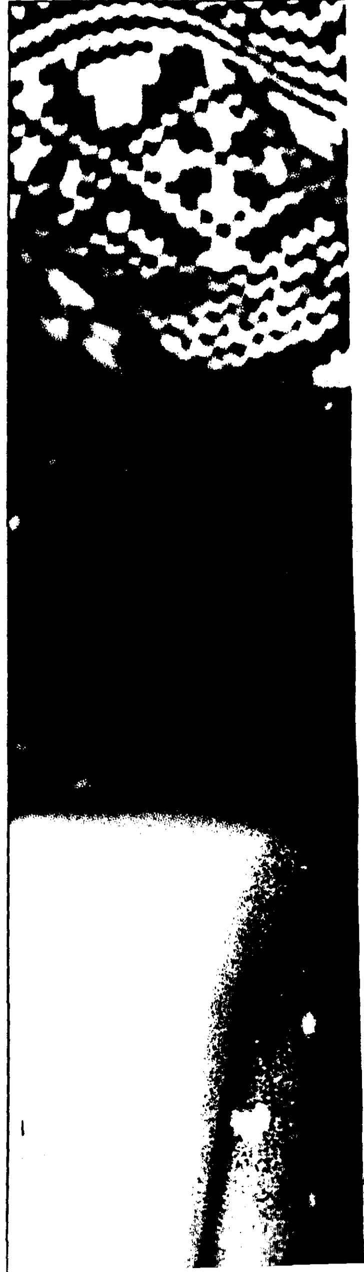
It would be hard to imagine another year like 1993 for the Food Bank of the Rockies. But it is because of our accomplishments during this banner year that we look ahead to doing even more in 1994. Last year saw the continuing and expanded success of our ability— handling a record 8.8 million pounds of food for agencies that help feed the many men, women and children of northern Colorado and Wyoming in need of assistance. It saw the successful culmination of our Capital Campaign and construction of our reclamation center. It also witnessed the purchase and remodeling of our warehouse on 47th Avenue—yielding a savings of $81,000 annually to further expand services.

We view this new home as a launching pad from which we can introduce such programs as Kid's Cafe. Launched in February 1994, Kid's Cafe is designed to provide hot nutritious meals for children in the security of a nurturing environment. Food Bank's new home also serves to enhance programs such as our three-year-old Denver's Table—which routes prepared foods that might otherwise go to waste, from restaurants, institutions and catering services, through our warehouse and out into the community to provide meals for the hungry.

We saw the introduction of several new food and fund raising events in 1993. With the community participation and imagination which provided us our 47th Avenue launch pad, we will endeavor to create even more events. We will offer expanded opportunities for those who are more fortunate, to help those who are in need.

And, of course, there have been all the donations in hours and dollars which have assisted us since our modest beginnings in a single classroom in an unused school just 15 years ago.

Together, we can do even more.



Who benefits from the Food Bank of the Rockies?

According to the 1993 *Second Harvest National Hunger Study*, 31.4 percent of Food Bank's beneficiaries are former skilled workers, salespeople, skilled craftspeople, technical, managerial, professional or self-employed individuals. These are men and women who, for the most part, did not expect to need this type of assistance as recently as three months ago.

Even more serious are the hungry children who need proper nutrition so they can grow physically and mentally. Then there are the senior citizens who sometimes have to make the choice between medication or food, which is no choice at all.

The problem of feeding the needy escalates every year, every month and every day. It affects people across all socioeconomic, ethnic and geographic lines. The cry for help is heard in suburbs, rural areas, inner cities and small towns alike. In the United States, the numbers add up to more than 25 million hungry people, or a staggering 10.4 percent of the population.

In northern Colorado and Wyoming, there is a proportionate number of people who are down on their luck, who need nutritious meals to help them get back on their feet.

The Food Bank of the Rockies directly assists men and women who are temporarily unemployed or underemployed. We assist women—often single parents—who are trying to rebuild their lives from the tattered remains of an abusive relationship. We assist the elderly who need a means of stretching their meager, fixed incomes. But most importantly, the Food Bank assists the children, who need good nutritious meals to allow them to concentrate on their education. This translates into the knowledge and self-esteem necessary to become good productive citizens, to contribute to the common good — rather than becoming a burden to society.

Who benefits from the Food Bank of the Rockies? We all do.

How much food does it take to feed the needy?

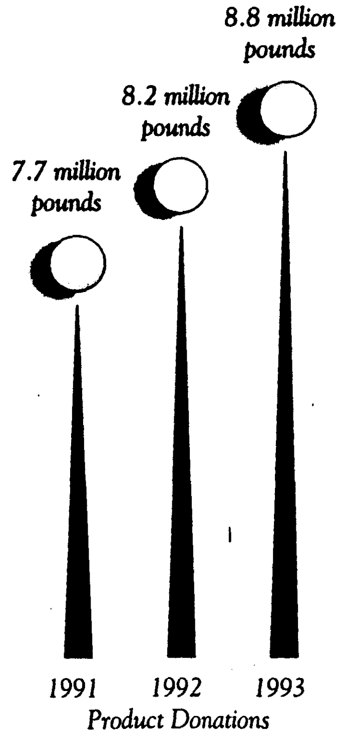
During 1993, the Food Bank handled more than 8.8 million pounds of food, up 600,000 pounds from the year before. This translates into a total of 550,000 meals each month. All of this was donated from more than 400 food manufacturers, distributors and retail stores including Cub Foods, General Mills, Keebler Company, King Soopers, Oroweat, Ralston Purina and Safeway, Inc. For the most part, food donations consist of milk and dairy products, beverages, frozen and canned vegetables, cereals and protein supplements that come from surpluses, mis-marked packaging, or items about to reach their "sell-by" date codes.

Once collected by, or delivered to the Food Bank, items are brought to the warehouse where staff and volunteers inspect everything to ensure that industry standards are maintained. The Food Bank warehouse meets all food industry standards for product handling, storage, warehouse sanitation and inventory control.

The food is then made available to 610 member agencies such as shelters, emergency assistance programs, child welfare centers, senior citizen nutrition programs, churches, synagogues, community centers and halfway houses. A support fee contributed by these nonprofit agencies, helps cover the Food Bank's operating expenses. Under an approved IRS plan, the Food Bank can ask participating agencies to contribute $.14 per pound of food and essentials. However, to prevent spoilage—and further waste—the Food Bank of the Rockies asks only $.07 per pound for bread, and asks nothing for fresh produce or food collected via food drives. During 1993, more than two million pounds of food were distributed at no fee.

Many of the 610 member agencies in northern Colorado and Wyoming support several nutritional programs, extending Food Bank's contributions to more than 900 feeding programs.

Yet, with all the hundreds of volunteers, and all the tons of food donated and distributed, someone in our beautiful Rocky Mountain region still goes hungry.



Product Donations

What's the cost of feeding the hungry?

As part of the national food bank network, Second Harvest, Food Bank of the Rockies forms a vital link with food distributors to reclaim groceries which might otherwise be wasted. In fact, *Money* magazine ranks Second Harvest as the second most efficient charity in the United States.

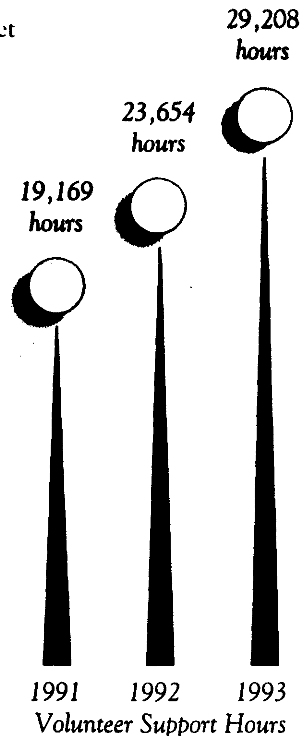
Founded on the simple principle of reducing hunger by reducing waste, Food Bank of the Rockies gets more value out of a dollar than almost anyone. Food Bank volunteers numbering 1,130 in 1993, contributed an average of 2,434 hours (the equivalent of 14 full-time staff persons) each month to assist in administrative and warehouse operations. This significantly reduced overhead so that donated money was available to improve and expand services and programs.

Volunteers and efficient management help the Food Bank make every $1 contributed account for $16 worth of donated food which reaches someone's table.

$\$1 \times \frac{\text{8.8 million pounds of food}}{\text{Contributed income}} \times \underset{\text{(Estimated retail value)}}{\text{\$2.17 per pound}} = \$16$

This converts a donation of $115 into enough nutritious food to feed a hungry child for a year. It helps individuals over a tough spot, and back into a productive life. And, in 1993, the Food Bank helped thousands of people here in the Rocky Mountain region get back on their feet.

What is the cost of feeding the hungry?
Maybe the better question is,
What is the cost of not feeding the hungry?



Volunteer Support Hours

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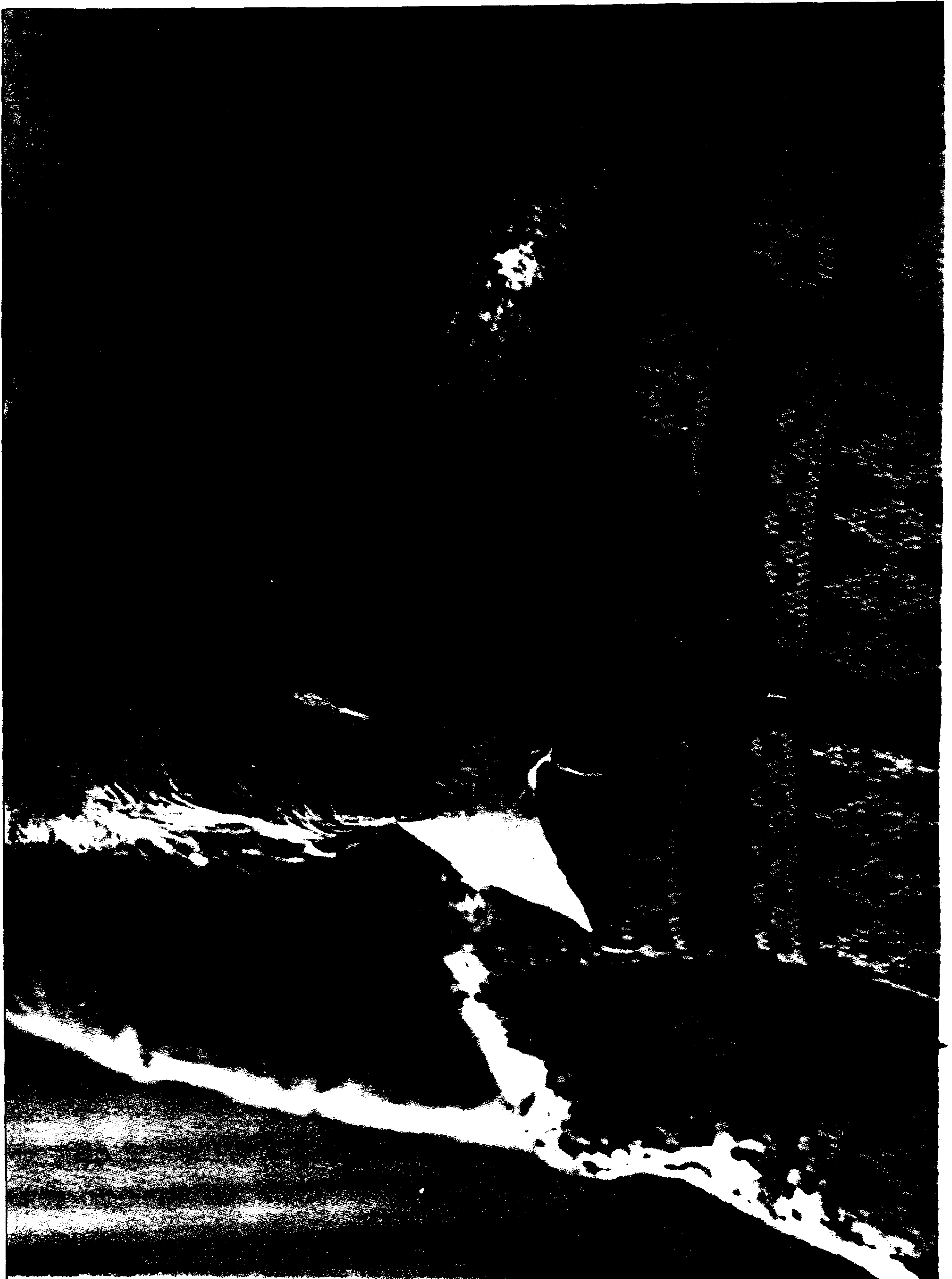
How did the Capital Campaign help the Food Bank?

The Capital Campaign was the most significant fundraising activity ever mounted by the Food Bank of the Rockies. The Campaign implemented our plan to purchase and remodel existing Food Bank facilities and to erect the new Frances J. Cole Reclamation Center on 47th Avenue.

The new facility brought all operations under one roof, saving time and energy for the staff of the Food Bank, and the staffs of its member agencies. In addition, ownership of the entire complex saves the Food Bank $81,000 per year in rent and taxes, money which can be used to improve and expand service and programs.

The entire philanthropic community, including the City and County of Denver, corporations, foundations and individuals rallied to the cause and raised enough funds to make these impressive capital improvements. From these many sources, the Food Bank of the Rockies continues to grow and serve those in need.

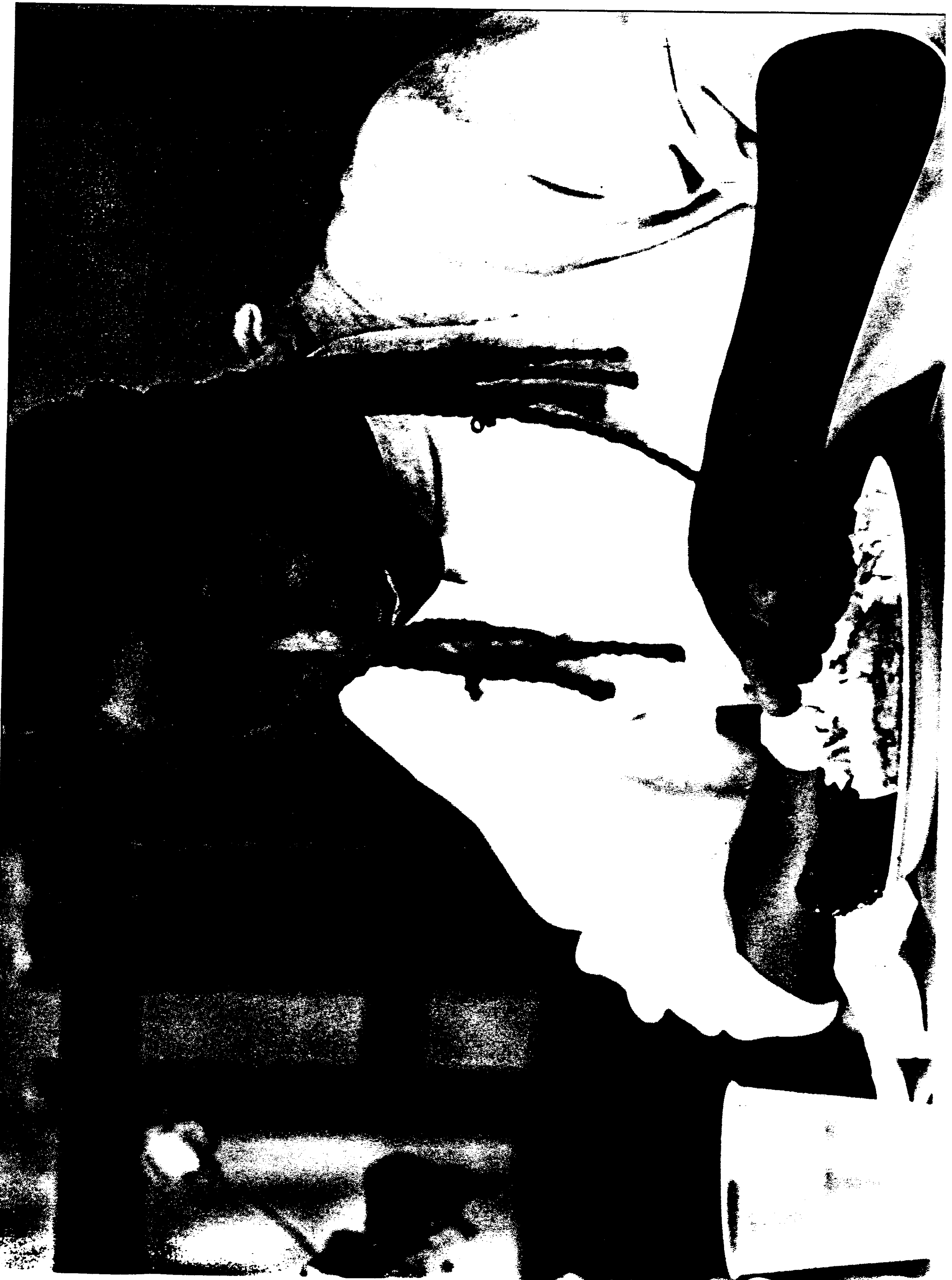


Does the Food Bank help the community in other ways?

Denver's Table was launched by the Food Bank in 1991 to address the fact that 20 percent of the food prepared in commercial settings in the United States is wasted—enough to feed millions of people. Denver's Table now picks up surplus, prepared food from caterers, restaurants, institutional cafeterias, corporate dining rooms, hotels, convention centers, hospitals and other providers throughout the food service industry.

Requiring special handling and containers, this food is transported to the Food Bank in specially-designed temperature-controlled trucks (the first one was donated by Continental Airlines) to assure freshness. Agencies receiving this food reheat it according to health and nutrition guidelines to provide meals for the needy.

Kicked-off in February of 1994, Kid's Cafe will become one of the prime recipients of the bounty from Denver's Table. Kid's Cafe carefully selected five inner-city programs to serve meals to needy children (some during the day, others in the evening) in a safe and nurturing atmosphere. These programs were chosen for this partnering endeavor because of their existing mentoring, tutoring, gang intervention or leadership development services to children. Kid's Cafe enlists its own specially-qualified team of volunteers who typify realistic, quality role models in this atmosphere of dignity, respect and care.



Has the Food Bank exhausted its sources of food donations?

Thanks to the efforts of volunteers, an integrated network of food banks across the nation and the support of the community, there is no end to what Food Bank of the Rockies can accomplish. A variety of food drives and other programs—some instituted by groups and organizations, some by other food banks in the United States—have created new ways to generate food donations.

In 1993, the Food Bank of the Rockies received donations from food drives such as the National Association of Letter Carriers Union, who picked up cans of food as they delivered the mail; from Subway Sandwich Shops, who traded a six-inch sandwich for a can of food; from concerts, where entertainers like Bruce Carroll performed and admission was food for the needy. In addition, corporations like Cub Foods helped with "Check out Hunger," a program where, through the use of a coupon, shoppers could make a point-of-purchase donation directly to the Food Bank when they bought groceries. Safeway, Pepsi-Cola and *The Denver Post* lent their considerable efforts through the "Harvest of Hope" food drive—where a grocery bag was inserted in the morning paper, so subscribers could fill it with nonperishable items, and then leave it at a Safeway store for pick up.

The second annual Canstruction Food Drive was staged by the Denver Chapter of the Society of Architectural Administrators and the American Institute of Architects. Creative edifices, constructed entirely of cans and boxed foods, drew an admiring audience and 11,000 pounds of food items to donate to the Food Bank.

Additionally, 1993 saw the repeat of such successful food and money raising events as the annual One Step Closer run, sponsored by Alfalfa's Markets, Coleman Meats, Coors and Rice Dream; and the Heart of Gold Ball honoring Mrs. Barbara Johnson Hartley. The year also saw a once-in-a-lifetime food drive event when thousands of international pilgrims converged for World Youth Day. Along with the Pope and President Clinton, swollen food coffers appeared with such exotic products as *Trai Vai*, *Ananas* and *Soupe Aux Tomates*.

Has the Food Bank exhausted its sources of food donations?

Not as long as there are caring individuals willing to help their less-fortunate neighbors with imaginative events, generous hearts and their precious time.

1993 Food Bank of the Rockies Donors

Annual Campaign Donors

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D.C. Metzger Company, Inc.
Daily Juice Product
Damage Track
Dan-Ka International, Inc.
Dannon Company, Inc.*
Dawn Bakery Service Center
Denver Bishop's Storehouse
Denver Buffalo Company
Dial Corp.
Disco (Monfort Transportation)
Dixon Paper Company
Dole Fresh Vegetables Company
Dolly Madison
Dominos Commissary
Donson's Distributing, Inc.
DowBrands, Inc.*
Dreyer's Grand Ice Cream, Inc.
DPI, Dykstra Sales.
Entenmann's Inc.-Oroweat
F&S Sales
Farm & Homes
Federal Fruit & Product Company
FFE
Fiesta Canning
Food Products Company
Fresh Fish Company
Frito-Lay, Inc.
Frozen Fruit Corp.
Fuji Foods US, Inc.
Full Service Beverage
Gallo Salami
General Mills, Inc.
Geo. A. Hormel & Company
Georgia-Pacific Corporation
Giambrocco Produce Company
Golden Grain Company
Golden Valley Microwave*
Grayson Distributors of Denver
Great Western Tortilla Company
Green Bay Food Company (Dean Foods)
Grill Brokerage Company
Hauser NW Forest Greens
Heinz Bakery Products*
Helmer & Associates
Hershey Chocolate USA*
High Rockies Transport
Highland Stone Hall
Hillshire Farm & Kahn
Hobby Whalen Marketing
Hormel Foods
Hudson Harwood Produce
Hunt-Wesson, Inc.*
IACH/GSA*
Imperial Bondware Corp.*
Information Resources
J & J Snack Food Corp.
J. M. Smucker Company
J. R. Simplot Company*
Jackson's Ice Cream
JDS & R Produce
Jensen's Foods
John Cope's Food Products, Inc.
John Morrel & Company (Honey Baked Hams)
Johnson Food Products
Johnsonville Foods
Just Squeezed Juices
Justborn, Inc.*
Keebler Company
Kellogg Company*
Kikkoman International
King Soopers
King's Hawaiian Bakery
Kinsella Cartage, Inc.
Kirkpatrick Brokerage Company
Kraft Food Service Company
Kraft General Foods*
Land O'Lakes, Inc.*
Larsen Vegetable/Dean Foods
Late Night Foods
Leaf Confectionery, Inc.*
Lenders Bagel Bakery
Leprino Foods
Liberty Orchards
Lickety Split Ice Cream
M&R Holstein
MC Snack, Inc.
M&M/Mars*
Mady's Specialty Foods, Inc.
Malt-O-Meal Company
Market West Brokers
Maui Foods
McFerren, Speakes & Gustafsen
McLane Western, Inc.
Mead Johnson Company*
Metwest Agribusiness
Meyer's Bakeries
Mid-Continent Sales
Mile Hi Express
Mile Hi Baking Company
Mile Hi Frozen Foods
Mile High United Way
Miles, Inc.
Miniat
Mountain States Plastics
Mountain View Brokerage
Mr. Bagel
Mrs. Condies Salad Company, Inc.
N.K. Hurst

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Nabisco Biscuit*
Nabisco Brands, Inc.*
Nally's Fine Foods
National Oats Company
National Sea Products
Nestle Food Corp.
Nobel-Sysco
Ocean Spray Cranberries, Inc.*
Ore-Ida*
Orval Kent
Oscar Mayer Foods Corp.
Owatonna Canning Company
Pace Warehouse
Packaging Systems
The Park Corporation
Pastitos, Inc.
Payless Drug Stores
Pepperidge Farm
Pepsico*
Perrier Group of America*
Pet, Inc.*
Pillsbury Company*
Pillsbury Refrigerated Foods
Pitaria
Pizza Hut, Inc.*
Plochman, Inc.*
Post Food Service
Price Club
Pro Source Distribution Services
Proctor & Gamble Company*
Quaker Oats*
Quality Distributing
Rainbow Natural Foods
Ralston Purina Company
Real Food
Red Seal Snack Co.
Reese Finer Foods, Inc.
Riceland Foods
Rich Products Corp.*
Riviana Foods, Inc.*
Robinson Dairy
Rocky Mountain Natural Meats
Rocky Mountain Fruit & Produce
Rocky Mountain Fresh & Natural
Rocky Mountain Shitake
Rocky Mountain Marketing Services
Ron Son Mushrooms
Ross Laboratories*
Royal Crest
Royal Crown Foods
S&W Foods
Sabritas c/o PFS*
Safeway, Inc.
Sales West Inc.
Salvation Army
Sam's Meats
Sara Lee Bakery Company*
Seneca Foods
Sidari Food
Sigman Meat Company
Silver State Foods, Inc.
Simply Potatoes
Snapple Natural Beverage Company*
Snider-Hayes & Hurd
Solo Cup Company*
Southern Tea Company
Southland Foods*
Sportsmen Against Hunger
Steve's Meat Market
Stokes-Ellis
Stouffers Foods
Sullivan Hayes Companies
Sunkist Growers, Inc.
Sunset Specialty Foods
Super Valu Stores, Inc.
Superior Performance International
T.J. Lipton, Inc.
Templin & Erickson Brokerage, Inc.
Thomas Frozen Foods
Three Tomatoes
Tom's of Maine
Trans-Western Express, Ltd.
Tree Top, Inc.*
Trinidad Benham
Tropicana Products, Inc.*
True Value Hardware
Tyson Foods, Inc.*
Ultimate Foods
Uncle Ben's*
United Distributing Company
Universal Frozen Foods*
University Hills Baptist Church
U.S. Post Office-Denver Branches
Van Den Bergh Foods Company
Veryfine Products, Inc.*
Vie de France
Violet Speakes
Vollmers Bakery
VSA
Walley's Quality Meats
Western Sugar Company
William Sonoma Stores
Ernestine Williams
Willis Shaw Frozen Express, Inc.
Yoplait Foods
York Distributing Company

*Donated nationally through Second Harvest

Other Food Bank Donors

Food Bank of the Rockies' Affiliates
    Community Food Share, Boulder;
    Food Distribution Center of Larimer County, Fort Collins;
    Weld Food Bank, Greeley
Akron-Canton Regional Foodbank
    Akron, Ohio
Care and Share
    Colorado Springs, Colorado
Central Coast Second Harvest
    Watsonville, California
Community Food Bank, Inc.
    Tucson, Arizona
Food Bank of Iowa
    Des Moines, Iowa
Food Bank of Southeastern Virginia
    Norfolk, Virginia
Food Bank of Northern Nevada
    Sparks, Nevada
Food Depot of West Tennessee
    Jackson, Tennessee
Gleaners Community Food Bank
    Detroit, Michigan
Harvester, Kansas City, Missouri
Houston Food Bank, Houston, Texas
Nebraska Food Bank Network
    Omaha, Nebraska
San Antonio Food Bank
    San Antonio, Texas
Second Harvest Gleaners Food Bank of W. Michigan, Grand Rapids, Michigan
Second Harvest St. Paul Food Bank
    Maplewood, Minnesota
Second Harvesters of Wisconsin
    Milwaukee, Wisconsin
South Central Pennsylvania Food Bank,
    Steelton, Pennsylvania
South Plains Food Bank
    Lubbock, Texas
Southern Appalachian Food Bank
    Knoxville, Tennessee
Spokane Food Bank
    Spokane, Washington
Westside Food Bank
    Sun City, Arizona

Denver's Table Food Donor List

Adam Wholesalers
Air & Waste Management Association
Alpine Bakery
American Airlines
American Linen Supply
American Society of Hospital Pharmacists
ARA Leisure Services
Ascot Dinner Theater
AT&T
Aurora Regional Medical Center
Baby Doe's Restaurant
Bagel Boys
Bequette Appetizers, Inc.
Black-Eyed Pea Restaurants
Broker Restaurant-Downtown
Buckhorn Exchange Restaurant
Burger King
Cakes by Karen
Caulkins Indiantown Citrus Company
Chives American Bistro
Cincinnati Bell Information Systems
CDS Corporation
Chelsea Catering Corporation
Chowda House
CoCo's Restaurants
Colorado Convention Center
Colorado Restaurant Association
Colorado Rockies
Country Palace
Craig Hospital
Cruisin' Cuisine
Denver Art Museum
Denver Department of Social Services
Denver Marriott City Center
Denver's Catering
El Paso Restaurant
Elitch Gardens
Embassy Suites Hotels (2 Locations)
Emerald Isle Restaurant
Federal Reserve Bank
First Interstate Bank
Frangis Italian Food
Great West Life Assurance Company
Greek Orthodox Cathedral
Grill Brokerage
Girelli's Sub Shop
Helmer & Associates
Hilton Hotel
Holiday Inn
Hyatt Regency Hotel Downtown
In House Food Service
Inn At The Mart
International Golf Tournament
Jimmy's Grill
King Soopers Catering
King Soopers Floral Design Center
Kraft Food Service, Inc.
Le Bakery Sensual
Life Partners Group
Littleton Hospital
Longmont Foods
Lutheran Medical Center
Manchester Farms
Marc's Restaurant
Meadow Gold
Merchandise Mart
Mile High Frozen Foods
Mrs. Fields Cookies (3 Locations)
National Association of College Stores
National Jewish Center
National Linen Service
Old Spaghetti Factory
Olive Garden Restaurants
Pappardelles Pasta
Peaberry Coffee
Philadelphia Filly
Pizza Hut (13 Locations)
Postal Customer Council
Pour la France! Catering, Inc.
Presbyterian St. Lukes Hospital
Prime Sports
Radisson Hotel Denver
Rainbow Juices
Rockies Deli
Rocky Mountain Diner
Rocky Mountain Event Specialists
Rocky Mountain Seafood
Rose Medical Center
Scanticon Hotel and Resort
Security Life of Denver
Service America Corporation
Shamrock Foods
Sinton Dairy
Souper Salad
Sportsmen Against Hunger
St. Joan of Arc Church
St. Joseph Hospital
Table Share - Boulder
Taste of Colorado
Translogic Inc.
TRC Marketing
Trinity Grille
United Artists
University Hospital
US West
Vollmer's
Wellshire Inn
West Pines Hospital
Western Dairy Farmers Association
Westin Hotel Tabor Center
Word Perfect Corporation
Xplor International
Yanni's

Denver's Table Gifts-In-Kind

American Linen
Black Hawk Freight Services
Colorado Restaurant Association
Denver Department of Health and
    Hospitals-Consumer Protection
G & K Services
Hamilton Linen Supply
Lutheran Medical Center
National Linen Service
Nobel/Sysco
North West Transport
Operation Food Share
Rocky Mountain Association of Meeting
    Planners International

Financial Statements

Year Ended December 31, 1993

with Report of Certified Public Accountants

Independent Auditors' Report

To the Board of Directors
Food Bank of the Rockies, Inc.

We have audited the accompanying balance sheet of the Food Bank of the Rockies, Inc. as of December 31, 1993, and the related statement of support and revenue, functional expenses and changes in fund balances for the year then ended. These financial statements are the responsibility of the Food Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Food Bank of the Rockies, Inc. at December 31, 1993, and the results of its operations and changes in its fund balances for the year then ended in conformity with generally accepted accounting principles.

Loomis & Company, P.C.
Certified Public Accountants
January 28, 1994
Littleton, Colorado

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Balance Sheet

December 31, 1993

(With comparative totals for 1992)

Assets

	1993	1992
Cash		
Non-interest bearing	$ 41,372	$ 49,867
Interest bearing	302,610	162,654
Money market fund - restricted	175,829	238,322
	519,811	450,843
Accounts receivable		
Agency support fee	35,182	18,917
Contract receivable	2,162	1,317
Pledges receivable - restricted	181,543	639,920
- other		5,401
	218,887	665,555
Prepaid expenses	12,903	15,825
Property and equipment, at cost		
Building and improvements	786,852	62,712
Vehicles	180,879	180,879
Furniture and equipment	153,906	134,384
Refrigerators and freezers	140,028	90,194
Warehouse equipment	59,514	57,975
Capital leases	41,593	41,593
	1362,772	567,737
Accumulated depreciation	(415,617)	(376,919)
	947,155	190,818
Total assets	$1,698,756	$1,323,041

Liabilities and Fund Balances

	1993	1992
Accounts and payroll taxes payable	$ 98,205	$ 27,702
Accrued vacation payable	23,553	18,371
Deposits from agencies	9,274	5,235
Obligation under capital leases	25,747	33,788
Total liabilities	156,779	85,096
Deferred revenue		
Grant and other	893	8,527
	893	8,527
Commitments (Note E)		
Subsequent Event (Note F)		
Contingency (Note G)		
Fund balances		
Unrestricted	1,080,089	301,176
Designated - Capital Campaign	103,623	50,000
Restricted - Capital Campaign	357,372	878,242
	1,541,084	1,229,418
Total liabilities and fund balances	$1,698,756	$1,323,041

The accompanying notes are an integral part of these financial statements.

Statement of Support and Revenue, Functional Expenses and Changes in Fund Balances

for the year ended December 31, 1993 (With comparative totals for 1992)

	1993									1992
	Food Distribution	Salvage	Denver's Table	Fund Development	Administrative	Unrestricted	Board Designated Capital Campaign	Restricted Capital Campaign	Total	Total
Support and revenue										
Agency support fee						$ 816,822	$	$	$ 816,822	$ 737,179
Donated materials and services						171,720		2,000	173,720	132,559
Grants and contributions						114,928	134,000	170,727	419,655	1,083,324
Mile High United Way						61,649			61,649	108,197
Special events, net						74,598			74,598	24,839
Interest and miscellaneous						7,019			7,019	6,375
						1,246,736	134,000	172,727	1,553,463	2,092,473
Functional expenses										
Salary and fringes	$ 358,405	$ 52,838	$ 79,820	$ 67,675	$ 43,932	602,670			602,670	595,052
Donated services	102,707	58,454	954	1,416	8,690	172,221			172,221	126,160
Occupancy	106,674	51,976	1,072	1,628	9,194	170,544			170,544	148,901
Other operating expenses	193,478	28,608	9,727	2,389	6,628	240,830			240,830	234,248
Second Harvest membership fee	15,150	1,683				16,833			16,833	15,370
Depreciation	17,282	13,831	5,156	374	2,056	38,699			38,699	43,489
	$ 793,696	$ 207,390	$ 96,729	$ 73,482	$ 70,500	1,241,797	---	---	1,241,797	1,163,220
Excess of support and revenue over functional expenses						4,939	134,000	172,727	311,666	929,253
Fund balances, beginning of year						301,176	50,000	878,242	1,229,418	300,165
Acquisition of property and equipment						773,974	(80,377)	(693,597)	---	---
Fund balances, end of year						$1,080,089	$ 103,623	$ 357,372	$1,541,084	$1,229,418

The accompanying notes are an integral part of these financial statements.

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Notes to Financial Statements

December 31, 1993

Note A – Organization
The Food Bank of the Rockies, Inc. (Food Bank) is a Colorado nonprofit corporation, organized to collect and distribute food for the ill, needy and infants through nonprofit member agencies.

The Food Bank is a member of the Second Harvest National Food Bank Network and has affiliates in Boulder, Greeley and Fort Collins, Colorado. Its service area includes northern Colorado and the state of Wyoming.

The Internal Revenue Service recognizes the tax-exempt status of the organization, other than a private foundation, under section 501(c)3 of the Internal Revenue Code.

Note B – Summary of significant account policies
1. **General.** The accompanying financial statements have been prepared in accordance with the American Institute of Certified Public Accountants' guide on *Audits of Voluntary Health and Welfare Organizations*.

2. **Accounts receivable.** Management of the organization has determined that all receivables are collectible, thus, no allowance for doubtful accounts was deemed necessary at December 31, 1993.

3. **Property and Equipment.** Expenditures for property and equipment in excess of $500 are capitalized at cost. Expenditures for maintenance and repairs are charged to expense. When items are disposed of, the cost and related accumulated depreciation are eliminated from the accounts and any gain or loss is included in the results of operations. The provision for depreciation, which includes amortization of the capital lease equipment, is calculated using the straight-line method based upon the estimated useful lives of five to thirty years.

4. **Donated materials and services.** Donated materials and services are reflected in the accompanying financial statements at their estimated fair market value if an objective basis is available to determine such values. Volunteers from the community donate a significant number of hours in assisting the organization in achieving the goals of its programs; however, only the services for which an objective basis exists to measure their value are recorded. Donated materials with a value of $8,700 were recorded in 1993.

5. **Donated food – agency support fee.** The Food Bank receives and distributes substantial amounts of donated food. During 1993, over eight million pounds of food were distributed. Since this donated food passes through the Food Bank to its charitable beneficiaries, the donation is not recorded as a contribution and the value of the food on hand is not valued on the balance sheet. Donated food is distributed at a nominal fee per pound, which generates agency support fee revenue and accounts receivable.

6. **Contributions – deferred revenue.** Grants and gifts restricted by the donor, grantor or other outside party for particular operating purposes or for asset acquisitions are deemed to be earned and reported as revenue or as expenses in compliance with specific restrictions. Such amounts received but not yet earned are reported as deferred revenue. All contributions are considered to be available for unrestricted use unless specifically restricted by the donor.

7. **Functional expenses.** Expenses directly identified with a functional area are charged to such area. If an expense affects more than one area, it is allocated based on the time expended, space utilized, or by another rational basis.

8. **Reclassifications.** Certain December 31, 1992 balances have been reclassified to make them comparable to December 31, 1993 balances.

Note C – Cash
The cash balances at a financial institution exceeded the Federal Deposit Insurance Corporation's ceiling by $76,179.

Note D – Capital lease obligation
The Food Bank has a photocopier, forklift and pallet jack under capital leasing arrangements. The future minimum lease payments are:

1994	$ 9,435
1995	6,707
1996	6,707
1997	7,138
Total payments	$29,987
Amount representing interest	(4,240)
Present value of obligation under capital leases	$25,747

Note E – Leased facilities – commitments
The Food Bank's office and main warehouse lease was a five-year lease, which commenced March 1, 1990 at an annual rental of $40,000. The lease provided for an option which was exercised on August 30, 1992, to purchase the facility for $400,000 at the expiration of the third lease year. (Also, see Note F – Subsequent Event.) The salvage warehouse lease is a three-year lease, which commenced May 1, 1991, with escalating annual rentals of $24,000, $27,426, and $28,452. Future minimum annual rental payments, as of December 31, 1993, are $19,484. Rental expense under all lease agreements for the year ended December 31, 1993 was $76,232.

Note F – Subsequent event
On January 20, 1994, the Food Bank purchased its operating facility located at 10975 East 47th Avenue in Denver, Colorado for $400,000.

Note G – Contingency
The Food Bank will execute a Promissory Note and Deed of Trust to the City and County of Denver up to $199,236, which will be the amount disbursed by the City. The principal balance will be due if the property at 10975 East 47th Avenue ceases to be used as a nonprofit community facility during a ten year period from the date of the Promissory Note. The principal amount of the Note shall automatically be reduced by ten percent of the original amount on each anniversary date of the execution of the Note if there has been no violation of the nonprofit community facility restriction. It is the intent of the Food Bank to use this property at least ten years for its nonprofit purpose and, therefore, a note payable is not recorded.

Note H – Operating reserve
As a member of the Second Harvest National Food Bank Network, the Food Bank is required to maintain operating fund reserves.

Note I – Special events
During 1993, the Food Bank participated in two special events which incurred direct expenses of $29,598 and raised a total of $104,196.

Note J – Tax shelter annuities
The Food Bank offers each full-time employee a tax shelter annuity to which it will contribute three percent of an employee's gross earnings. During 1993, the Food Bank incurred $14,013 of expense related to this plan.

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BOARD OF DIRECTORS

Robert S. Slosky
Chairman of the Board
Director, Fairfield and Woods, P.C.

W. Scott Ferrier
Vice Chairman
First Officer, B747
Continental Airlines

Seth L. Patterson
Treasurer
Vice President, Finance/Administration
Power Resources, Inc.

Joan Harrison Golden
Secretary
Public Affairs Director
KDVR TV Channel 31

The Very Reverend John V. Anderson
Holy Ghost Church

Charles L. Assenmacher
Owner & Founder
Fall River Corporation

Brian T. Dolan
Partner
Davis, Graham & Stubbs

John C. Downing II
President
DownCourt Financial

George W. Cole
Executive Director
The Frances J. Cole Foundation

Stephen B. Forsey
President
Sales Promotion Consultants, Inc.

Allan Fries
Director of Marketing
M.A. Mortenson Company

Maria Garcia-Berry
President
CRL Associates, Inc.

Rick Gervasini
President, Rocky Mountain Marketing Services, Inc.

Donald J. Howe
Vice President/General Manager
KRFX-FM The Fox Radio

Dee Marsh
President
VIP Meetings & Events

Ellen C. Miller
Manager
Alfalfa's Market (Vail)

Douglas M. Price
President
First Bank of Republic Plaza, NA

Richard C. Rank
President and CEO
Food Bank of the Rockies

Kevin Seggelke
Director of Operations
Cub Foods/Colorado Division

James H. Skagen
President
Gordon Sign Company

Jeffrey J. Stroh
Public Affairs Director
Safeway, Inc.

John G. Stumpf
Regional President
Norwest Colorado, Inc.

Cheryl A. Wenzinger
Audit Partner
Deloitte & Touche

Mary S. Willis
Corporate Counsel
Tele-Communications, Inc.

DENVER'S TABLE VOLUNTEER ADVISORY COMMITTEE

Barbara Taylor Carpender
Larkin, Inc.

William K. Coors
Adolph Coors Company

Sterling Drumwright
City and County of Denver
Dept. of Health & Hospitals

Noel Ginsburg
Container Industries, Inc.

Leo Goto
Wellshire Inn

Doug Horn
Continental Airlines, Inc.

Donald Hunt
The Denver Post

The Honorable Patricia "Pat" Killian
Colorado House of Representatives

Ward Lucas
KUSA Channel 9

Dee Marsh
VIP Meetings & Events

Peter Meersman
Colorado Restaurant Association

Bill Mosher
Downtown Denver Partnership, Inc.

LaRae Orullian
Women's Bank

Richard C. Rank
Food Bank of the Rockies

Edward A. Robinson
Robinson Dairy

John Schafer
Hyatt Regency Denver

Leonard Strear
Strear Food Company

James Michael Sullivan
Sullivan Hayes Companies

The Honorable Wellington E. Webb
Mayor of Denver

Melvin Wolf
Melvin Wolf Oil Properties

Dr. Richard Wright
City and County of Denver
Dept. of Health & Hospitals

EMPLOYEES
OF FOOD BANK OF THE ROCKIES

Richard C. Rank
President and Chief Executive Officer

Tony Alexis
Operations Manager

Marian Anderson
Financial Assistant

Barbara L. Arko
Director of Development

Karen Backlund
Operations Assistant

Tonya Bolton
Agency Relations Assistant

Nancy Chase
Volunteer Coordinator

Olive Crawford
Inventory Specialist

Jeanne Downes
Kid's Cafe Project Manager

Sharon Fiscus
Administrative Manager

Craig Hansen
Driver

Laura Huey
Agency Relations Coordinator

Diane Kenley
Agency Relations Assistant

Russell Lesser
Warehouse Assistant

Sarah Masson
Assistant Fund Developer

Steve Mestas
Reclamation Project Manager

Carla Opp
Denver's Table Project Manager

Lee Ann Rodgers
Executive Assistant

Vivan Tuggle
Resource Developer

Starla Welch
Administrative Assistant

Harrison Williams
Denver's Table Driver

PART-TIME EMPLOYEES

Jessie Arnold
Receptionist

Debra Rees
Development Assistant

116 S. Michigan Avenue, Suite 4
Chicago, IL 60603
(312) 263-2303

COLORADO ASSOCIATION
OF SECOND HARVEST FOOD BANKS

Food Bank of the Rockies
10975 East 47th Avenue
Denver, CO 80239
(303) 371-9250

Care and Share, Inc.
4945 Northpark Drive
Colorado Springs, CO 80918
(719) 528-1247

Community Food Share
5547 Central Avenue
Boulder, CO 80301
(303) 443-0623

The Food Distribution Center
of Larimer County
1301 Blue Spruce
Fort Collins, CO 80524
(303) 493-4477

Weld Food Bank
104 11th Avenue
Greeley, CO 80631
(303) 356-2199

The Food Bank of the Rockies is a participating member of Mile High United Way

CREDITS

Fred Larkin, photography

Access Publishing
Steve Berger, copywriting
Jackie Howard, production
Jeff Phillips-Strain, design

North Suburban Printing

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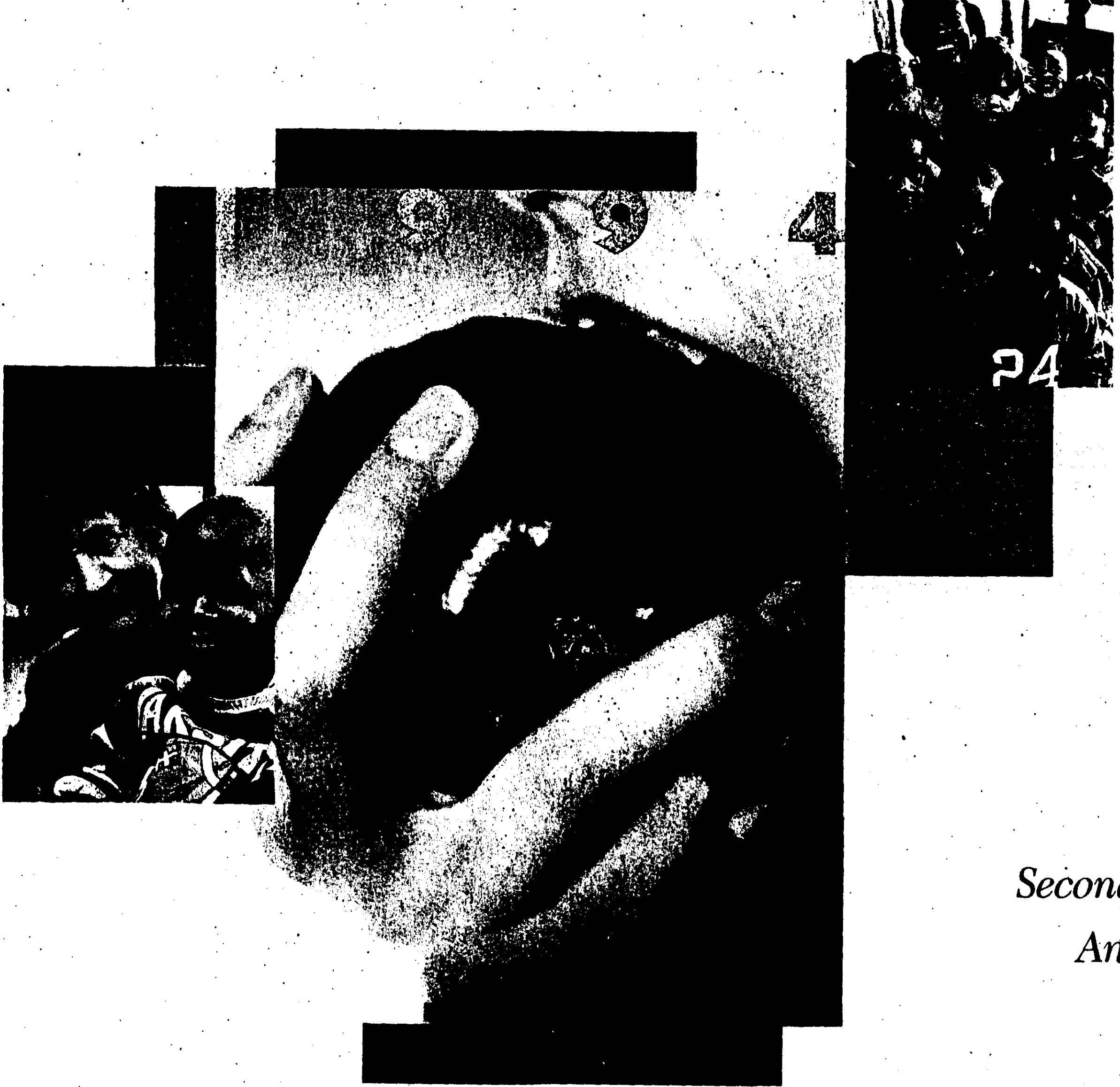
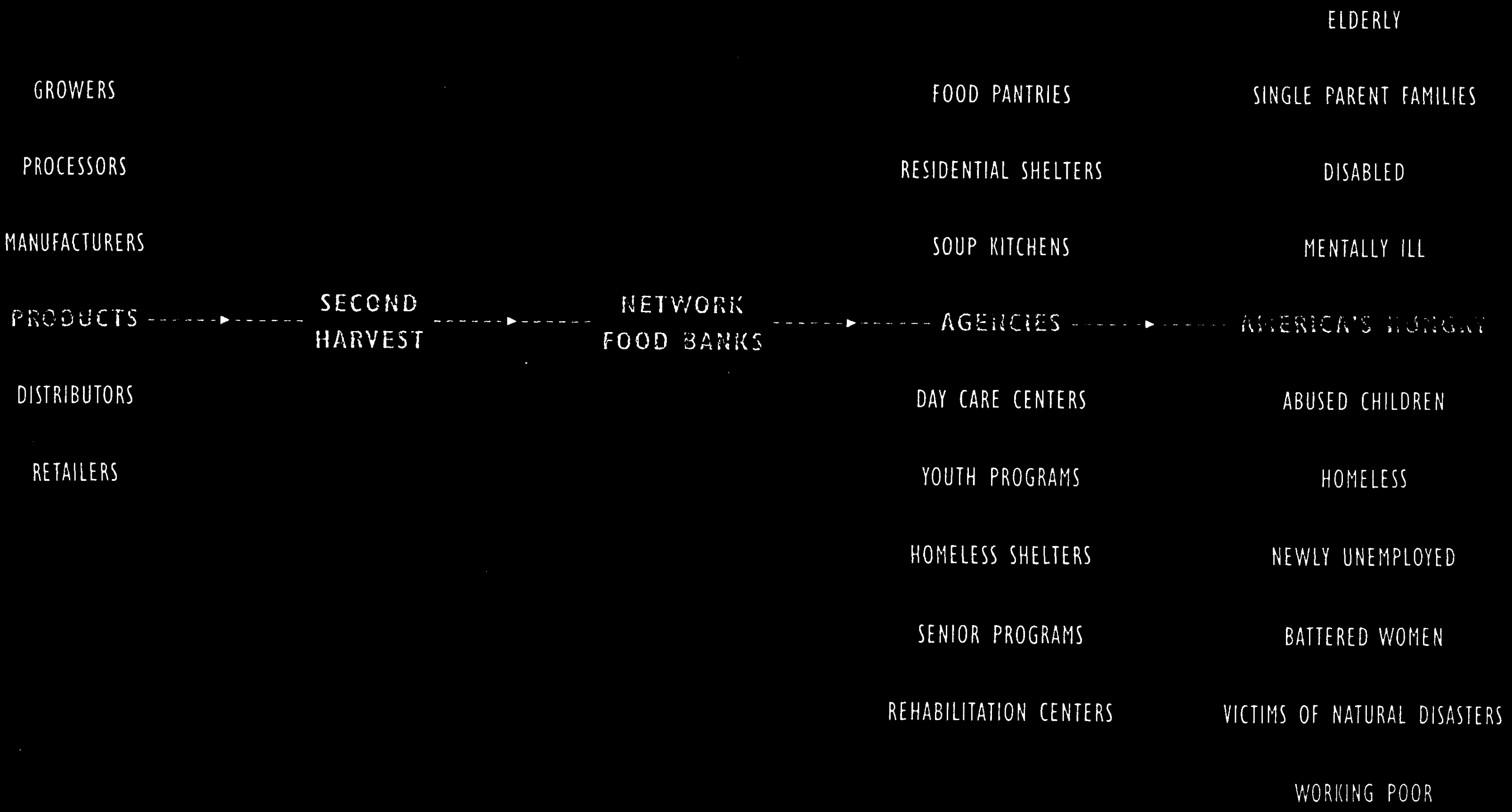
Letter 109
Attachment 2



Second Harvest Annual Report

THE SECOND HARVEST MISSION: Feed the hungry by soliciting and judiciously distributing marketable but surplus food and grocery products to a nationwide network of food banks; Develop, certify, and support Second Harvest food banks that channel food and grocery products to local nonprofit charities that provide services to the needy; Serve as liaison between food banks and donors; and Educate the public about the nature of and solutions to the problems of hunger.

THE FLOW OF FOOD TO THE HUNGRY

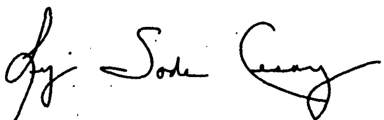


The year was 1979. The Eagles and Fleetwood Mac topped the Billboard Charts. The Pittsburgh Pirates beat the Baltimore Orioles in the World Series. Bill Clinton was featured in *Time* magazine's "50 Faces for America's Future." And Second Harvest, the nationwide network of food banks, was founded.

Nineteen-ninety-four marked the 15th Anniversary for Second Harvest. In that relatively short amount of time, Second Harvest has grown to become one of the largest and most efficient charities in the country. In fact, we are the largest hunger relief organization in the United States. Each year we distribute hundreds of millions of pounds of food and grocery products.

Will Second Harvest be able to end hunger in America? The answer is no. But we do intend to be a key player in the fight against hunger. And in today's political climate, it appears as if the work of the nation's charities will only grow in importance. As the government reduces its role in food and nutrition programs, more and more people will turn to charitable organizations for help. The need for food will only grow. It is a challenge we must be ready to face.

It is only through the support of corporations, foundations, and individuals that we can continue our mission of feeding hungry people and bridge the gap between waste and need. Let me thank you for placing your continued confidence in Second Harvest. Together, we are hunger's hope.



LIZ SODE CESARZ

BOARD CHAIR

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We had an exciting year in 1994. One that begins to realize years of hard work and vision. Let me share with you some of the highlights.

Second Harvest released the results of the most comprehensive study ever completed on emergency feeding programs. The 18-month study revealed that 10.4% of the population, or a staggering 25,970,319 Americans, were served by the network during 1993. The findings were widely reported by the national media and became a factor in political debates on health and welfare issues.

Food donations climbed to record levels during the year. This despite indications that food donations would actually decline. A total of 257.2 million pounds of food and grocery products were acquired by the national office. Moreover, real progress was made in our efforts to acquire more nutritious donations. Take a moment to review our product category list in this report and you will see significant amounts of grains and cereals, fruits and vegetables, as well as meats and proteins. Combined with the local donations of 185 food banks nationwide, the network distributed a total of 755.9 million pounds to charitable agencies.

We joined the information superhighway with the help of Lotus Development Corporation. The company generously donated their cc:Mail software to link the entire network with electronic mail. After the initial test pilot program, the system will cover 80% of the network and will be installed at 150 of our 185 food banks. Now information can be shared quickly and easily.

Public awareness of hunger reached new heights thanks to a number of high-profile promotions. Kids found out how to make the world a better place as Second Harvest joined in The

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Big Help campaign with Nickelodeon. Sports fans learned more about hunger as the National Basketball Association teamed up with Second Harvest. And country music fans enjoyed some of their favorite recording stars paying tribute to Merle Haggard on the *Mama's Hungry Eyes* album, with all proceeds going to support the hunger relief efforts of Second Harvest.

Perhaps the best public awareness of all will come from the successful launch of the Hunger's Hope public service advertising campaign. The three-year campaign features television, radio, and print ads created by J. Walter Thompson and backed by the Ad Council. Callers to a toll-free number receive a free brochure highlighting ways to get involved in hunger relief. It is our hope that this campaign will raise the issue of hunger and inspire more people to take action.

These accomplishments reveal an effort to meet the needs of hungry people both today and tomorrow. Let me extend my gratitude to you, our loyal supporters, for all that you do to help us meet the needs of hungry people. And remember that together we are hunger's hope.

Christine Vladimiroff, OSB

CHRISTINE VLADIMIROFF, OSB

PRESIDENT AND CEO

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1994 AWARD RECIPIENTS

National Donor of the Year
Kraft Foods

Food Distributor Award
The Stop & Shop Supermarket Company

Foundation Award
Robert R. McCormick Tribune Foundation

Sponsorship Award
Thomas J. Lipton, Inc.

Partnership Award
Beech-Nut Nutrition Corporation
Best Foods–CPC International
Borden, Inc.
Bristol-Myers Squibb Company
Cargill, Inc.
The Clorox Company
Coca-Cola Company Foods Division
Continental Baking Company
Dow Brands, Inc.
Friday Canning Company
Frito-Lay, Inc.
General Mills, Inc.
Heinz USA
Helene Curtis, Inc.
Hershey Chocolate USA
Hunt-Wesson, Inc.
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Kellogg Company
Kimberly Clark Corporation
Kraft Foods
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Nabisco Foods Group
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PFS–A Division of PepsiCo, Inc.
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The Procter & Gamble Company
The Quaker Oats Company
Ralston Purina Company
Rich Products Corporation
Society of St. Andrew
Snapple Beverage Corporation
Supermarkets General Corporation
Veryfine Products, Inc.

Food Bank Excellence Award
Second Harvest Food Bank of Santa Clara and San Mateo County

Model Food Bank Program Award
Food for Survival
Food Bank of Greater Tarrant County
Los Angeles Regional Foodbank
Metrolina Food Bank
Second Harvest Food Bank of Central Florida
Second Harvest Food Bank of Nashville

1994 NATIONAL PRODUCT DONORS

Act Media
Advantage Food Products
Alberto-Culver
Alcon Labs
Alex Foods, Inc.
All American Gourmet
All Good, Inc.
All Pure Chemical, Inc.
Allen Canning Company
J.W. Allen & Company
American Airlines
American Beverage Corporation
American Cereal Corporation
American Home Foods, Inc.
American Meat Institute
American Specialty Manufacturing
Amway
Andrew Jergens Company
Apple & Eve, Inc.
Aqua Vie Beverage Corporation
Archer Daniels Midland Company
Ardmore Farms
Armour Swift-Eckrich, Inc.
Ateeco, Inc.
Atlanta Dairy

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A warehouse of hope in a time of need. No matter how you describe it, a food bank is a true community resource. Thousands of square feet of storage space are dedicated for the sole purpose of making sure local charitable feeding programs have enough food. And any one community may have hundreds of agencies that rely on their local food bank for food and grocery products. This relationship provides agencies with convenient access to a large assortment of products. Many food banks also take a leadership role in the community and offer client referral services that put people in contact with their local agencies, and some even operate their own feeding programs to meet specific needs of the community.

Aunt Nellie's Farm Kitchens
Avon Products
Azteca Corn Products
Bama Pies, Ltd.
Basic American Foods
Baskin-Robbins USA
Baxter Healthcare Corporation
Beatrice Cheese, Inc.
Becker Food Company
Beech-Nut Nutrition Corporation
Ben & Jerry's Homemade, Inc.
Berks Packing Company
Bessin Corporation
Best Foods–A Division of CPC International
Best Foods Baking Group
Best Kosher
Big Valley Marketing Company
Bil-Mar Foods, Inc.
Blue Grass Foods
Blue Ocean
Blue Water Fishermen's Association
Bob Evans Farms, Inc.
Borden, Inc.
E.J. Brach Corporation
Bridgford Foods Corporation
Bristol-Myers Squibb Company
Bruno Scheidt, Inc.
Bryan Foods
Budreck Trucking
Burger King Corporation
Bush Brothers & Company
C&S Wholesale Grocers, Inc.
CPC Foodservice
CPC Specialty Products, Inc.
Cabana Foods
Cadbury Schweppes, Inc.
Campbell Soup Company
Cargill, Inc.
Cascadian Farms, Inc.
Celentano
Chattem, Inc.
Chesebrough-Ponds, Inc.
Chiquita Brands International
Chung's Gourmet Foods
Church & Dwight Company, Inc.
Circa Company
W.J. Clark & Company
Claxton Poultry Farms, Inc.
Cliffster Corporation
Clintec Nutrition Corporation
The Clorox Company
The Coca-Cola Company
Coca-Cola Foods
Colgate-Palmolive Company
Colombo, Inc.
Compass Foods
Comstock Foods
ConAgra Frozen Foods
ConAgra Poultry
Concord Beverage Company
Consolidated Biscuit Company
Continental Baking Company, Inc.
Continental Mills, Inc.
Cornuts, Inc.
Cott Beverages USA, Inc.
Creative Products Company
Crestar Foods
Crookham Company
Crown, Cork & Seal Company, Inc.
Cumberland-Swan, Inc.
DEP Corporation
Dairy Mart Convenience Stores
The Dannon Company, Inc.
Dean Foods Company
Dean Pickle & Specialty Products
Deep South Products
Del Monte Corporation
Del Monte Fresh Produce
The Dial Corporation
Diehl, Inc.
Discovery Foods
Diversified Avocado Products
Dole Food Company
Doskocil Companies
Doumak, Inc.
DowBrands, Inc.
Dreyer's Grand Ice Cream, Inc.
Dunkirk Ice Cream Company, Inc.
Marshall Durbin
ESI Meats, Inc.

Eagle Snacks
Earth's Best
Edwards Baking Company
Edy's Grand Ice Cream, Inc.
Emmber Brands
Entenmann's, Inc.
Erbrich Products Inc.
Everfresh Beverage
Famous Amos
Farley Candy Company
Farmland Foods, Inc.
Fast Food Merchandisers
Food Lion Distribution
Foodmaker, Inc.
Fresh Start Bakeries, Inc.
Friday Canning Company
Frito-Lay, Inc.
Fun Foods, Inc.
Furman Foods, Inc.
Gallo Salame
Gehls Gurnsey Farms
General Foods Corporation
General Mills Inc.
Genpak Corporation
Gerber Products Company
Gifts In Kind America
Gillette Company
Gilroy Foods
The Ginger Group Ltd.
Go-Jo Industries
Gold Bond Ice Cream, Inc.
Gold'n Plump Poultry
Golden Grain Company
Golden State Foods Corporation
Golden Valley Microwave
W.W. Grainger
Great Foods of America
Green Bay Food Company
Green Ridge Fruit, Inc.
Griffith Laboratories USA
Grimmway Frozen Foods
Grist Mill
The Häagen-Dazs Company, Inc.
[illegible]
[illegible]
Heinz Bakery Products
Heinz USA
Helene Curtis
Hene Meats
Hershey Chocolate USA
Hershey Pasta Group
Hershey Refrigerated Products
Hillshire Farm & Kahn's Company
Homestead Pole Bean Co-op, Inc.
Honey Baked Hams
H.P. Hood, Inc.
Hormel Foods Corporation
Hudson Foods, Inc.
Huffstutter Orchards
Hunt-Wesson, Inc.
Hygrade Food Products
Idahoan Foods
Imperial Bondware Corporation
Interagency Council on the Homeless
Interbake Foods, Inc.
International Paper Company
J&J Snack Foods Corporation
Jennie-O Foods, Inc.
Jimmy Dean Foods
S.C. Johnson & Son, Inc.
Johnsonville Sausage
Jones Dairy Farm
Just Born, Inc.
Kagome USA, Inc.
L. Karp and Sons
Kashi Company
The Keebler Company
Kellogg Company
Louis Kemp Seafood
Kenosha Beef International
Keystone Foods Corporation
Kikkoman International
Kimberly-Clark Corporation
King and Prince Seafood
Klement Sausage
Koala Springs International
Kraft Foods
La Francaise Bakery
La Victoria Foods, Inc.
Lakeside Foods
Lamb Weston, Inc.
Land O'Lakes, Inc.
Larsen of Idaho
Leaf Confectionery, Inc.
Lender's Bagel Bakery
Lever Brothers Company
Thomas J. Lipton, Inc.

Our list of national food donors reads like a who's who of the food industry. Kraft Foods, Nabisco, Quaker Oats, Sara Lee, and hundreds more. And financial support comes from corporations, foundations, and individuals alike. What do they all have in common? They believe in the mission of Second Harvest. So much so that each supports the organization in whatever ways they can. In turn, Second Harvest uses these resources to make sure that hungry people receive food and grocery products. In fact, for every dollar Second Harvest spent during 1994, $83 worth of products were distributed to food banks all across America. This has earned Second Harvest the distinction of being one of the most efficient charities in the country.

Lykes Pasco
Malt-O-Meal Company
Mamacita, Inc.
The B. Manischewitz Company
Manufacturer's Assortment
Mar Brands USA
Marriott Corporation
Mart Produce
The Martin-Brower Company
McCormick & Company, Inc.
McDonald's Corporation
McKee Foods Corporation
McLane Foods
McIlhenny Company
Mead Johnson Nutritional Group
Metro Beverage, Inc.
Meyer's Bakeries
Mid America Farms
Miles, Inc.
Monfort
John Morrell & Company
Morton International, Inc.
Mosey's Meat, Inc.
Mrs. Fields Cookies
Mrs. Smith's Frozen Foods Company
Mullins Foods
Mulsen Trading Company
Multifoods Corporation
Nabisco Foods Group
The Nabob Coffee Company
Nalley's Fine Foods
Nancy's Specialties
Nation Pizza Products
National Beverage Corporation
National Broiler Council
National Frozen Foods Corporation
National Gardening Association
National Marine Fisheries Service
National Oats Company, Inc.
Nestle USA
Northern States Beef
Northwest Food Strategies
Nutrasweet
OHSE Foods
Ocean Spray Cranberries, Inc.

Oconomowoc Canning Company
Ohio Packing Company
The Olds Products Company
Orange Bakeries, Inc.
Ore-Ida Foods, Inc.
Oroweat Foods Company
Orval Kent Food Company
Oscar Mayer Foods Corporation
PFS
PYA/Monarch, Inc.
R.M. Palmer Company
The Pampered Chef
Park Sausage Company
Parco Foods
Peanut Corporation of America
Pepperidge Farm, Inc.
Pepsi Cola Company
Perdue, Inc.
Perrier Group
Pet, Inc.
The Pillsbury Company
Pizza Hut Inc.
Plochman, Inc.
The Popcorn Factory
Premier Beverage
Premium Beverage
Presto Foods Products, Inc.
The Procter & Gamble Company
The Quaker Oats Company
Ragu Foods Company
Ralston Foods
Ranir
Reckitt & Colman
Revlon, Inc.
Rich Products Corporation
Rich-Seapack Corporation
Richardson Foods Corporation
Riviana Foods, Inc.
Rocco, Inc.
Ross Laboratories
Rothbury Farms, Inc.
Royal Crown Cola
Royal Quality Foods
Rudy's Farm Company
S.E. Rykoff & Company
Sage Foods
Sand Mountain Marketing

Sandoz Nutrition Corporation
Sara Lee Corporation
Savannah Foods & Industries, Inc.
Schulze and Burch Biscuit Company
Scott Paper Company
Seaboard Farms
Seagrams Beverage Corporation
Seasons' Enterprise Ltd.
Seitz Foods
Seneca Foods Corporation
Seven-Up/Royal Crown Bottling
Sharon's Finest
J.R. Simplot Company
Slim Fast
Smith Provision Company, Inc.
The J.M. Smucker Company
Snapple Beverage Company
Society of St. Andrew
Specialty Brands, Inc.
Spreckles Sugar, Inc.
Star Specialty Foods
Starbucks Coffee Company
State Fair Foods, Inc.
Stokely USA, Inc.
Stroehmann Bakeries, Inc.
[illegible]
Sunkist Growers
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Sunshine-Salerno
Superior Coffee & Foods
Sweetheart Cup
Sysco Grocery Marketing
TCBY Enterprises, Inc.
TKI Foods, Inc.
Tambrands, Inc.
Tetley, Inc.
Thorn Apple Valley
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Tree Top, Inc.
Tri-Valley Growers
Tropicana Products, Inc.
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Tyson Foods, Inc.
U.S. Mills Inc.
United Fresh Fruit and Vegetable Association
Usinger Famous Sausage
Van Den Bergh Foods Company
Van Mel USA
Veryfine Products, Inc.
Victory Wholesale Grocers
Vlasic Foods, Inc.
Vogel Popcorn
Wampler-Longacre Chicken, Inc.
Weight Watchers
Welch's
White Castle Systems, Inc.
Wimmers Meats
Wis-Pak
J.R. Wood, Inc.
Wright Brand Food
Yoo-Hoo Chocolate Beverage Corporation
Zackey Foods
A. Zerega's Sons Inc.
Zeropack Company

Sampling of local grocery distributors.

ABCO Markets, Inc.
ACME Markets
Albertson's
Aldi's
Alfalfa's Market
Apple House
Apple Tree Markets
Arnold's Bakery
Associated Grocers
B&R Corporation
Baltimore Bakery
Bi-Low
Bi-Mart
Bi-Right
Big Bear Stores Company
Big Star
Big Valu
Big Y Supermarket Company
Boulder County Farmer's Market
Bread & Circus Whole Foods Supermarkets
Brookshire Brothers
Brookshire Grocery Company
Bruno's, Inc.
Buehler's Buy-Low
Bueno Foods
Buttrey Food, Inc.
Byerly's

Whether it is a food pantry, a soup kitchen, or a youth program, the mission is much the same. Getting food to people who need it during a time when they need it the most. This is where the hungry can pick up groceries or sit down for a hot meal. And all of these important services are provided at no cost to those in need. Many of those needing assistance are recently unemployed, live in single parent families, or are homeless. Our own research has shown that many people visiting an agency did not expect to need assistance as little as three months ago. With so many people living only a paycheck away from poverty, it is nice to know that help is just around the corner.

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Camellia Food Stores, Inc.
Carr-Gottstein Foods
Certco Foods
Certified Grocers Midwest
Chalmers Distributors
Clemens Markets
Clovervale Foods
Consumer's Market
Copps Corporation
Costco
County Market
Cub Foods
D&W Food Stores
Dave's Supermarkets
Dawn Food Products
Delchamp's
Dillman's Foods
Dillon Stores
Dominick's Finer Foods
Dynamic Foods
Eavey's
Econofood
Eppley & Sons
Farm Fresh Supermarkets
Farmer's Country Markets
Felpausch Food Centers
Festival Foods
First National Supermarkets
Fleming Companies, Inc.
Food City
Food-4-Less
Food Lion
Foodland Super Market
FoodMax
Fox's Food Markets
Fry's Food Stores of Arizona
Fulmer Supermarkets
Furr's Supermarkets
Gelson's Markets
Genuardi Supermarkets, Inc.
Giant Eagle Markets, Inc.
Giant Food Inc.
Git 'N Go Stores
Goodings Supermarkets, Inc.
The Grand Union Company
The Great Atlantic and Pacific Tea Company, Inc.
The Grocery Store
HEB Grocery Company
Harris Teeter Super Markets
Harvest Foods
Hays Warehouse Foods

Heinen's, Inc.
Hinky Dinky Stores
Homeland Stores
Hughes Markets
HyVee Food Stores
IGA Stores
Ideal Market
Ingle's Markets
Jewel Food Stores
Jitney Jungle Stores of America, Inc.
D.D. Jones
Ben E. Keith Foods
Kienows Food Stores
King Soopers
Kohl's Food Stores
Kowalski's
The Kroger Company
Levers Foods
Little Lady Foods
Lowes Foods
Lowe's Marketplace
Lucky Stores
M System Food Stores, Inc.
Madison Wholesale
Market Fresh Foods
Marsh Supermarkets, Inc.
Malone & Hyde
Mama Kayer's Bakery
Max Foods
Mega Market
Meijer Inc.
Fred Meyer Inc.
Military Distributors of Virginia
Minyard Food Stores, Inc.
Mousivitz Produce
Murry's Steaks
Nash Finch
National Supermarket
Nob Hill Stores
OK Grocery
P&C Food Markets, Inc.
Pace Warehouse Club
Parco Foods, Inc.
Pay Less Super Markets
People's Drug Store
Petrey Wholesale
Pick 'N Save
Piggly Wiggly
Pike Market
Pratt Foods

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Price Chopper Supermarkets
Price Club
Publix Supermarkets, Inc.
Quality Markets, Inc.
Rainbow Foods
Ralph's Grocery Company
Randall Food Markets, Inc.
The Red Food Stores
Riser Foods
Riverside Markets
Roche Brothers Supermarkets, Inc.
Ross' Supermarkets
Roundy's, Inc.
Safeway Stores, Inc.
Sam's Club
Sandler Foods
Save-A-Lot
Savannah Foods
Schnuck's
Schultz Sav-O Stores, Inc.
Schwegmann Giant Super Markets
[illegible]
Seessel's Supermarkets
Sentry Stores
Shaw's Supermarkets, Inc.
Shiloh Distribution
Shop 'N Bag
Shop 'N Save, Inc.
Shop Rite Enterprises, Inc.
Smith's Food and Drug Stores
Southland Corporation
Spartan Stores
Springfield Grocer Company
Star Market
Stater Bros. Markets
The Stop & Shop Supermarket Company
Super Fresh
Super Kmart
Super Saver
Summit Town County Market
Sunshine Food Markets
Super 1 Foods
Super Rite Foods
Super Valu Stores
Supermarkets General Corporation
Supermercados Amigo
Sweet Life
Sysco Foods
Thriftway
Times Super Market, Ltd.
Toddy's
Tom Thumb
Tom's Foods Inc.
Tops Markets
Tri-State Wholesale Associated Grocers, Inc.
URM Stores
Ukrop's Super Markets
Ultra Foods
United Grocers, Inc.
United Supermarkets
VG's Food Centers
Vanee Foods Company
Variety Foods
Von's Markets
Wal-Mart
Waldbaum's Foodmart
Walgreen Company
Washington Cash & Carry
Wegman's Food and Pharmacy
Weis Markets
Wesselman's
White Villa Grocers
Whole Foods
Winn-Dixie Stores, Inc.

1994 CORPORATE & FOUNDATION GIFTS

Up to $499

Automated Enterprises, Inc.
Cigna Foundation
Congregation Ohev Shalom
Congregation Solel
Diakonia Presbyterian Church
The Gryphon Fund
Herrmann Charitable Foundation
Label Appeal
Mutual Trust Life Insurance Company
National Business Furniture, Inc.
Patcar, Inc.
Plymouth Church
The Quaker Oats Company –Gatorade Division
Radio Cap Company, Inc.
Saks & Zwieg Law Offices

People of all ages and from all walks of life have discovered the rewards of giving by volunteering their time. And the hunger relief efforts of the Second Harvest network provide a rich variety of ways to help. At nearly every level of the network you can find people who are giving their time to make sure no one goes to bed hungry. Some serve food while others sort it. A few answer the phone or provide light administrative help. There are even some who donate professional services whenever they can. It all adds up. It has been said that one should never doubt that a small group of dedicated individuals can change the world. Indeed, it is the only thing that ever does.

The Schecter Foundation, Inc.
Sharp and Barney
Supreme Dairy Farms
The Tower Foundation
U.S. Property & Appraisal Services Corporation
Welch's
Zurich-American Foundation

$500–$2,499

ADP
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Foosaner Foundation
Frito-Lay
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S.T. Jerrell Company, Inc.
Johnson & Quin, Inc.
The Mayer & Morris Kaplan Foundation
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J.W. Kieckhefer Foundation
McMaster-Carr Supply Company
The Nalco Foundation
Textron Charitable Trust
The Trull Foundation

$5,000–$14,999

The Baxter Foundation
Beta Sigma Phi Endowment Fund
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CNA Insurance
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Coregis Managers Corporation
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Gage Marketing Group
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I&G Charitable Foundation

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Outreach International
Pre-Residential Mortgage
Premark International
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Willard E. Smucker Foundation

$15,000–$24,999
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Mazon: A Jewish Response to Hunger
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Con Agra, Inc.
General Mills Foundation
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Kohlberg Kravis Roberts & Company
Kraft Foods
The Pillsbury Company Foundation
The Quaker Oats Foundation

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The Allstate Insurance Company Employee Campaign
Chicago Tribune Holiday Fund
The Combined Federal Campaign
Nabisco Foundation
The Procter & Gamble Fund
The Stop & Shop Companies, Inc.

$100,000 or more
Sara Lee Foundation

Second Harvest would also like to thank the anonymous donor who made a gift to our organization in 1994.

1994 INDIVIDUAL GIFTS

$250–$499
Mrs. Joan R. Adams
James and Randi B. Aguiar
Mr. Douglas P. Allen
Mr. Harold Amos
Mr. Scott R. Anderson
Ms. Jeanette Angelbeck
Mr. Mark Ansel
Mr. and Mrs. Arthur Arfa
Ms. Annette Arnold
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Ms. Dorothy Arnston
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Mr. and Mrs. James H. Bull
Mr. Eric R. Bunselmeyer

SECOND HARVEST NETWORK FOOD BANKS

Birmingham–The United Way Community Food Bank
Huntsville–Food Bank of North Alabama
Mobile–Bay Area Food Bank
Montgomery–Montgomery Area Food Bank, Inc.

Anchorage–Food Bank of Alaska, Inc.

Mesa–United Food Bank
Sun City–Westside Food Bank
Tucson–Community Food Bank
Willcox–Southeast Arizona Food Bank Association

Fort Smith–Northwest Arkansas Foodbank
Jonesboro–Food Bank of Northeast Arkansas
Little Rock–Second Harvest Food Bank of Central and Southern Arkansas

Cathedral City–FIND, Inc.
Chico–Butte County Gleaners, Inc.
Concord–Contra Costa Food Bank
Fairfield–Solano Food Bank
Los Angeles–Los Angeles Regional Foodbank
North Highlands–Senior Gleaners, Inc.
Oakland–Alameda County Community Food Bank
Orange–Food Distribution Center Serving Orange County
Oxnard–Food Share, Inc.
Riverside–Survive Food Bank
Roseville–Community Resources Council, Inc.
Salinas–Food Bank for Monterey County
San Diego–San Diego Food Bank
San Francisco–San Francisco Food Bank
San Jose–Second Harvest Food Bank of Santa Clara and San Mateo Counties
Santa Barbara–Foodbank of Santa Barbara County
Santa Rosa–The Redwood Empire Food Bank
Tracy–San Joaquin County Food Bank
Visalia–FoodLink for Tulare County
Watsonville–Second Harvest Food Bank Serving Santa Cruz and San Benito Counties

Boulder–Community Food Share
Colorado Springs–Care and Share, Inc.
Denver–Food Bank of the Rockies
Fort Collins–The Food Distribution Center of Larimer County
Greeley–Weld Food Bank

Hartford–Foodshare Commission of Greater Hartford
New Haven–Connecticut Food Bank

Newark–Food Bank of Delaware

Washington–Capital Area Community Food Bank

Jacksonville–Second Harvest Food Bank of Northeast Florida
Miami–Daily Bread Food Bank
Orlando–Second Harvest Food Bank of Central Florida
Tallahassee–Food Bank of Tallahassee
Tampa–Divine Providence Food Bank

Albany–The Salvation Army SOWEGA Food Bank
Atlanta–Atlanta Community Food Bank
Augusta–Golden Harvest Food Bank
Columbus–Interfaith Action Food Bank
Macon–Middle Georgia Community Food Bank
Savannah–Second Harvest Food Bank of Coastal Georgia

Honolulu–The Hawaii Foodbank, Inc.

Boise–Idaho Food Bank Warehouse, Inc.

Carol Stream–Bethlehem Center Food Bank
Chicago–Greater Chicago Food Depository
Moline–River Bend Food Bank
Peoria–Peoria Area Food Bank
Springfield–Central Illinois Foodbank
Urbana–Eastern Illinois Foodbank

Anderson–East Central Regional Indiana Food Bank
Evansville–Tri-State Food Bank
Fort Wayne–Community Harvest Food Bank
Gary–Northwest Indiana Foodbank
Indianapolis–Gleaners Foodbank of Indiana, Inc.
Terre Haute–Terre Haute Catholic Charities

Cedar Rapids–HACAP Food Reservoir
Des Moines–Food Bank of Iowa
Ottumwa–Food Bank of Southern Iowa
Waterloo–Cedar Valley Food Bank

Wichita–Kansas Foodbank Warehouse

Elizabethtown–Kentucky Food Bank, Inc.
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New Orleans–Second Harvest Food Bank of Greater New Orleans

Lewiston–Good Shepherd Food Bank

Baltimore–The Maryland Food Bank, Inc.

Boston–Greater Boston Food Bank
Hatfield–Western Massachusetts Food Bank
Shrewsbury–Worcester County Food Bank

Battle Creek–Food Bank of South Central Michigan
Detroit–Gleaners Community Food Bank
Flint–Genesee Regional Food Bank
Grand Rapids–Second Harvest Gleaners Food Bank of West Michigan
Lansing–American Red Cross Regional Food Distribution Center
Pontiac–Food Bank of Oakland County

Crookston–North Country Food Bank, Inc.
Duluth–Second Harvest Food Bank of the Northern Lakes
Grand Rapids–Second Harvest North Central Food Bank
Minneapolis–Second Harvest Food Bank of Greater Minneapolis
Rochester–Channel One Food Bank
St. Paul–Second Harvest St. Paul Food Bank

Jackson–Mississippi Food Network

Columbia–Central Missouri Food Bank
Kansas City–Harvesters
Sikeston–Boot Heel Food Bank
Springfield–Ozarks Food Harvest
St. Joseph–MO-KAN Regional Food Bank
St. Louis–St. Louis Area Food Bank

Lincoln–Food Bank of Lincoln
Omaha–The Nebraska Food Bank

Las Vegas–Community Food Bank of Clark County
Sparks–Food Bank of Northern Nevada

Manchester–New Hampshire Food Bank

Camden–Food Bank of South Jersey
Hillside–Community Food Bank of New Jersey

Albuquerque–Second Harvest Roadrunner Food Bank of New Mexico

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NEW YORK

Buffalo–Food Bank of Western New York
East Syracuse–Food Bank of Central New York
Elmira Heights–Southern Tier Community Food Bank
Latham–Regional Food Bank of Northeast New York
Millwood–Food PATCH
New York–Food for Survival, Inc.
Rochester–Foodlink, Inc.
West Brentwood–Long Island Cares Regional Food Bank

NORTH CAROLINA

Asheville–Manna Food Bank
Charlotte–Metrolina Food Bank
Elizabeth City–Albemarle Food Bank-Food Pantry, Inc.
Fayetteville–Cape Fear Community Food Bank
Raleigh–Food Bank of North Carolina
Winston-Salem–Food Bank of Northwest North Carolina

NORTH DAKOTA

Fargo–Great Plains Food Bank

OHIO

Akron–Akron-Canton Regional Foodbank
Amherst–Second Harvest Food Bank of North Central Ohio
Cincinnati–FreeStore/FoodBank, Inc.
Cleveland–Cleveland Foodbank, Inc.
Columbus–Mid-Ohio FoodBank
Dayton–Emergency Food Bank
Fairfield–Shared Harvest Foodbank
Nelsonville–Southeastern Ohio Foodbank
Springfield–Loaves and Fishes Foodbank
Toledo–Toledo-Northwest Ohio Food Bank
Youngstown–Second Harvest Food Bank of the Mahoning Valley

Oklahoma City–Oklahoma City Food Bank
Tulsa–Tulsa Community Food Bank

Portland–Oregon Food Bank

Allentown–Second Harvest Food Bank of the Lehigh Valley
Erie–Second Harvest Food Bank of Northwest Pennsylvania
Farrell–Community Food Warehouse
Harrisburg–South Central Pennsylvania Food Bank
McKeesport–Greater Pittsburgh Community Food Bank
Philadelphia–Greater Philadelphia Food Bank
Reading–Greater Berks Food Bank
Williamsport–North Central Pennsylvania Food Bank
York–York County Food Bank

Bayamon–Caribbean Food Bank

West Warwick–Rhode Island Community Food Bank

Columbia–Harvest Hope Food Bank
Ladson–Lowcountry Food Bank
Mauldin–Community Food Bank of the Piedmont

Sioux Falls–Second Harvest Food Bank of South Dakota

Chattanooga–Chattanooga Area Food Bank
Elizabethton–Second Harvest Food Bank of Northeast Tennessee
Jackson–Second Harvest Food Bank of West Tennessee
Knoxville–SHARE: Southern Appalachian Food Bank
Memphis–Memphis Food Bank
Nashville–Second Harvest Food Bank of Nashville

Abilene–Food Bank of Abilene
Amarillo–High Plains Food Bank
Austin–Capital Area Food Bank of Texas
Corpus Christi–Food Bank of Corpus Christi
Dallas–North Texas Food Bank
Fort Worth–Tarrant Area Food Bank
Houston–The Houston Food Bank
Lubbock–South Plains Food Bank
McAllen–Food Bank of the Rio Grande Valley
Odessa–Permian Basin Food Bank
San Antonio–San Antonio Food Bank
Tyler–Regional East Texas Food Bank
Wichita Falls–Wichita Falls Area Food Bank

South Barre–Vermont Foodbank, Inc.

Fredericksburg–Fredericksburg Area Food Relief Clearinghouse, Inc.
Newport News–Food Bank of the Virginia Peninsula
Norfolk–Foodbank of Southeastern Virginia
Richmond–Central Virginia Foodbank, Inc.
Roanoke–Second Harvest Food Bank of Southwest Virginia
Verona–Blue Ridge Area Food Bank

Seattle–Food Lifeline
Spokane–The Spokane Food Bank
Tacoma–Food Bank of Southwest Washington

Gassaway–Mountaineer Food Bank
Huntington–Huntington Area Food Bank, Inc.

Madison–Southern Wisconsin Foodbank
Milwaukee–Second Harvest Food Bank of Wisconsin
Omro–Second Harvest Food Bank of the Fox Valley, Inc.

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Rank Among National Charities According to *The Chronicle of Philanthropy*	
1.	Salvation Army
2.	American Red Cross
3.	**Second Harvest**
4.	United Jewish Appeal
5.	YMCA of the USA
6.	American Cancer Society
7.	Catholic Charities USA
8.	American Heart Association
9.	YWCA of the USA
10.	Public Broadcasting Service

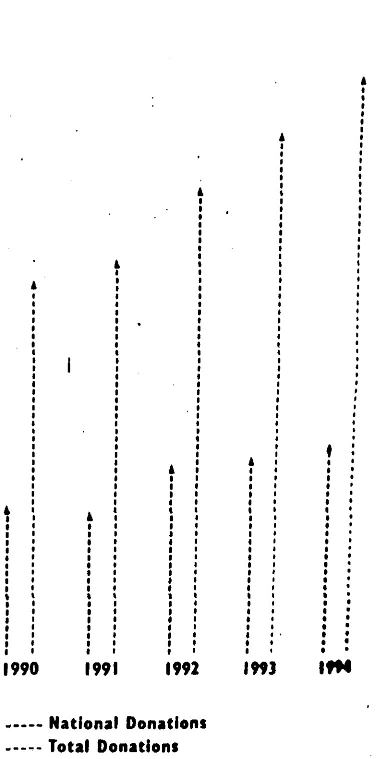
Rank was determined by the level of private support each charity received in the last year.

Value of Donated Products

● **National Donations**	**$421,808,000**
Local Donations	**$498,700,000**
Total Donations	**$920,508,000**

National donations are valued at a wholesale figure of $1.64 per pound. The value of local donations vary nationwide, but are estimated at an overall wholesale figure of $1.00 per pound.

Product Donations Over Time
In Millions of Pounds



Donations do not reflect any government commodity programs or purchased product programs.

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Profile	
Food Banks	185
Agencies Served	41,587
Food Recipients	25,970,319

Figures drawn from the 1993 National Research Study.

Efficiency Level

According to *Money* Magazine

99.7%

The percentage was based on the amount of resources directed to services over a three-year period.

Product Category Summary

In Millions of Pounds

- Assorted Non-Food Items
- Baby Food and Formula
- Beverages
- Bread Products
- Cereals and Grains
- Complete Meals
- Dairy Products
- Desserts
- Fruits and Vegetables
- Household Cleaning Products
- Juice Beverages
- Meats and Proteins
- Mixed Assorted Food Items
- Nutritional Aids
- Paper Products
- Pasta and Rice
- Personal Care Items
- Pet Supplies
- Snack Foods and Cookies
- Spices and Condiments

Figures are for products donated at the national level. Note that weight in pounds is not always a true indication of volume, particularly when referring to dry products such as pasta, rice, or mixes.

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BALANCE SHEETS

December 31, 1994, with comparative totals for December 31, 1993

	General Fund: Unrestricted Fund	General Fund: Board-Designated Reserve/Endowment	Restricted Fund	Plant Fund	Total All Funds 1994	Total All Funds 1993 (*Memo Only*)
Assets						
Current assets:						
Cash and cash equivalents	$ 430,183	$ –	$ 11,122	$ –	**$ 441,305**	$ 334,654
Pledges receivable	376,508	–	–	–	**376,508**	555,945
Other receivables and prepaid expenses	132,537	–	–	–	**132,537**	66,357
Due from other funds	–	20,123	5,494	–	**25,617**	–
Total current assets	939,228	20,123	16,616	–	**975,967**	956,956
Other assets:						
Investments	136,082	2,004,453	267,103	–	**2,407,638**	2,846,500
Pledges receivable–Long term	105,000	–	–	–	**105,000**	230,000
	241,082	2,004,453	267,103	–	**2,512,638**	3,076,500
Furniture and equipment	–	–	–	500,497	**500,497**	485,253
Construction in progress	–	–	–	54,137	**54,137**	–
	–	–	–	554,634	**554,634**	485,253
Less: Allowance for depreciation	–	–	–	343,186	**343,186**	305,986
	–	–	–	211,448	**211,448**	179,267
Designated assets relating to value-added processing program:						
Cash and cash equivalents	65,537	–	60,000	–	**125,537**	138,360
Accounts receivable	55,075	–	–	–	**55,075**	–
Due from other funds	25,000	–	–	–	**25,000**	–
	145,612		60,000	–	**205,612**	138,360
	$1,325,922	$2,024,576	$343,719	$211,448	**$3,905,665**	$4,351,083
Liabilities and fund balances						
Current liabilities						
Accounts payable	$ 218,822	$ –	$ –	$ –	**$ 218,822**	$ 74,410
Accrued employee benefits	19,183	–	–	–	**19,183**	38,492
Due to other funds	50,617	–	–	–	**50,617**	
Due to food banks	23,115	–	–	–	**23,115**	21,504
Total current liabilities	311,737				**311,737**	134,406
Deferred revenue and lease payable	266,315	–	–	–	**266,315**	787,956
Deferred revenue relating to value-added processing program	–	–	30,000	–	**30,000**	
Fund balances						
Designated by Board of Directors as funds functioning as:						
Reserve Account	–	1,651,130	–	–	**1,651,130**	1,555,910
Endowment	–	373,446	–	–	**373,446**	372,783
Designated for general purposes	602,258	–	–	211,448	**813,706**	448,516
Designated for value-added processing program	145,612	–	30,000	–	**175,612**	134,995
Restricted Fund	–	–	283,719	–	**283,719**	583,497
	747,870	2,024,576	313,719	211,448	**3,297,613**	3,428,721
	$1,325,922	$2,024,576	$343,719	$211,448	**$3,905,665**	$4,351,083

See notes to financial statements.

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STATEMENTS OF PUBLIC SUPPORT, REVENUE, EXPENSES, AND CHANGES IN FUND BALANCES

Year ended December 31, 1994, with comparative totals for year ended December 31, 1993

	General Fund				Total All Funds	
	Unrestricted Fund	Board-Designated Reserve/ Endowment	Restricted Fund	Plant Fund	1994	1993 (Memo Only)
Public support and revenue						
Public support:						
Contributions	$1,076,933	$ 4,496	$ 94,787	$ –	**$1,176,216**	$1,350,232
Individual contributions	1,641,555	–	8,531	–	**1,650,086**	1,347,584
Promotions	433,350	–	–	–	**433,350**	308,343
Revenue:						
Food bank fees	1,229,033	–	–	–	**1,229,033**	1,297,755
Conference fees	164,525	–	–	–	**164,525**	147,831
Investment income	26,882	172,221	564	–	**199,667**	163,813
Publications, administrative fees, and fees for materials	63,155	–	–	–	**63,155**	60,778
Value-added processing	–	–	30,000	–	**30,000**	12,956
Total public support and revenue	4,635,433	176,717	133,882	–	**4,946,032**	4,689,292
Expenses						
Program services:						
Network services	1,517,874	–	261,150	21,432	**1,800,456**	1,644,023
Distribution	736,586	–	–	12,664	**749,250**	581,276
Product solicitation	642,035	–	–	10,319	**652,354**	489,496
Public education	686,081	–	–	6,970	**693,051**	438,714
	3,582,576	–	261,150	51,385	**3,895,111**	3,153,509
Supporting services:						
General and administrative	413,257	22,655	–	7,683	**443,595**	336,531
Fund development	734,447	–	–	3,987	**738,434**	533,818
	1,147,704	22,655	–	11,670	**1,182,029**	870,349
Total expenses	4,730,280	22,655	261,150	63,055	**5,077,140**	4,023,858
Excess (deficiency) of public support and revenue over expenses	(94,847)	154,062	(127,268)	(63,055)	**(131,108)**	665,434
Other changes in fund balances:						
Transfer of net purchases of furniture and equipment	$ (95,236)	$ –	$ –	$ 95,236	**$ –**	$ –
Transfer of investments	533,709	(391,199)	(142,510)	–	**–**	–
Fund balance at beginning of year	404,244	2,261,713	583,497	179,267	**3,428,721**	2,763,287
Fund balance at end of year	$ 747,870	$2,024,576	$ 313,719	$211,448	**$3,297,613**	$3,428,721

See notes to financial statements.

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Ms. Carol De Vegvar
Ms. Sharon A. Diamen
Mr. John D. Donahue
Mr. Jerry Dryer
Mr. Henry Eisenberg
Ms. Ruth L. Emerson
Mr. Thomas Ferwerda
Ms. Carol Feuerstein
Ms. Barbara M. Flom
Ms. Jean Joicey Fox
Mr. Russell Frehling
Herbert and Marjorie Fried
Mr. Roger Grimm
Mr. Robert Hagge, Jr.
Ms. Suzanne Hall and Mr. Ken Corhan
Mr. and Mrs. Donald Hansen
Mr. John M. Harding
Ms. Linda Hauser
Mr. Robert Heimbichner
Ms. Carolyn C. Holm
Ms. Barbara Holt
J. Huft
Italian American War Veterans Vittorio Post #13 of Illinois
Mr. Timothy Jacobson
Dr. Craig Johnson and Ms. Constance Hofland
Mr. C.L. Johnson
Mr. and Mrs. Michael Keiser
Ms. Bonnie Brae Korin and Dr. Norman S. Ryan
Mr. Donald Lateiner
Ms. Debra Leff
The Liebman Family
Mrs. A.C. Lo Prest
Mr. William H. Loren
Dale and Pat Lye
John C. and Margaret C. MacKersie
Leslie McKee
Mr. Albert P. Neilson
Romain O. Nelsen
G. Olerich
Mr. Chester I. Palmer
Ms. Susie Powell
Mr. Paul L. Sailer
Santa Maria De La Vid Priory
Mr. and Mrs. Alan Scharff
Mr. Donald Schneider
Mr. Glenn A. Scott
Mr. David K. Small
J.C. Small
Charles W. and Cynthia A. Smithson
Mr. Timothy Smucker
Dr. Vincent H. Stack
Ms. Renee Jeanne Steig
Mr. and Mrs. Daniel Tellep
Miss Clara G. Theine
Mr. Bob Tobin
Judith M. and Alan F. Trinkwald, Sr.
Ms. Anne Von Rosenstiel
Mr. Siegfried Weiler
Mr. George N. Williams
Mr. David W. Wilson
M. Woodward

Second Harvest would like to thank everyone who made gifts to our organization in 1994, including several anonymous donors. Every effort is made to acknowledge as many individuals as possible, and we apologize for any errors or omissions in our individual gift listing.

STATEMENTS OF FUNCTIONAL EXPENSES

Year ended December 31, 1994, with comparative totals for year ended December 31, 1993

	Program Services					Supporting Services			Total All Funds	
	Network Services	Distribution	Product Solicitation	Public Education	Total	General and Administrative	Fund Development	Total	**1994**	199
										(Memo Only
Salaries	$ 501,339	$296,228	$241,364	$163,042	$1,201,973	$179,714	$ 93,250	$ 272,964	**$1,474,937**	$1,318,32
Employee benefits	92,188	54,472	44,383	29,981	221,024	33,047	17,147	50,194	**271,218**	231,58
Payroll taxes	43,435	25,664	20,911	14,126	104,136	15,570	8,079	23,649	**127,785**	103,78
Total salaries and related expenses	636,962	376,364	306,658	207,149	1,527,133	228,331	118,476	346,807	**1,873,940**	1,653,68
Travel	113,723	67,196	54,751	36,984	272,654	40,766	21,153	61,919	**334,573**	297,83
Professional services	111,517	65,893	53,689	36,267	267,366	39,975	20,742	60,717	**328,083**	257,65
Office rent and utilities	89,234	52,726	42,961	29,020	213,941	31,988	16,598	48,586	**262,527**	276,08
Telephone	59,186	34,971	28,494	19,248	141,899	21,216	11,009	32,225	**174,124**	88,42
Consumable supplies	21,772	12,864	10,482	7,081	52,199	7,805	4,050	11,855	**64,054**	55,76
Postage	20,940	12,373	10,082	6,810	50,205	7,506	3,895	11,401	**61,606**	50,375
Equipment repairs and maintenance	14,055	8,304	6,766	4,571	33,696	5,038	2,614	7,652	**41,348**	52,633
Printing	13,683	8,085	6,587	4,450	32,805	4,905	2,545	7,450	**40,255**	40,306
Fees for service	12,429	7,344	5,984	4,042	29,799	4,455	2,312	6,767	**36,566**	24,115
Professional development	12,136	7,171	5,843	3,947	29,097	4,350	2,257	6,607	**35,704**	28,378
Board costs	6,778	4,005	3,263	2,204	16,250	2,430	1,261	3,691	**19,941**	36,763
Task force	16,036	–	–	–	16,036	–	–	–	**16,036**	46,060
Insurance	4,174	2,466	2,009	1,357	10,006	1,496	776	2,272	**12,278**	8,833
Publications	3,525	2,083	1,697	1,147	8,452	1,264	656	1,920	**10,372**	11,571
Memberships	2,910	1,719	1,401	946	6,976	1,043	541	1,584	**8,560**	8,745
Development campaign efforts	16,282		7,480	32,290	56,052	4,435	510,346	514,781	**570,833**	421,850
Disaster relief campaign	261,150	–	–	–	261,150	–	–	–	**261,150**	112,002
Public service advertising	–	–	–	243,669	243,669	–	–	–	**243,669**	–
Informational materials	81,808	48,338	39,385	26,605	196,136	28,909	15,216	44,125	**240,261**	165,394
Conference costs	176,297	–	–	–	176,297	–	–	–	**176,297**	145,392
Network materials	86,133				86,133		–	–	**86,133**	55,597
Studies	18,294		46,600	18,294	83,188			–	**83,188**	120,268
Pilot projects	–	24,684	7,903	–	32,587	–	–	–	**32,587**	–
Total expenses before depreciation	1,779,024	736,586	642,035	686,081	3,843,726	435,912	734,447	1,170,359	**5,014,085**	3,957,735
Depreciation	21,432	12,664	10,319	6,970	51,385	7,683	3,987	11,670	**63,055**	66,123
Total	$1,800,456	$749,250	$652,354	$693,051	$3,895,111	$443,595	$738,434	$1,182,029	**$5,077,140**	$4,023,858

See notes to financial statements.

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NOTES TO FINANCIAL STATEMENTS

Report of Independent Auditors

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We have audited the accompanying balance sheet of Second Harvest as of December 31, 1994, and the related statements of public support, revenue, expenses, and changes in fund balances and functional expenses for the year then ended. These financial statements are the responsibility of Second Harvest's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Second Harvest at December 31, 1994, and the results of its operations for the year then ended in conformity with generally accepted accounting principles.

Ernst + Young LLP

February 14, 1995

1. Summary of Significant Accounting Policies

Second Harvest is a nonprofit, tax-exempt (section 501 (c)(3)) organization established to feed the hungry by soliciting surplus food and distributing these donations to a nationwide network of food banks. The food banks, in turn, distribute the food to community charities with feeding programs for the needy. Second Harvest also strives to educate the public about the nature of and solutions to the problem of hunger. Second Harvest does not take title to the surplus food donated; Second Harvest serves only as an agent for the donors. Accordingly, revenue related to donated food does not appear in the financial statements. During 1994, Second Harvest distributed 257.2 million (unaudited) pounds of donated product from 349 national donors. Of this total, the U.S. government contributed 945,000 (unaudited) pounds. The market value of one pound of food and grocery products at the national level was determined at a wholesale value of $1.64 (unaudited). An additional 498.7 million (unaudited) pounds of product were donated to Second Harvest food banks by local companies.

Second Harvest's financial statements are prepared in accordance with the principles of fund accounting. A description of each fund is as follows:

Unrestricted Fund–Used to account for all resources over which the Board of Directors has discretionary control, except for unrestricted amounts invested in furniture and equipment that are accounted for in the Plant Fund. Contributions designated for future periods' operations have been recorded as deferred revenue.

Board-Designated Reserve/Endowment Fund–Used to account for the principal amount of funds that is board-designated. Certain unrestricted fund investments designated by the Board of Directors of Second Harvest as funds functioning as a Reserve Account are

1994 CORPORATE MATCHING GIFTS

ARCO Chemical Company
ARCO Foundation
Allendale Insurance Foundation
American Express Foundation
Apple Computer
BP America Inc.
Bank of Highland
Becton Dickinson and Company
Benjamin Moore & Company
The Black & Decker Corporation
Budget Rent-A-Car Corporation
Leo Burnett Company, Inc.
Business and Legal Reports, Inc.
CNA Insurance Companies
CPC International Inc.
The Chase Manhattan Corporation
Chicago Tribune Foundation
Computer Associates International, Inc.
Cray Research Foundation
Digital Equipment Corporation
Fel-Pro
First Bank System Foundation
First Data Corporation
Follett Corporation
General RE Corporation
The Samuel Goldwyn Foundation
W.W. Grainger, Inc.
Harcourt General
Household International, Inc.
IDS Financial Services Inc.
Illinois Tool Works Foundation
The Robert Wood Johnson Foundation
The Jostens Foundation, Inc.
Kemper National Insurance Companies
Kirkland & Ellis
Chas. Levy Company
McDonald's Corporation
Microsoft Corporation
Nippondenso Manufacturing USA, Inc.
Nuveen & Company
Omron Foundation, Inc.
The Open University
Orion Capital Companies
Osmonics, Inc.
Paramount Communications Foundation
Pfizer Inc.
Philip Morris Companies Inc.
Pitney Bowes
The Playboy Foundation
The PQ Corporation
Premark International, Inc.
The Quaker Oats Foundation
SAFECO Insurance Companies
Sara Lee Foundation
The Stanley Works
The Sun Microsystems Foundation, Inc.
Travelers Express Company, Inc.
U.S. West Foundation
The Washington Post
Wheelabrator Technologies Inc.

1994 CAUSE-MARKETING PARTICIPANTS

Arista Records Nashville
Atlanta Journal & Constitution
American Cyanamid Company
Bon Appétit
Chicago Cable Marketing Council
Citicorp Diners Club
Cornucopia Natural Foods
Gold'n Plump Poultry
Golden Grain Pasta
The Good Catalog Company
Liberty Optical
Lifetouch Portrait Studios
Lucky Stores
Nabisco Foods Group
Newman's Own
The Pampered Chef
Prime Cable of Chicago
Promotional Concept Group
Subway
Sutter Home Winery
TCA Cable

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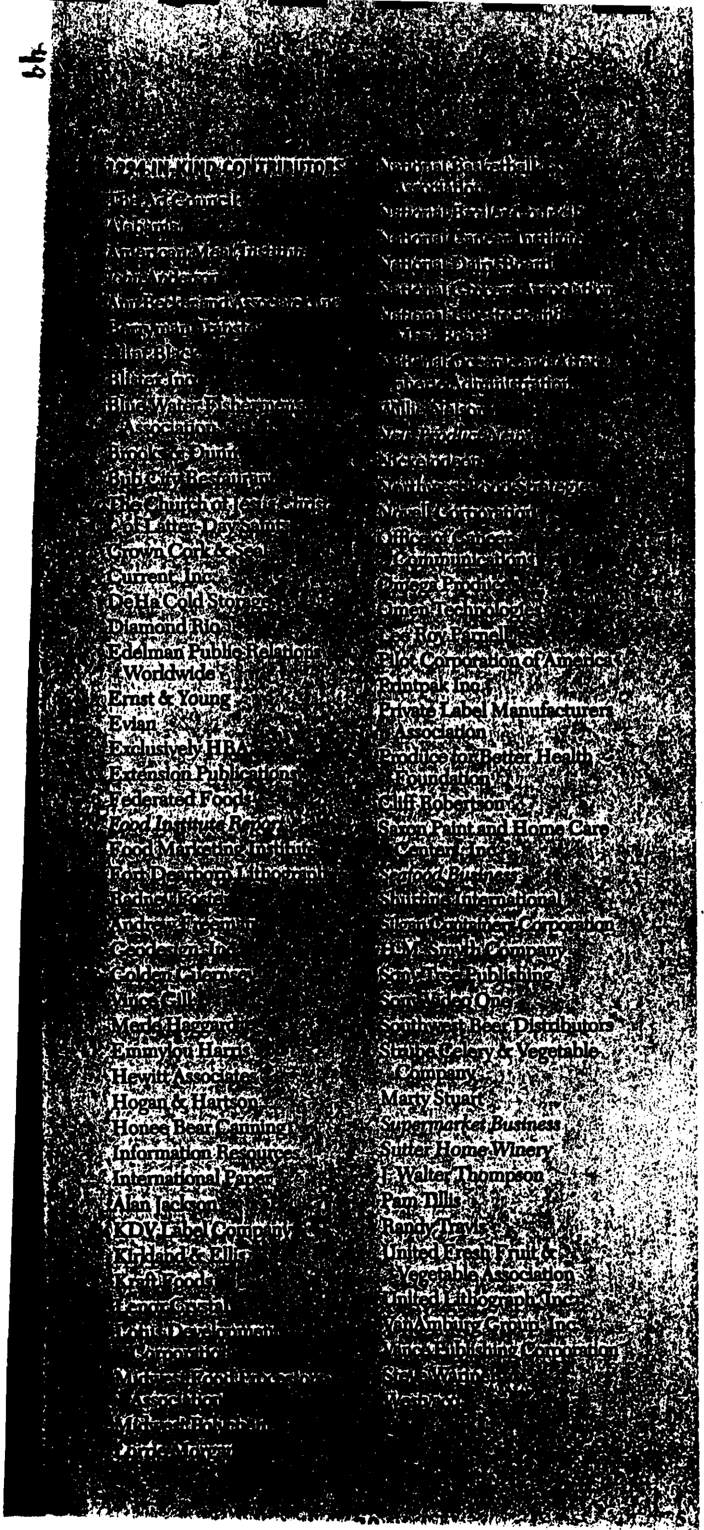

1994 IN-KIND CONTRIBUTORS
Crown Cork & Seal
Current Inc.
DeHa Cold Storage
Diamond Rio
Edelman Public Relations Worldwide
Ernst & Young
Evian
Exclusively HBA
Extension Publications
Federated Foods
Food Institute Report
Food Marketing Institute
Merle Haggard
Emmylou Harris
Hewitt Associates
Hogan & Hartson
Honee Bear Canning
Information Resources
International Paper
Alan Jackson
KDV Label Company
Kirkland & Ellis
Kraft Foods
Pilot Corporation of America
Printpak Inc.
Private Label Manufacturers Association
Produce for Better Health Foundation
Cliff Robertson
Sapp Paint and Home Care Centers
Seafood Business
Southwest Beer Distributors
Marty Stuart
Supermarket Business
Sutter Home Winery
J. Walter Thompson
Pam Tillis
Randy Travis
United Fresh Fruit & Vegetable Association
United Lithograph Inc.

appropriated for future operating contingencies. The Endowment Fund principal is to be invested and maintained intact in perpetuity.

Restricted Fund–Used to account for contributions and grants which are restricted for a specific purpose by the donor.

Plant Fund–Used to account for the net investment in property and to account for unexpended resources restricted by donors to be used for the acquisition of property for use in operations.

Cash Equivalents: Cash equivalents consist of highly liquid, short-term investments including money market account deposits and commercial paper investments.

Investments–Investments are stated at cost, which approximates market. Income earned on the board-designated investment funds amounted to $172,221, of which $146,383 was applied to the Reserve Account and $25,838 to the Endowment Fund.

Pledges Receivable–Pledges are recorded in the year made.

Furniture and Equipment–Property is stated on the basis of cost or market value at the date of donation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets.

Value-Added Processing Program–Value-added processing is a program managed by Second Harvest, whereby food that is donated in bulk quantities from a particular contributor is received directly by Second Harvest to be processed and packaged for individual food banks.

Reclassifications–The separate accounts of the funds at December 31, 1993, and for the year then ended are not presented in the accompanying financial statements. Combined fund "memo only" amounts are presented to facilitate comparison to combined totals at December 31, 1994, and for the year then ended. Certain amounts in the 1993 combined fund balances have been reclassified to conform to the 1994 presentation.

2. Commitments

At December 31, 1994, Second Harvest was committed under a noncancelable operating lease for certain office space that expires July 31, 1999. The lease contains escalation clauses and required no lease payments in the first year. Total rent expense was approximately $199,000 in 1994 and 1993. The lease has future minimum lease payments of approximately $234,700 annually, for years 1995 through 1998, and $136,900 for 1999, for an aggregate of $1,075,700.

3. Related Party Transactions

For the years ended December 31, 1994 and 1993, Second Harvest recorded approximately $175,000 and $227,000, respectively, in contributions from companies that have representatives who are members of Second Harvest's Board of Directors. At December 31, 1994 and 1993, Second Harvest has $215,000 and $311,000, respectively, of pledges receivable from companies that have representatives who are members of Second Harvest's Board of Directors.

4. Allocation of Joint Costs

In 1994, Second Harvest incurred joint costs of $570,833 for informational materials and activities that included fund-raising appeals. Of those costs, $16,282 was allocated to network services expense, $7,480 was allocated to product solicitation expense, $32,290 was allocated to public education expense, $4,435 was allocated to general and administrative expenses, and $510,346 was allocated to fund development expense. In 1993, Second Harvest incurred joint costs of $421,850 and allocated $41,000 to public education expense and $380,850 to fund development expense.

SECOND HARVEST

BOARD OF DIRECTORS

CHAIR
Lizabeth Sode Cesarz
Vice President–Corporate Relations (former)
Beatrice Company
Chicago, Illinois

VICE CHAIR
Larry Sly
Executive Director
Contra Costa Food Bank
Concord, California

PRESIDENT
Christine Vladimiroff, OSB
Chief Executive Officer
Second Harvest
Chicago, Illinois

Wende Baker
Executive Director
Food Bank of Lincoln
Lincoln, Nebraska

William Bolton
President
Jewel Food Stores
Melrose Park, Illinois

Bessie Braggs
Executive Director
Community Food Bank of Clark County
North Las Vegas, Nevada

Al Brislain
Executive Director
Spokane Food Bank
Spokane, Washington

Karen Brown
Senior Vice President
Food Marketing Institute
Washington, D.C.

Cindy Creede
Executive Director
Foodbank of Southeastern Virginia
Norfolk, Virginia

Carl M. Curry
Vice President–Logistics
The Quaker Oats Company
Chicago, Illinois

Catherine D'Amato
Executive Director
Western Massachusetts Food Bank
Hatfield, Massachusetts

Clifford Ehrlich
Senior Vice President–Human Resources
Marriott Corporation
Washington, D.C.

Robert Fersh
Executive Director
Food Research and Action Center
Washington, D.C.

Frank Finnegan
Executive Director
St. Louis Area Food Bank
St. Louis, Missouri

Peter Kooi
President
Cargill–North American Grain
Minneapolis, Minnesota

Robert Lauer
Vice President–Corporate Affairs
Sara Lee Corporation
Chicago, Illinois

Marilyn McLaughlin
Executive Director
Dare to Care
Louisville, Kentucky

Liz Minyard
Co-Chair of the Board of Directors
Minyard Food Stores, Inc.
Coppell, Texas

Manly Molpus
President and CEO
Grocery Manufacturers of America
Washington, D.C.

David Nasby
Director of Community Affairs
General Mills, Inc.
Minneapolis, Minnesota

Anne Register
Executive Director
Metrolina Food Bank
Charlotte, North Carolina

Donald Schneider
President
Schneider National, Inc.
Green Bay, Wisconsin

Reverend Arthur Simon
Director
Christian Children's Fund
Washington, D.C.

Frank P. Smith
Vice President–Commercial Service Products
The Procter & Gamble Company
Cincinnati, Ohio

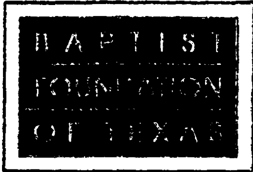
Joseph M. Stewart
Senior Vice President–Corporate Affairs
Kellogg Company
Battle Creek, Michigan

Robert G. Tobin
President and Chief Operating Officer
The Stop & Shop Supermarket Company
Quincy, Massachusetts

H. Reid Wagstaff
Vice President–Government and Environmental Affairs
The J.M. Smucker Company
Salinas, California

TREASURER
Beth E. Saks
Director of Finance and Information Systems
Second Harvest
Chicago, Illinois

SECRETARY
Sandra L. Hensley
Executive Secretary
Second Harvest
Chicago, Illinois



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AUG 15 1995

August 10, 1995

Wayne Cherry

Vice President

and Treasurer

1601 Elm Street

Suite 1700

Dallas, Texas

75201-7241

214-922-0125

FAX:

214-978-3397

An agency of

The Baptist

General

Convention

of Texas

Direct Dial:

214-978-3342

Mr. Joel Tanenbaum, Technical Manager
File #3605.AG
Accounting Standards Division
American Institute of CPA's
1211 Avenue of the Americas
New York, New York 10036-8775

Gentlemen:

Baptist Foundation of Texas manages approximately $1 billion in assets for Baptist not-for-profit organizations. About $150 million is in planned gifts with the remainder being in endowment funds. I make the following comments regarding Chapter 6, split-interest agreements:

6.06 Revocable trusts originally recorded at fair market value should be exempt from annual revaluing of assets, especially on hard to value assets. I am not aware of any accounting guidelines on how to value hard to value assets. The cost would certainly outweigh the benefits. A revocable trust has no effect on the net assets of a not-for-profit organization.

6.07
6.27 Clarification that on a trust paying only net income, there would not be a liability for future payments.

6.09 If you recognize a liability for payment of part of a trust to another organization and measure it using a discounted present value, you have overstated the funds remaining with the trustee institution.

6.21 The donor's life expectancy is irrevelant in a charitable lead trust.

6.29 Recognizing the present value of a payable so that net assets are not overstated is fine. But, I do not see the benefit of using present value on trust assets you will eventually receive. This adds a complexity on whose costs outweigh any potential or perceived benefit.

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I have a deep concern that the FASB's and the proposed Audit and Accounting Guide that affect not-for-profit organizations are adding a degree of complexity and costs that are far outweighing their benefits. It seems that the not-for-profit community is spending more financial resources and management time on these complex accounting issues rather than on the mission of the not-for-profit organization.

I thank the committee for its work which I know has consumed a great deal of their personal time and upon which they will receive few if any thanks.

Thank you for your consideration.

Sincerely yours,

Wayne Cherry

WC/jd

222 North LaSalle Street
Suite 1400
Chicago, Illinois 60601-1009
312.372.3356
312.580.7411 FAX
312.853.0394 TDD

The Chicago Community Trust

/ / /

AUG 15 1995

August 14, 1995

Mr. Joel Tannenbaum
Technical Manager
File 3605 .AG
Accounting Standards Division
1211 Avenue of the Americas
New, York, NY 10036-8775

RE: Exposure Draft - Proposed Audit and Organizations Guide: Not-for -Profit Organizations

This letter is in response to the Exposure Draft of the Proposed Audit and Accounting Guide for Not-for-Profit Organizations. Our response specifically addresses the questions listed in the Exhibit - Specific Issues for Comment on page v of the Exposure Draft and other issues that directly impact community foundations.

As you are aware, the Statements of Accounting Standards (SFAS) No. 116 and No. 117 if not properly interpreted, will have a significant negative impact on financial reporting of community foundations. Because the Proposed Audit Guide for Not-for-Profit Organizations incorporates relevant provisions of SFAS No. 116 and No. 117, and thus, impact financial reporting, we appreciate the opportunity to respond and especially the opportunity to provide additional insight on the nature and operations of community foundations.

The first issue for comment questions whether the variance power provides not-for-profit organizations with sufficient discretion to recognize resources received as contributions? And, whether the not-for-profit organizations history of exercising its variance power affect the answer to that question?

Generally, we feel that gifts to a community foundation, whether they are classified as unrestricted funds, field of interest funds, designated funds or donor advisor funds, are contributions to and net assets of a community foundation as long as the gift instrument does not allow the donor the right to withdraw the assets through either a written or an implied agreement.

In support of this position, the following paragraphs are sighted from FASB Concepts Statement No. 6 and SFAS No. 116:

- Paragraph 26 of FASB concepts Statement No. 6 states that "[a]n asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and

control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred."

- SFAS No. 116 states that " [a] contribution is an unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner."

- Paragraph 4 of the SFAS No. 116 states that "[t]his statement does not apply to transfers of assets in which the reporting entity acts as an agent, trustee, or intermediary, rather than as donor or donee"

Sighting Paragraph 26 of FASB Concepts Statement No. 6 and relating it to community foundations, we find that the various funds or net assets of a community foundation provide future cash flows which the foundation utilizes in its grant making to benefit the community that is serves. In addition, the transfer of assets to a community foundation is a transaction or event that gives the community foundation the right to obtain the future economic benefit of the asset and control others' access to the benefit of the fund. When a donor makes a contribution to the community foundation, the donor relinquishes title and all rights to the asset.

In the case of designated funds, where the written instrument establishing the fund designates that the income from the fund be distributed to one or more specifically named charitable organizations, we feel that the variance power gives the community foundation sufficient discretion and control to determine the use of and the recipient of fund assets.

The community foundation, by virtue of its variance power can modify any donor-imposed restriction on the distribution of assets, if in its sole judgment and discretion, the restriction becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community it serves.

When establishing a designated fund within the community foundation, the donor is aware of the variance power, and has made a clear choice not to make the gift directly to the designated operating charity. (see attached document used by The Chicago Community Trust to assist donors when creating gift instruments). By establishing a designated fund within the community foundation the donor has taken steps to insure that the community foundation has control over the assets and the income earned thereon. We feel that one of the reasons that a donor establishes a designated fund is to provide for current needs in the community; however, the donor realizes that as community needs change, the community foundation has the discretion to exercise the variance power *in the best interest of the community*.

Conversely, the establishment of a designated fund with a community foundation does not cause the charitable organization named in the instrument creating the designated fund to obtain the future economic benefits of the fund or control others' access to the benefit. The designated beneficiary has no right to demand the transfer of assets to them or any other institution.

The history of the community foundations' use of the variance power has no affect on the community foundations' right to recognize resources received as contributions. We believe that the relevant factor is that the power exists, not the frequency of its use. We feel that it is inappropriate to suggest otherwise or to imply that a power unless exercised does not exist or is irrelevant.

The second issue questions whether donor-advisor provisions, in combination with variance power, provides not-for-profit organizations with sufficient discretion to recognize resources received as contributions? Does the not-for-profit organization's history of deviating from the resource provider's advice affect the answer to this question?

When a donor makes a contribution to a community foundation creating a donor advisor fund, the donor relinquishes title and all rights to the asset. In order for the donor to receive a charitable deduction, the donor must make a "completed gift" and relinquish legal control of the asset to the community foundation. Donor advisor funds are *unrestricted funds* of the community foundation where the *donor reserves the privilege* from time to time to make nonbinding suggestions to the community foundation regarding the specific charitable organizations or projects to receive distributions from the fund. The transfer of the assets to the community foundation by the donor gives the community foundation the right to obtain the future economic benefits of the fund and to control others' access to the benefit of the fund.

Donor advisor funds by definition are unrestricted, they are to be used to further the general charitable purposes of the community foundation, and therefore, the variance power is irrelevant in determining if resources received in the form of donor advisor funds should be recognized as contributions.

In addition, the review of the history of the foundation deviating from the resource providers advice is irrelevant in determining if the community foundation has sufficient discretion to recognize these resources as contributions. One must remember, that the advisor to a donor-advisor fund has the privilege to make non-binding recommendations regarding the distribution of assets; the control and discretion is vested in the community foundation.

The third issue explores if the accounting for the income from resources that must be retained in perpetuity differ from the accounting for resources held in perpetuity? For example, can the receipt of resources that must be retained in perpetuity be accounted for as a contribution if the income from the resources is accounted for as an agency transaction?

We believe that the two transactions can be accounted for differently, however, we feel that this treatment would be inappropriate and confusing to users of the financial statements.

This approach does not appear to be consistent with current accounting concepts, particularly paragraph 26 of Concepts Statement No. 6. If the receipt of the resource is recognized as a contribution, and therefore as an asset of the foundation, it seems that the foundation would benefit from the future net cash flows and control others'

access to the benefit of the fund. This interpretation would disallow the treatment of the income derived from the contribution to be accounted for as an agency transaction.

On the other hand, if paragraph 26 of Concept Statement No. 6 were ignored and the income derived from the fund held in perpetuity was accounted for as an agency transaction, then the foundation would recognize a liability equal to the present value of future income stream, which would probably equal the value of the original contribution. This accounting treatment in essence would have the same impact as treating the entire transaction as if it were an agency transaction.

In addition, FASB Concepts Statement No. 4, Objectives of Financial Reporting by Non-Business Organizations, states that one of the basic objectives of financial statements is "to provide information to help present and potential resource providers and other users in assessing the services that a non-business organization provides and its ability to continue to provide those services."

In that connection, there is concern regarding the reporting of designated fund transactions if they are not considered contributions to and net assets of the community foundation. If these transactions are reported as agency transactions by the community foundation and recorded as net assets of the designated beneficiary, we feel that the basic objective of Concept Statement No. 4 is not achieved. We feel that the financial statements of the designated beneficiary will reflect an overstatement of assets which could be misleading to users of their financial statements because the foundation has no obligation or intention of transferring the assets to the designated beneficiary and could at the discretion of the foundation redirect the income of the designated fund.

One other area of the Proposed Audit and Accounting Guide that will have a significant impact on The Chicago Community Trust is the accounting treatment related to Charitable Lead Trust. The Chicago Community Trust is the recipient of a Charitable Lead Trust with a 60 year term. The Chicago Community Trust receives annually the greater of the investment income or 6% of the fair market value of the Trust as determined annually.

In the examples given in the Proposed Audit and Accounting Guide, related to Charitable Lead Trust, there is considerable reference made to the "donor's life expectancy". We don't believe that the donor's life is a factor in a Charitable Lead Trust. In the case of The Chicago Community Trust, the Charitable Lead Trust is for a stated time period unrelated to the donor's life expectancy and therefor not affected by actuarial assumptions.

In addition, in reviewing the treatment of the subsequent accrual of the interest element in split interest trust (a Charitable Lead Trust is a form of a split interest trust), there appears to be inconsistent treatment of the subsequent accruals of the interest element in the case of a promise to give (SFAS No. 116 paragraph 20) and the treatment related to Charitable Lead Trust.

Accounting literature requires the accounting for the treatment of the subsequent accrual of the interest element as follows:

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- Paragraph 20 of SFAS No. 116 states, "The present value of estimated future cash flows using a discount rate commensurate with the risks involved is an appropriate measure of fair value of unconditional promises to give cash. Subsequent accruals of the interest element shall be accounted for as contribution income by donees."

- Paragraph 6.21 of the AICPA Proposed Audit and Accounting Guide states, "Accretion of the discount and revaluation of expected future cash flows based on revisions in investment returns and in the donor's life expectancy should be recognized as adjustments to the receivable and as changes in the value of split-interest agreements in the statement of activities in the temporarily restricted net asset class."

We feel that the accounting related to the subsequent accrual of the interest element should be consistent regardless of the form of the gift. Economically an organization will receive the same amount of cash regardless of the gift; however, under the proposed accounting treatment, the amount recorded as contribution revenue will vary depending on the form of the gift.

It appears that the intent of paragraph 20 of SFAS No. 116 is to recognize contribution revenue equal to the total amount received from the donor. In case of the Charitable Lead Trust, contribution revenue would be equal to the present value at the time of the gift which is not equal to the total amount received over the term of the Charitable Lead Trust. The accounting treatment for the Charitable Lead Trust appears consistent with the *initial* exposure draft related to SFAS NO. 116; but not consistent with the final treatment of promises to give which recognizes subsequent accruals of the interest element as contribution revenue rather than as a change in the value of the agreement.

We recommend that the change in value of the Charitable Lead Trust be recorded as contribution revenue to be consistent with paragraph 20 or SFAS No. 116.

Again, we appreciate the opportunity to response to the Proposed Audit and Accounting Guide for Not-For-Profit Organizations and thank you for your consideration of the issues discussed.

If you have questions, please feel free to contact us.

Sincerely

Bruce L. Newman
Executive Director

Carol Crenshaw
Chief Financial Officer

enclosure

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The following forms are suggested for use by donors. Counsel for The Chicago Community Trust will be pleased to consult with counsel for donors regarding gifts and bequests.

FORM ONE

Lifetime Gift

"The Donor, ____________________, hereby transfers to The Chicago Community Trust, a charitable foundation now having its offices at 222 North LaSalle Street, Chicago, Illinois, the property described in Schedule A attached hereto as a part hereof. Such gift shall be devoted to the general purposes of The Chicago Community Trust as set forth in its Declaration of Trust, as amended."

FORM TWO

Bequest

"I bequeath to The Chicago Community Trust, a charitable foundation now having its offices at 222 North LaSalle Street, Chicago, Illinois, the sum of______________ ________________________dollars ($________________)"or "the rest, remainder and residue of my estate." "Such bequests shall be devoted to the general purposes of The Chicago Community Trust as set forth in its Declaration of Trust, as amended."

FORM THREE

Named Fund

(If it is desired that the gift or bequest bear the name of the Donor or some other person, the following sentence may be added. However, because of the expense of creating and maintaining separate funds, it is requested that named funds be used only for substantial gifts or bequests.) "This gift, (or bequest) shall be known as: 'The __________ ________________________Fund.' "

FORM FOUR

Designated Charitable Purpose

(If it is desired that the gift or bequest be devoted to the support of a designated purpose or institution, the following sentence may be used in lieu of the second sentence in suggested forms 1 and 2. However, because of the expense of creating and maintaining separate funds, it is requested that the designated funds be used only for substantial gifts or bequests.)"The foregoing gift (or bequest) shall be devoted to the support of ______________________ (designation of charitable purpose or charitable institution) until such time as such charitable use, in the judgement of the Executive Committee of The Chicago Community Trust, shall have become unnecessary, undesirable, impracticable, incapable of fulfillment or inconsistent with the charitable needs of the community; in any of which events it shall be devoted to the general purposes of The Chicago Community Trust as set forth in its Declaration of Trust, as amended."

(continued on back)

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FORM FIVE

Trust Special Field of Interest Funds

(If it is desired that the gift or bequest be made to one of the Trust's special Field of Interest Funds, the following sentence may be used in lieu of the second sentence in forms 1 and 2.) "Such gift (or bequest) shall be added to its Cultural Arts Fund (or Children and Youth Fund or Concern for the Aging Fund or Metropolitan Fund)."

FORM SIX

Gift or Bequest to be Used Outside Cook County

(If it is desired that the gift or bequest be used outside Cook County, the following sentence may be used in lieu of the second sentence of suggested forms 1 and 2.) "Such gift (or bequest) shall be devoted to the general purposes of The Chicago Community Trust as set forth in its Declaration of Trust, as amended, but may be used anywhere in the metropolitan Chicago area, or outside such area if it benefits the inhabitants of the metropolitan Chicago area." Form Five describing a gift to the Trust's Metropolitan Fund may also be used.

The Chicago Community Trust
222 North LaSalle Street
Suite 1400
Chicago, Illinois 60601-1009
(312) 372-3356

1043 E. Morehead St., Suite 100, Charlotte, NC 28204
P.O. Box 34769, Charlotte, NC 28234-4769
Phone: (704) 376-9541 Fax: (704) 376-1243

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FOUNDATION FOR
THE CAROLINAS

AUG 15 1995

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Legal Advisor

August 14, 1995

Mr. Joel Tannenbaum, Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Tannenbaum:

This letter is to provide comment regarding SFAS 116 and 117 as they pertain to community foundations. You specifically requested comment on donor advised funds as well as organizational endowments.

Community foundations, in comparison with many other charities, are a rather recent phenomenon. The first community foundation was established early in the 1900's; however, there are now more than 400 community foundations across the country. Each community foundation brings with it certain characteristics peculiar to its audience. But one characteristic is inherent - the wish to increase philanthropy. This wish propels community foundations into the personal and private charitable objectives of individuals, corporate giving officers, and not-for-profit endowment boards.

One avenue to increasing philanthropy is through a donor advised program. When an individual first becomes aware of the community foundation, their initial gift many times creates a donor advised fund. This vehicle allows the donor to "taste" the community foundation. By being involved in the grantmaking endeavor, donors learn about the important work of the foundation's distribution committee; they learn of the importance of charities' maintaining a 501(c)(3) tax status; and they become an active partner with the Foundation in addressing community needs. A substantial document called, "Procedures for the Operation of Donor Advised Funds" is given to each new contributor. It very clearly and concisely provides the framework for the administration of these funds. In all documentation, it is plainly noted that the donor acts as "advisor" on the distribution of the fund, and that final approval

is in the hands of the Distribution Committee. All grants are reviewed and specifically approved by the Distribution Committee prior to disbursement. From time to time, the Distribution Committee must decline a request. It may involve the fact that the request is not deemed to be consistent with the broad purposes set forth by the Foundation in its guidelines for distribution. Perhaps the charitable organization was uncooperative in sharing information about its programs, or perhaps the organization did not have a 501(c)(3) tax status. In those cases, a letter is written to the donor explaining the reason for the decline. However, the donor understands that an irrevocable gift was made to the Foundation, and no return of funds would be considered. As a matter of fact, I do not know of a single incident when it was suggested by the donor that a refund would be in order. Quite simply, donors understand that the Foundation is the charitable institution to which they are making a gift. To display these funds as anything but contributions would be inaccurate and inconsistent with the Foundation's program.

Another avenue to increasing philanthropy is through our organizational endowment funds. Many of these endowments were created in the early 1980's when the river of federal funding began drying up. Many not-for-profit organizations saw the need to build permanent platforms, the income from which would supplement their annual fundraising efforts. They also realized that much stability, credibility, security and confidence would be ensured by placing their endowment within the framework of a community foundation. We act as a partner and cooperate with agencies in building charitable capital by providing technical assistance and support including access to our legal and accounting counsel. We provide at no cost to the organizations copies of documents and calculation projections which are used in cultivating planned or deferred gifts such as unitrusts. An advantage that endowment committees perceived is the firm knowledge that the permanence of the fund would be maintained. By placing the funds with the community foundation, the endowment committee was assured that no future spendthrift board of the NPO could invade the corpus, or "borrow" against it, or in any way infringe on the integrity of the originating document. Donors could be assured that their gift to the endowment would be working in perpetuity for charity. But it is not merely enough to perpetualize the principal of the fund. The community foundation, through its investment committee, sets and monitors the asset allocation of the fund to ensure that comparable purchasing power is available into the future. In addition, objective, realistic spending policies are formulated by the community foundation and subsequently disseminated to the endowment funds. This is all accomplished independent of the NPO. The Foundation very keenly recognizes its responsibility to protect this community capital.

As a final point, I would like to return to my opening comment regarding community foundations' origins. As stated earlier, community foundations are a fairly recent phenomenon. For example, the Foundation For The Carolina's first endowment fund was created less than 20 years ago. We now have over 250 such funds. By extension, in another 20 years, perhaps we will have 500 endowments, thus providing evidence of the ever-increasing awareness and need within our society - a society that is changing

rapidly. And as society changes, needs change as well. The community foundation is a dynamic organization that has been empowered with the ability to meet those changing and challenging needs. The variance power that is indelibly engraved in all our documents is not merely a convenient closing paragraph. It is the characteristic that separates the community foundation from other charities. Far-thinking pioneers in this field foresaw the need to establish an entity adoptable by all its citizenry that would provide the "foundation" to address its concerns - not just the arts, or human services, or education - but the entire genre of charitable endeavors. We respect the responsibility that accompanies this power. Who knows in the future which organizations will be obsolete and antiquated. What new concerns or opportunities will be revealed? For example, in the early part of the century, it was very common to find tuberculosis sanitariums or smallpox wards. These concerns, however, are no longer the life-threatening diseases of today. But if the community foundation held funds for these purposes, rather than sitting in idle dismay, an appropriate modern alternative would be found. Perhaps a home for AIDS victims or a Hospice may be an answer. What I am trying to convey is that the community foundation, through its variance power, will be ready and able to redirect the funds designated for obsolete purposes to those organizations that are vibrant and vital. To disregard this power by displaying NPO endowment funds as merely extensions or "satellites" of the NPO would be inaccurate and completely ignores the responsibility of the community foundation to keep those funds working in a dynamic scenario.

Thank you for the opportunity to comment on the issues regarding donor advised funds, organizational endowments and the variance power. Please do not hesitate to contact me if you have any questions.

Sincerely,

William L. Spencer

August 10, 1995

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AUG 15 1995

Mr. Joel Tannenbaum, Technical Manager
File 3605.AG
Accounting Standards Division, AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tannenbaum,

COMMUNITY
FOUNDATION
OF ST. JOSEPH
COUNTY

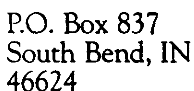
I would like respond to AICPA's request for comments with respect to FASB Statements 116 and 117 and 1) Designated and Agency Endowment Funds and 2) Donor-Advised Funds.

Question: Does variance power provide not-for-profit organizations with sufficient discretion to recognize resources as contributions? Does the not-for-profit organization's history of exercising its variance power affect the answer to this question?

Designated and Agency Endowment funds are the legal property of the Community Foundation over which community foundations typically exercise complete control of the principal, the investment, the spending policy and ultimate legal discretion with respect to distributions because of our variance power. These funds should **not** be reflected as liabilities of community foundations **unless** there are any provisions through which the beneficiary agency can access the principal or withdraw the corpus. Barring such "compromises" of typical community foundation practices, these funds should not be viewed as assets of the beneficiary organization, but rather reflected as a footnote to the income line which discloses distributions received from the fund.

Contributions to designated or agency funds are given deliberately by donors to the Community Foundation fund rather than to the organization itself; therefore, they should be viewed as contributions to the Community Foundation. Donors specifically choose Community Foundation funds over direct contributions to the beneficiaries, many of which hold their own endowment funds in addition to the fund in the Community Foundation, because **the donors do not want the gift to be in the control of the beneficiary.** Indeed, a major reason community foundations were invented was because of the variance power that allows a board composed of community citizens to redirect income from a fund in order to preserve the original charitable intent of the fund.

Donors give to the Community Foundation of St. Joseph County rather than directly to a proposed beneficiary for the following reasons:



P.O. Box 837
South Bend, IN
46624

Phone (219) 232-0041
FAX (219) 233-1906

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- Invasion of principle is not allowed under any circumstances.
- Confidence that the Community Foundation's board of directors can and will redirect the income from the fund in the event the designated charitable organization ceases to exist, ceases to serve a useful purpose, or becomes ineffective.
- Better investment management and objective control over spending so that the real value of the endowment does not erode with inflation.

There are many dimensions to the "control" issue. FASB 116 & 117 places the *likelihood* of receiving the economic benefit of the income stream above a number of other control issues which I know from experience are much more salient to the beneficiary organizations.

The number one control issue for charitable organizations with respect to their endowment funds is their board's ability to invade principal. Period. Every organization I have worked with agonizes at length about allowing any of their assets to become the legal property of the Community Foundation, knowing full well that the Foundation will deny them access to the principal regardless of the circumstances. Frankly, I found FASB's suggestion that organizations give away assets to community foundations in order to look poorer preposterous. The many organizations I have worked with are more concerned about a healthy looking balance sheet and the ability to borrow against endowment assets. Looking poorer has never been a concern.

Please understand: The Community Foundation of St. Joseph County's ability to attract additional transfers of endowment assets from not-for-profit agencies ***will likely increase*** as a result of a strict interpretation of FASB 116 & 117. But my strong belief is that these changes in accounting standards will cause far greater confusion and misinterpretation than they correct. Agencies whose balance sheets remain relatively unaffected by the **permanent, legal transfer** of assets to community foundations will be less likely to understand the full implications of what they are doing. Further, these changes create a disjunction between legal reality and financial reporting standards, opening community foundations to the risk that creditors of beneficiary organizations will try to confiscate the income stream from these charitable funds in the event of bankruptcy.

The fact that actual use of variance power is rare does not alter the fact that such power exists. There are two reasons you are unlikely to find frequent examples of community foundation's use of this power: 1) Most community foundations are quite young. Of the 67 community foundations in Indiana, nearly sixty did not exist five years ago. There simply has not been much time for situations to develop for use of variance power to be necessary; 2) Community Foundations would not take use of this power lightly. Designated or agency endowment funds are usually only established for "mainstream" charitable organizations in a community— organizations that have stood some test of time and have proven their value. Typically they are serving needs (youth, the arts, the elderly, the environment) that do not grow obsolete and are doing so competently. The fact remains, and both donors and agencies know this, that in the event the need becomes obsolete, the agency becomes incompetent, or insolvent, the Community Foundation board has the ability and indeed the duty to redirect the fund's income.

If the beneficiary organization has no interest in or control of a fund other than as the likely income recipient, I strongly urge AICPA to allow these assets, and contributions to them, to continue as assets of the community foundation, free of any corresponding liability. If, on the other hand, in cases where community foundations have compromised this standard by giving the agency the ability, under any circumstances, to access or remove the fund's corpus, the changes recommended by FASB 116 & 117

are arguably appropriate.

Question: Do donor-advised provisions, in combination with variance power, provide not-for-profit organizations with sufficient discretion to recognize resources received as contributions? Does the not-for-profit organization's history of deviating from the resource provider's advice affect the answer to this question?

The answer to the first question is simply yes. It is made abundantly clear to donor-advisors, even by their designation as "advisors," that their recommendations are just that, nothing more.

For years I have been trying to understand what is the wrong that the I.R.S., FASB, or any other organization is trying to right by impeding a donor's involvement in how the income from their Community Foundation fund is distributed. Providing there is no personal inurement to the donor from these distributions, other than the gratification of participating in the good works their funds accomplish, what is the harm?

Let me explain why you are not likely to find many examples of community foundations who reject their donor-advisors' advice. First, donor-advisors are well-educated on this subject. The Community Foundation of St. Joseph County works closely with donor-advisors. Simply put, they have **never** made any inappropriate recommendations to date, such as trying to award scholarships to relatives or buy fundraising event or raffle tickets with the income from their funds. If such inappropriate recommendations were made, they would be rejected.

Secondly, more and more, the donors' recommendations are being developed in consultation with community foundation staff who are knowledgeable about community needs. Community foundations work to avoid situations upfront where the donor makes suggestions we flatly reject. Donors do know, however, that their recommendations must be approved by the Foundation board and they are notified when the approval has been secured. In other words, they are not likely to forget that they do not control the distributions from their fund.

Allowing a donor to make ***appropriate*** recommendations for distribution from a fund established through that donor's personal generosity does not warrant FASB's (or any other organization's) concern. This continuing involvement simply allows a donor ongoing involvement in the good works their generosity has made possible. The gratification enjoyed from their continuing involvement often inspires them to make additional gifts from which our communities all benefit. Hindering the ability of community foundation's to offer this meaningful involvement to local citizens would have only negative, and totally unnecessary, consequences.

Mr. Tannenbaum, thank you for this opportunity to comment on appropriate implementation of FASB 116 & 117 as they pertain to community foundations. If I can provide any further information, please call me at (219) 232-0041.

Sincerely,

Rose Meissner
Executive Director

LAWRENCE R. DOYLE
CERTIFIED PUBLIC ACCOUNTANT
726 MOTT FOUNDATION BUILDING
FLINT, MICHIGAN 48502

(810) 238-2515

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AUG 15 1995

August 9, 1995

Joel Tannenbaum, Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of Americas
New York, NY 10036-8775

Dear Mr. Tannenbaum:

I would like to make comments with regard to the Proposed Audit and Accounting Guide for Not-for-Profit Organizations. Specifically I wish to address my comments to the three sets of questions AcSEC asks that respondents consider as they affect the accounting for Community Foundations.

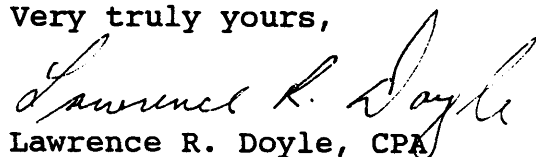
With regard to the first set of questions as to whether variance power provide the not-for-profit with sufficient discretion to recognize resources received as contributions, I believe the answer is yes because in the case of community foundations the assets received are transferred into the community foundation's name and this fact along with the ability of the being able to exercise variance power over the income of the resources is sufficient to recognize the receipt as a contribution to the community foundation. The fact that a community foundation may not exercise its variance power should not carry much weight since in accepting an agency endowment, the community foundation would determine whether the purpose of the activity supported was within its purview. The fact that the donor has a purpose in concert with the community foundation has been taken into account when the resources are accepted; and therefore, not changing the agreed purpose is not significant in determining whether the receipt of resources should be accounted for as a contribution.

In the second set of questions regarding donor-advised provisions, my answers are similar to the first set. Donor advised provisions in donor advised grants are nonbinding. Control rests with the community foundation. Here again a donor and community foundation working together to solve community problems is usually the goal of the granting of advised funds to the community foundation. I would not expect the community foundation to often deviate from the agreed purpose; and therefore, a history of deviating from the resource provider's advise would not have much bearing on changing the contribution to some other accounting classification.

For the third set of questions I believe that the accounting for income from resources that must be retained in perpetuity should be the same as income from resources that are held in perpetuity. In the case of community foundations, it is the foundation that has discretion over how the income is to be used and I do not see that there is very much difference in accounting for income from a permanent endowment and other assets owned by the foundation.

In general I believe that the changes proposed would be detrimental to community foundations and to the communities that they serve. I believe that accounting in the not-for-profit community would become much more complicated and confusing for both community foundations and not-for profit organizations supported by agency endowments and donor advised grants. And further, potential donors would be more reticent to make contributions because of the confusion in tracking their donations and the use of income from the resources they provide.

Very truly yours,



Lawrence R. Doyle, CPA

WINEGARDEN, SHEDD, HALEY, LINDHOLM & ROBERTSON
A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS
ATTORNEYS AT LAW
501 CITIZENS BANK BLDG.
FLINT, MICHIGAN 48502-1983
TELEPHONE: (810) 767-3600
TELECOPIERS: (810) 767-8776
(810) 767-8874

MYRON WINEGARDEN (1906-1986)
WILLIAM C. SHEDD*
DENNIS M. HALEY*
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OF COUNSEL:
HOWARD R. GROSSMAN

August 10, 1995 115

AUG 15 1995

Joel Tannenbaum
Technical Manager, File 3605.AG
Accounting Standards Division, AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

re: AICPA Draft Audit Guides, Not for Profit Organizations

Dear Mr. Tannenbaum:

This correspondence is in response to the above noted Audit Guides for Not for Profit Organizations. I have been a practicing attorney in the Flint Michigan area for over 20 years, specializing in taxation and estate planning. Because of my tax background, including a Master of Laws in Taxation from NYU, I have represented numerous charitable organizations, both public charities and private foundations.

Although the abuse perceived by the AICPA that certain nonprofit organization use community foundations to " hide assets " to look " poorer " may occur in isolated instances, I have never seen such activity. In my experience donors make charitable contributions because of their desire to benefit an area of the community, not because a charity is " poor ". In the Flint and surrounding communities the charitable needs vastly exceed the charitable funds and it is not necessary for a charity to look " poor ".

The right of a community foundation, through its community based board of trustees, to exercise its variance powers is fundamental to the role of a community foundation in charitable giving. Donor's recognize that over a longer period of time charitable organizations and charitable needs of a community change. The flexibility of a gift to a community foundation is essential for donors to make gifts.

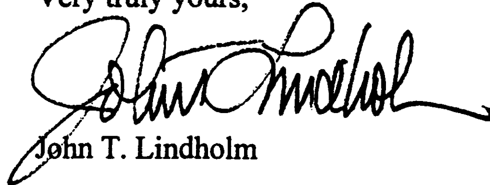
Bank trust departments do not have the time or desire to monitor and evaluate charitable organization and purposes. These trust departments have had to become profit centers under the increasingly competitive banking industry. Charitable donors are unwilling to pay fees to banks to monitor charitable organizations, except for extremely large charitable funds. There are simply <u>too</u>

few large charitable funds in our community and in many communities to entice banks to allocate time and personel to such purposes.

The ability of community foundations, with their variance authority, to review charitable organizations provides the necessary control many small donors require in order to make charitable contributions.

Your Audit Guides are overkill for a perceived abuse which does not exist in most communities.

Very truly yours,



John T. Lindholm

JTL/jk

Community Foundation
For Southeastern Michigan

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AUG 15 1995

August 9, 1995

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333 West Fort Street
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313/961-6675

Mr. Joel Tannenbaum
Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Tannenbaum:

Thank you for the opportunity to comment on the Not-For-Profit Organization's Proposed Audit and Accounting Guide Exposure Draft. The Exposure Draft specifically requested comments on the issue of "variance power and donor-advised provisions." The Community Foundation for Southeastern Michigan would like to comment on this issue.

The above issue relates to community foundation designated funds, agency endowment funds, and donor advised fund contributions. Contributions to designated, agency endowment and donor advised funds are important to the Community Foundation for Southeastern Michigan's charitable mission and comprise a significant portion of the Community Foundation's assets. Every contribution to each of these component funds becomes the legal property of the Foundation. To be accepted as a gift to a component fund of the Community Foundation, the gift must be free of material restrictions. This is required for the donor to claim a tax deduction for a contribution to a public charity and for the Community Foundation to use the contribution to satisfy the public support test. The Foundation decides on the investment of the assets, and the recipient, amount, and timing of any distributions from these funds - both principal and income.

Each Fund is established by a separate agreement which provides for holding of the fund by the Foundation on the terms and subject to the conditions in the Foundation's governing instruments, as amended from time to time, and any resolutions or procedures in effect. Each donor making a gift to the Foundation accepts and agrees to all provisions of the Foundation's Articles of Incorporation and Bylaws and acknowledges that their gift is subject to the provisions therein regarding the presumption of donor's intent, variance provisions and power of modification.

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In addition to the provisions stated in the written fund agreement, the Community Foundation also makes donors aware of the Community Foundation's control over the assets gifted to the Foundation by means of additional written materials and in conversations with donors. For instance, Community Foundation for Southeastern Michigan's **Information About Donor Advisor Funds** states:

> *"The law expressly recognizes the privilege of living donors to make grant suggestions from time to time; it also clearly states that our Board of Trustees has the responsibility of exercising final discretion concerning the expenditures of such funds. This is reflected in the agreement by which you initially create your fund."*

Also,

> *"Donor advisors may, from time to time, suggest specific grants. We use the term 'suggest' because the Foundation's Board of Trustees must retain final discretion over the grants made from each fund. There is a logical basis for this in the law; since you received a full tax deduction for giving the money away, you cannot retain control over how it is distributed."*

In summary, the Community Foundation for Southeastern Michigan maintains full control over contributions to designated, agency endowment, and donor advised funds of the Foundation. We hope that our comments above will be helpful in demonstrating this control. We will be happy to answer any questions that you may have.

Sincerely,

Mariam C. Noland
President

/sat

cc: FASB Task Force

ERNST & YOUNG LLP

900 United Center
500 Virginia Street East (25301)
P.O. Box 2906
Charleston, West Virginia 25330

Phone: 304 343 8971
Fax: 304 353 9383

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August 10, 1995

Mr. Joel Tanenbaum
Technical Manager
American Institute of CPA's
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Tanenbaum:

AcSec is currently considering an Exposure Draft of a Proposed Audit and Accounting Guide for non-profit organizations (NPO's). I wish to comment on provisions of the exposure draft as they relate to community foundations. I serve as a member of the board of trustees of such a foundation and believe that the issues of variance powers held by foundations provides the community foundations with sufficient discretion to recognize the funds received as contributions. Such variance powers typically reside with the community foundations rather than the contributing NPO's because of the IRS regulations governing the tax-exempt status of the foundations (see 7/17/95 draft of the FASB 116 Technical Bulletin, ¶ 6). In my experience, the trustees of the community foundation pay careful attention to their responsibilities in this regard and, though the instance of exercising the power is relatively rare, it is part of the fiduciary management process.

Donor-advised provisions, in connection with the variance powers, do provide enough flexibility to justify the discretion to recognize donor-advised funds as contributions. Since the use of variance powers may be rare, thereby preventing an easy measurement test of the frequency of such variance, I would advise the AcSec against setting arbitrary criteria for such measurement. My personal experience is that community foundations do pay close attention to these important matters.

The accounting for funds which must be retained in perpetuity could differ from the accounting for the income from such funds (such accounting is common in bank trust departments), however, in the environment of a community foundation, I would question whether such accounting is either appropriate or if it provides any meaningful information since the distributions of funds is determined by distributions committees rather than any predetermined formula. Accordingly, I would advise against imposing such a restriction on community foundations.

Very truly yours,

Paul E. Arbogast
Managing Partner

THE GREATER KANSAS CITY COMMUNITY FOUNDATION AND AFFILIATED TRUSTS

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Supporting Organizations
Coalition of Community Foundations for Youth
Independence Community Foundation
Prime Health Foundation

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AUG 15 1995

August 11, 1995

Mr. Joel Tannenbaum, Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tannenbaum:

This letter is The Greater Kansas City Community Foundation's response to the AICPA's request for comments on the proposed AICPA Audit and Accounting Guide *Not-for-Profit Organizations.* If FASB Statements No. 116 and No. 117 are adopted as proposed, the changes in presentation of financial statements would adversely impact this organization, community foundations in general, and charitable organizations which rely on grants from funds at community foundations.

Of particular concern is the proposed treatment of designated funds. Chapter 5 of the Audit Guide specifies that assets contributed by donors to designated funds for specific charitable agencies may not be recognized as contributions to the community foundation, or included as part of the net assets of the community foundation. This position is indicated despite the fact that the agreements establishing designated funds provide the community foundation with control and discretion as to the use of those funds through its variance power.

In addition, all gifts to funds are irrevocable, including those made by an agency to a designated fund for the benefit of that agency. Grants back to the agency can only be made if approved by the community foundation's board.

We strongly believe that the proposed changes in accounting treatment of designated funds would not fairly reflect the legal and financial control of community foundations as owners of the assets and the income generated by the assets. Further, the proposed presentation of the financial statements would not properly reflect the charitable intent of the donors or the financial position of the charitable organizations that the designated

1055 Broadway, Suite 130 • Kansas City, Missouri 64105 • (816) 842-0944 • Fax (816) 842-8079

funds are intended to benefit, as their access to the assets is controlled by the community foundation's board.

For varying reasons, donors create designated funds at a community foundation rather than giving contributions directly to the benefiting agencies. One reason is to protect the principal from invasion by the benefiting agencies. Under Missouri law, a non-profit agency may spend principal of an endowment by action of their board of directors. A designated fund at a community foundation protects those principal dollars from invasion. In addition, a donor may recommend specific contingencies be met by a benefiting agency before a grant will be released. If those contingencies are not met, then the board may elect to grant the fund's assets to other charities.

The Greater Kansas City Community Foundation, in every instrument of transfer establishing a fund, including those for designated funds, refers to the Foundation's by-law that provides for its variance power. Further, the authorized representative(s) of an agency, in signing the instrument of transfer, attests to familiarity with that by-law. While The Greater Kansas City Community Foundation has yet to find it necessary to utilize its variance power over a designated fund, knowledge of the ability of the Foundation to use this power may act as a deterrent to an agency which might consider abusing the privilege of maintaining a fund at the Foundation. Additionally, it would not be prudent to exercise this power for the sake demonstrating this authority. We would not want to use the variance power unless it was absolutely necessary and appropriately served the best interests of the community and the donor's charitable intent.

While The Greater Kansas City Community Foundation's variance power has not been used with a designated fund, it has been utilized with other funds. An example of such use was with a field of interest fund established to help defray the cost of relocating a church organization's headquarters staff in the event that a proposed move to Kansas City was approved. Following a decision by that church not to locate it headquarters here, the Community Foundation's Board of Directors exercised its variance power by utilizing the balance in the relocation fund to establish a Community Development Fund. The purpose of this new fund was to further charitable purposes in economic development of the Kansas City area. No dollars were distributed to the church, even though the gifts to the fund were expressly for the church's benefit, because the church did not meet the contingencies established when the fund was created.

In addition to our concern with the accounting treatment of designated funds, we believe that contributions to donor advised funds, and the assets of those funds, also are contributions to, and assets of the community foundation. Donors provide recommendations for grants from those funds, but the final decision rests with the board of the community foundation. As is the case with designated funds, the donor attests to the existence of the foundation's variance power in signing the instrument of transfer to establish the fund and in making an irrevocable charitable contribution. In addition, the identity of grantees of the assets in donor advised funds is not generally known by the community foundation, or the grantees, when a fund is established. Therefore, if liabilities were to be established against the funds' assets, the community foundation

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would not be able to identify the specific charities to which donor advised funds' liabilities would be payable.

In summary, we believe that gifts to all funds of the community foundation should be treated as contributions under FASB Statements No. 116 and No. 117. Further, we believe that assets in these funds should be treated for accounting purposes as net assets of the community foundation. We request that the Audit Guide reflect this accounting treatment.

Sincerely,

J. Roy Baron
Vice President-Finance

COUNSELLORS AT LAW
HUTCHINS, WHEELER & DITTMAR
A PROFESSIONAL CORPORATION
101 FEDERAL STREET, BOSTON, MASSACHUSETTS 02110
TELEPHONE: 617-951-6600 FACSIMILE: 617-951-1295

JOHN H. CLYMER
617-951-6727

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AUG 15 1995

August 10, 1995

Joel Tanenbaum, Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: The AICPA Proposed Audit and Accounting Guide for Not-For-Profit Organizations (4/14/95 Exposure Draft)

Dear Mr. Tanenbaum:

As counsel to The Boston Foundation, Boston's community foundation, I have been requested to comment upon the above-referenced exposure draft, particularly Chapter 5 dealing with contributions received and "agency transactions," and its application to designated funds of community foundations.

As I understand it, the specific issue upon which the AICPA seeks comment is the importance of the variance power and donor-advised provisions in determining whether or not a contribution made to a community foundation which is to be held by it in perpetuity, but the income of which is designated by the donor for the support of one or more other organizations, should be treated as an asset of the community foundation against which there is no offsetting liability or whether it should be treated as an "agency transaction." In the latter case, the foundation would essentially be treating the fund as an asset held by it for another, as it were the other's agent. In such a case, the proposed financial statement treatment would be to show the fund as an asset against which there is an offsetting liability.

Commenting specifically on the questions raised with respect to the variance power, it is my view that an organization's history of exercising its variance power should

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not affect whether such a transfer is a contribution or an agency transaction. The mere existence of the variance power, in my view, places the community foundation in a controlling position with respect to such designated funds, and whether or not the variance power is ever exercised is little more than an historical accident. Given the fact that community foundations are designed to exist in perpetuity, even the 80 year history of the oldest community foundations in the country does not provide a long enough time frame for determining whether the exercise of a variance power is more significant from an accounting point of view than its "mere" existence. The real significance of the power is that it provides the community foundation with the ultimate authority to decide whether <u>in its judgment</u> (not the judgment of the donor or the designed agency) the distributions from such a fund are still appropriate.

The question raised about donor-advised funds is whether a community foundation's history of deviating from a donor's advice should affect the answer to whether a donor-advised fund is an agency transaction or a contribution to the foundation. Given the breadth of purpose of most community foundations, I believe that the history of following a donor's advice should not be relevant in any case in which distributions from such a fund are made for purposes which are consistent with, and are currently supported by, the community foundation. Here, it is absolutely clear (at least in the Boston Foundation's case) that the foundation is not required to follow a donor's advice and may, in fact ignore that advice. The legal right of the community foundation to ignore a donor's advice should be determinative with respect to treating such transfers as contributions to the community foundation.

Finally, the issue is raised whether the accounting for the income from such a designated fund can differ from the accounting for the fund itself. This appears to be a distinction without a difference, but I believe that it cannot, given paragraph 26 of FASB Concepts Statement No. 6. That paragraph states that (in this case) two of the three essential characteristics of an asset are (a) embodiment of a probable future contribution, directly or indirectly, to future net cash inflows and (b) the occurrence of a completed transaction giving rise to the community foundation's right to control of the benefit (i.e., the donation). It appears that for a designated fund which is designed to be perpetual, accounting for the income from the fund as an agency transaction would, if the income stream is deemed to be perpetual, require accounting for a liability which would equal the value of the asset itself, a liability which would offset the increase in assets resulting from receipt of the fund, thereby reaching the same

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result as if the entire transaction were deemed to be an agency transaction. Accordingly, separate accounting treatment does not appear to make any sense.

While the variance power is certainly an important one, from the material I have reviewed, I believe that the AICPA and the Financial Accounting Standards Board have not devoted sufficient attention to the following attributes of designated and donor-advised funds within community foundations, all of which seem to me to require that they be treated, when transferred to the foundation, as contributions to it, rather than as agency transactions.

LEGAL TITLE

It is clear that the foundation has legal title to such funds, either directly if it is in corporate form or through its trustee, if the community foundation is in trust form. There are no circumstances under which legal title to the fund may be transferred to the designated charity (referred to later in this letter, collectively and singly, as the "beneficiary"), unless the terms of the donation permit such a transfer.

INVESTMENT CONTROL

Except to the extent provided to the contrary by a donor in an instrument of transfer to the community foundation, the foundation has total control over the investment policy and investments for such a fund. The only limits on investment control are those provided by state law with respect to the standard of prudence required in managing the fund, or by the gift instrument itself with respect to that standard or other investment limitations or latitudes. Even if the management of such a fund should ultimately be determined to fall short of the required standard, the remedy is to change investment advisers or to transfer the fund to another trustee - the beneficiary itself cannot obtain possession of it.

ENFORCEMENT OF FIDUCIARY STANDARDS

In most states (certainly in Massachusetts), only the Attorney General may enforce the proper administration of charitable funds. The beneficiary has no power to control the management of the fund or to attempt to enforce a change in methods of management.

TIMING OF DISTRIBUTIONS

While most community foundations would undoubtedly consult with a beneficiary which is to receive distributions concerning

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matters of timing, as a legal matter, unless a donor provides to the contrary, the timing of distributions from such a fund is totally within the control of the community foundation.

OVERSIGHT

In order to determine whether, under its governing instrument, the purposes to be fulfilled by distributions from such a fund have become unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served (requiring exercise of the foundation's variance power), the foundation must require reporting back from the beneficiary receiving distributions, a relationship totally inconsistent with the concept that the foundation is merely the agent of such beneficiary.

TAX ATTRIBUTES OF COMMUNITY FOUNDATIONS

While the tax treatment of community foundations should certainly not dictate appropriate accounting for transfers to such foundations, the long history and careful consideration given to the tax rules in this area is at least relevant to these issues.

Those rules have long provided that transfers of assets to a qualifying charity are considered as made "to" that charity, while transfers from which a charity receives only the benefit of a stream of income are made not "to" the charity, but "for the benefit of" or "for the use of" the charity. Treasury Regulations §1.170A-8(a)(2). This is a very important distinction, because in the former case, an individual donor may obtain a charitable income tax deduction of up to 50% of her contribution base, while in the latter case, only a 30% deduction is available.

Similarly, a transfer to a community foundation of assets to be held in a designated fund is treated as a contribution "to" the foundation, rather than the beneficiary which may be entitled to receive income from the fund. Treasury Regulations §1.170-A-9(e)(11)(ii)(B) and §1.507-2(a)(8)(iii). This treatment is extremely important to community foundations in meeting their public support test and maintaining their publicly supported status for tax purposes.

Certainly tax rules should not govern financial reporting policies. However, where such rules have received very careful agency and judicial consideration over a long period of time, I believe that where possible accounting policies represent a significant departure from long-established practice, the tax rules should be looked to for guidance, especially where they are directly applicable to the organizations affected.

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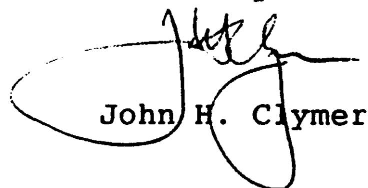
I believe all these factors make it quite clear that transfers of assets which create designated funds within a community foundation should be treated as increases in the assets of such a foundation.

Finally, I would pose a question: if these funds were to be treated as essentially held by community foundations as "agents," would there not have to be some reporting of them on the financial statements of the beneficiary for which they are held? And would not such reporting overstate the assets of such beneficiary, perhaps making them misleading to creditors who could not, in all probability (at least in Massachusetts), reach the beneficiary's interest in the income?

On behalf of The Boston Foundation, thank you for the consideration which the AICPA has given to issues raised by FASB 116 and 117 of particular importance to community foundations and for giving us the opportunity to comment upon the exposure draft.

Cordially,

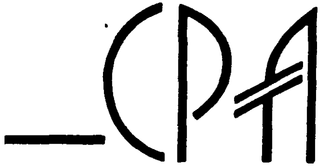


John H. Clymer

JHC/cla:9024C

cc: Anna Faith Jones, President
The Boston Foundation

Steven E. Honyotski, Chief Financial Officer
The Boston Foundation



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2 Players Club Drive, Charleston, WV 2531
P.O. Box 1988, Charleston, WV 25327
304-343-4188 □ FAX 304-344-5035

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AUG 15 1995

August 10, 1995

Mr. Joel Tannenbaum, Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Tannenbaum,

I'm writing you to comment on the proposed audit guide for non-profit organizations. I am a member of the Board of Trustees of The Greater Kanawha Valley Foundation and am concerned about the potential misleading effects of implementation of FASB 116 in connection with contributions received from other non-profit organizations.

I encourage you to consider our position, as discussed in the enclosed memorandum. After much discussion and review of the enclosed, I am convinced it describes a sound approach to dealing with this concern.

By their nature, community foundations must rely on public confidence and must have financial statements which are understandable to the users of those statements. I believe that accounting for contributions from other non-profit entities, where there is no legal liability to return those funds, as liabilities could serve to be very misleading and will be very difficult to explain to the community.

Thank you for the opportunity to express my views on this important issue.

Sincerely,

William D. Chambers
Certified Public Accountant

enclosures
cc: Greater Kanawha Valley Foundation

Members: American Institute of Certified Public Accountants and West Virginia Society of Certified Public Accountants

MEMORANDUM

To: Joel Tannenbaum, Technical Manager
From: The Greater Kanawha Valley Foundation
Subject: Proposed Audit and Accounting Guide
Not-For-Profit Organizations
Date: July 25, 1995

This memo is to address concerns of The Greater Kanawha Valley Foundation regarding the accounting treatment for contributions received from other not-for-profit organizations (NPO). There are three areas of concern:

1) Misleading financial statements;
2) Variance power; and
3) Differences between foundations and other not-for-profit organizations.

MISLEADING FINANCIAL STATEMENTS:

The recommended accounting treatment of contributions to The Greater Kanawha Valley Foundation could result in the issuance of misleading financial statements for both the foundation and the not-for-profit organizations. Under the proposed audit guide, the Foundation will record liabilities which do not exist and the NPO will record assets which it does not control or own.

The not-for-profit organization will retain assets on its financial statement which it no longer owns or controls. The not-for-profit organization could submit its financial statements to a bank for a loan based upon the assets reflected on its financial statement (which are actually owned and controlled by the community foundation).

The foundation will record a liability which does not exist (the contribution received from a not-for-profit organization). Using the example above, if the not-for-profit organization has assets (held by the foundation) on its financial statements and the foundation has a corresponding liability on the foundations' financial statements, it builds a very strong case for creditors to look to the foundation for assets, should the not-for-profit organization go bankrupt.

This places the foundation in a very delicate position, since it has no control over the boards, directors or operations of the not-for-profit organization. However, a foundation could be forced into a liability position on behalf of the not-for-profit organization.

This financial reporting could also mislead future and current contributors to believe that The Greater Kanawha Valley Foundation is incurring debt, when it actually is not, and that the foundation is not exercising good management over the funds. This could deter contributors from supporting the foundation in the future.

There is an argument that the current accounting treatment allows the not-for-profit organization to look "poorer" than it really is, which enables the NPO to request additional contributions/grants.
This argument states that the NPO has "effective control" over the assets and enjoys the "economic benefits" from the assets without having to report the assets on its financial statements. The Greater Kanawha Valley Foundation disagrees with this viewpoint.

Not-for-profit organizations place their funds with a community foundation for many reasons (other than to look "poor"):

a. The community foundation has normally been in existence longer than the not-for-profit organization;
b. The community foundation has strong community leaders who have many community interests, rather than one specific organization;
c. The community foundation can manage its money better than a single not-for-profit organization;
d. The community foundation has credibility in the community and may be able to get more contributions than a specific not-for-profit organization could raise by itself;
e. The community foundation has legal and accounting expertise, which not-for-profit organizations cannot always afford.

VARIANCE POWER:

The community foundation board has the power to spend the income and principal from contributions in a way to meet the community needs. If the needs of the community change, then the Board will decide how the funds will be spent in the future.

The foundation not only has ownership of the funds, but also the board can use its "variance power" to decide how to distribute money from the funds. This power is stated in the foundation's trust agreement and also in each trust agreement with contributors.

DIFFERENCES BETWEEN FOUNDATIONS AND NPO'S:

The purpose of a community foundation is to receive contributions from individuals, businesses, other not-for-profit organizations, trusts, estates and any other form of entity. The foundation distributes those funds to meet the various needs of the community.

As such, the purpose of a community foundation differs from other not-for-profit organizations in that the community foundation board decides:

1) what the community's needs are; and
2) which organizations will receive funds to meet those community's needs. The recipient NPO's can change from year to year.

Not-for-profit organizations exist for a single reason: only medical, only arts, only education, etc. The boards of other not-for-profit organizations do not have the power to spend funds for purposes other than their original intent.

CONCLUSION:

1) Record contribution as a liability:
There are certain circumstances when foundations should report contributions as a liability. If an NPO contributes assets to a foundation, but does not relinquish control over the assets, then this transaction should be recorded as a liability of the foundation. Under these conditions, the Foundation has no ownership nor control over the funds. It would truly act as and intermediary. Normally, a foundation does not receive this type of contribution.

2) Record contribution as income:
A community foundation should be able to recognize contributions from NPO's on its income statement for several reasons:

a) it owns the funds- through legal documents and through its daily operations;
b) it controls funds through its "variance power";
c) it has not incurred a liability;
d) it should not be liable for creditors of other NPO's; and
e) it operates and is organized differently from other NPO's.

The foundation should not be required to report liabilities which do not exist. The foundation should not be financially responsible for other not-for-profit organizations.

Due to these reasons, The Greater Kanawha Valley Foundation requests that foundations have separate accounting and financial reporting requirements. Since the basic organization and operation of foundations differs from other NPO's, then the proper financial presentation should be adopted for readers of financial statements. The foundation's financial statements should fairly present the financial position, operations (activities?) and changes in financial position of the foundation.

621 S.W. Morrison St., Suite 725 Portland, Oregon 97205
(503) 227-6846 Fax (503) 274-7771

A Tradition of Community Caring

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August 14, 1995

AUG 15 1995

Mr. Joel Tanenbaum
Technical Manager
File 3605.AG
AICPA Accounting Standard Division
1211 Avenue of Americas
New York, New York 10036-8775

Dear Mr. Tanenbaum:

I have reviewed the AICPA's Proposed Audit and Accounting Guide "Not-For-Profit Organizations" and am writing in response to the request for comments regarding variance power and donor-advised provisions.

I support the response you have received from the FASB Task Force For Community Foundations with respect to this issue. I believe that community foundations have sufficient discretion to recognize resources received in the kinds of transactions described on page v of the exposure draft as contributions. Treating these transactions as agency or intermediary transactions indicates that community foundations have "little or no discretion" over the resources. In fact, variance power gives the community foundation ultimate control and discretion over the use of its funds, including designated and donor-advised funds.

A community foundation's "history of exercising its variance power" does not necessarily affect the answer to the question posed. The nature of variance power is such that it is not expected to be exercised regularly. More important than the history of actual use of variance power is the community foundation's history of evaluating community conditions and individual grantees to determine if conditions exist that warrant its use and the foundation's willingness to use the power when such conditions do exist.

Thank you for your consideration.

Sincerely,

Brenda VanKanegan, CPA

Brenda VanKanegan, CPA
Director of Finance
and Administration

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Dean Schooler
4414 Apple Way
Boulder, Colorado 80301
303.449-0918 (Voice, Fax)
73142.2205@compuserve.com (Email)

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AUG 15 1995

August 10, 1995

Mr. Joel Tanenbaum
Technical Manager, File 3605.AG
Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Tanenbaum:

I am providing these comments on the Exposure Draft, Proposed Audit and Accounting Guide, Not-for-Profit Organizations dated August 14, 1995 with particular focus on the general consequences of FASB Statements No. 116 and 117 and the proposed Guide for community trusts and community foundations. Many of my observations will relate directly to the specific request for comments on Issue 1: Variance Power and Donor-Advised Provisions (Exhibit, p. v).

I am providing these comments as an individual who has benefitted from a number of professional and personal perspectives within the not-for-profit sector, namely as a founder and board member of a community foundation; as a manager of a private foundation; as a donor to not-for-profit organizations; as a consultant to nonprofit organizations and foundations; as a chair of a statewide task force encouraging philanthropy; and as an academic trained in political science and public policy analysis. I have no special background in accounting or law with respect to not-for-profit organizations. I am not providing these comments as a representative of any institution or not-for-profit organization, even though I have associations with many who will be variously affected by FASB Statements and Technical Bulletins and AICPA Audit Guides.

The comments are organized in the following four sections as (1) variance power; (2) donor-advised provisions; (3) accounting for income and income from resources; and (4) description of a donor-advised funds as contributions and as agency transactions.

I. Variance Power and Recognition of Resources as Contributions

The variance power, as described in Treasury Regulation 1.170A-9(e)(11)(v)(B)(1), requires that community trusts, in order to be treated as a single entity rather than as an aggregation of separate funds and, in order to have all funds treated as component parts of a single organization, have the power "*to modify any restrictions or condition on the distribution of funds for any specified charitable purposes or to specified organizations if in the sole judgment of the governing body (without the necessity of the approval of any participating trustee,*

custodian, or agent), such restriction or condition becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served."

The Committee would have to develop information from various community trusts in order to fully understand how, how often, when, and why they have considered modifying or actually modified any restrictions or condition associated with funds, including donor-advised funds, but from my perspective, the following could be said:

1. Variance power, as defined in Treas. Reg. 1.170A-9(e)(11)(v)(B)(1), appears to be useful only when a "restriction or condition becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served" but not useful in modifying most suggestions or recommendations on distributions from most donor-advised funds. Most if not nearly all suggestions from donors who have established donor-advised funds would have community trusts providing funds for legitimate, mainstream, publicly-supported, tax exempt 501(c)(3) organizations. Consequently, the exercise of the power to modify is not often considered and, when considered, invoked in unusual circumstances. Moreover, the circumstances in which most any tax exempt 501(c)(3) organization, including a community foundation, would not be fulfilling or operating programs inconsistent with the charitable needs of the community or area served, or those needs as defined by the community trust or community foundation, are relatively rare. In addition, the power to modify may be intended as a check and backup provision, not to be considered in each and every instance where a restriction or condition exists or where donor "suggestions" are made.

The power to modify, per se, assumes that something must exist in order to be modified. Thus, variance power implies and assumes the existence of some measure of donor influence, some level of donor right or privilege, and perhaps explicit or implicit restrictions or conditions imposed on a fund. Varying or modifying something seems to imply some initial direction or initiative from someone else that requires legal authority to change or refuse. If this is so, then, the variance power, in and of itself, implies agency as much if not more than it implies a contribution received.

2. Expenditure responsibility might provide additional basis for insuring that donor "suggestions" are routinely reviewed with an eye toward their being necessary, capable of fulfillment, and consistent with the charitable needs of the community or area served. "Expenditure responsibility", required only of community trusts in a five-year transition ruling period and private foundations, is not required of most community foundations (cf. Treasury Reg. 1.170A-9(e)(13)(xiii). However, a policy of exercising expenditure responsibility over all distributions from a foundation, including distributions resulting from the non-binding suggestions of advisor/donors, would be a way of addressing concerns over restrictions, conditions, and agency. And expenditure responsibility, if fully exercised, requires contributions and complete control by the foundation over distributions. Stated another way, no community foundation can fully exercise expenditure responsibility when agency exists and unless a contribution has been received.

3. Community foundations are generally expected to earn and distribute net income annually from endowed funds. When donors make suggestions with respect to these distributions, then community foundations can easily meet this expectation. When donors fail or refuse for whatever reason to make suggestions, then community foundations need the power to make distributions from donor funds nonetheless to meet these expectations. Similarly, in order to meet the requirements of Treasury Reg. 1.170A-9(e)(11)(v)(F) to produce a "reasonable return of net income (or appreciation where not inconsistent with the community trust's need for current income), with due regard to safety of principal, in furtherance of the exempt purposes of the community trust," community foundations must have full and complete control over funds provided by donors. These provisions in the Regulations seem to assume that gifts by donors to donor-advised funds are and must be contributions, not agency transactions. Stated another way, while not related to the power to modify, the requirement to produce and distribute a reasonable return of net income may provide a additional basis for considering resources provided to donor-advised funds as contributions rather than as agency transactions.

II. Donor-Advised Provisions and Recognition of Resources as Contributions

Hopefully, as a result of comments and other information provided by various community foundations, the Committee will acquire a more complete understanding of the wide variety of donor-advised provisions and donor-advised funds in existence. Experience and written materials, meanwhile, make possible the following observations:

1. Donor-advised funds are established and operated in varying ways. Many community foundations, in theory and in practice, conduct donor-advised funds with policies, procedures, and practices which would lead any reasonable person to conclude that a contribution and "complete gift" have been made; that no agency transaction has occurred; that no restrictions or conditions have been accepted; and that exercising variance power is actively considered. Others use language and metaphor; implement policies and practices; and engage in a patterns of conduct that suggest agency, de facto donor control, restrictions and conditions, reserved donor rights and granted donor privileges. What does a "donor-advised" fund mean? What does it look like? It all depends, since in theory and in practice in this area where marketing and fund raising may be more influential than law and accounting, "donor advised" means, to paraphrase Humpty-Dumpty, what a particular community foundation and individual donor says it means, or would prefer to think it means. Whether assets in a particular donor-advised fund are contributions received or agency transactions may well ultimately depend on the individual fund agreement and its implementation.

2. Donor intent seems important, if not controlling, in determining classification of assets as unrestricted, temporarily restricted, and permanently restricted. Consequently, could "donor intent" as expressed in donor-advised fund agreements, *as they would be drafted from a donor's point of view and with principal regard for a donor's interest rather than drafted from a community foundation's perspective*, be the way to resolve these questions? Similarly, the donor's

understanding and intentions, and not those of the community foundation, with respect to whether resources provided are contributions made or an agency transaction, may be the determining factor in distinguishing contributions from other transactions.

3. Treasury Reg. Sec. 1.507-2(a)(8)(iv)(A) indicates that the Internal Revenue Service "will examine carefully whether the seeking of advice by the community trust from, or the giving of advice by, any donor after the assets have been transferred constitutes a reservation of an indirect right to direct distributions, which would in turn constitute a material restriction or condition." (David Wheeler Newman and Jose Silva, "A Look at Alternatives to Private Foundations," *Trusts & Estates*, August 1994). When a donor-advised fund is established and a donor is accorded the right or "privilege" to make suggestions on distributions of income and/or principal from the fund, then a condition has been created and agreed to - if only a requirement that the foundation solicit, receive, listen to, and/or consider those suggestions. Whether this condition is "material" or not, it would seem, depends on the facts and circumstances of each individual donor-advised fund arrangement and partnership between donor and foundation. Does the "reservation of an indirect right to direct distributions (after assets have been transferred)" create agency?

4. Donor-advised funds which are designed, marketed, and implemented in ways which clearly and in practice are distinguishable from private foundations are desirable. Donor-advised funds ought not to become in effect "mini-foundations" with lessor administrative costs, fewer rules, and greater tax advantages than those accompanying private foundations. Donor advised funds which make it possible for donors to effectively influence, if not control, distributions of income and principal in years beyond the year in which tax deductions are taken for income tax purposes illustrate this potential "problem." Does the Committee want to address these questions with these issues in mind? Contributions to private foundations are disadvantaged for several reasons, principally, however, because they are made by disqualified persons who are presumed to be able to control distributions after assets have been transferred.

5. Many community foundations assess fees on donor-advised funds. What can be concluded from these fees, and the manner in which they are assessed and paid, that would shed light on the issue of contributions vs. agency transactions? Are fees for investment management different from fees for donor services as related to determining whether resources are contributions or as agency transactions? Does it make a difference whether these fees are levied on the funds themselves or assessed separately on the donor? Are fees requested from donors or contributions in lieu of fees for donor services and/or investment management evidence of agency with regard to a donor-advised fund?

III. Accounting for Income and Resources

Donor advised funds usually involve complete transfers of resources from the donor to the foundation. What differs widely from donor advised fund to donor advised fund would be rights

and privileges to suggest investment managers, investment strategies and to suggest distributions of income, net return, or principal.

Consider two situations where accounting might reasonably and accurately reflect and recognize resources and income from resources differently?

1. Donor provides resources for advised fund, requiring those resources be retained in perpetuity. Foundation receives, changes form of, and manages the assets. Foundation accords donor privilege of making "non-binding suggestions" (which are usually if not always followed) on distributions of net income to recipients. Situation could result in resources provided being treated as a contribution; in principal being treated as restricted net asset; and in net income being accounted for as an agency transaction. What would happen, however, were the donor to remove the donor-imposed restriction on principal being retained in perpetuity?

2. Donor provides resources for advised fund, not requiring those resources be retained in perpetuity. Foundation receives, changes form of, and manages the assets. Foundation accords donor privilege of making "non-binding suggestions" (which are usually if not always followed) on distributions of net income, net return, and/or corpus to recipients and on investment strategies and investment managers. Situation could result in resources provided being accounted for as an agency transaction; in principal being treated as a temporarily restricted net asset; and in net income being accounted for as an agency transaction. What would happen, however, were the foundation to exercise the power to modify over a donor suggestion to distribute the half of the fund's corpus?

Unfortunately, there may be no single answer to the question which would apply universally to all donor-advised funds. What may be required will be the application of criteria to each donor-advised fund based on the fund's marketing, practices, solicitation representations, formal agreement, implementation, and the intent and understanding of the donor/resource provider.

IV. Description of Donor-Advised Funds: Contribution Model and Agency Model

Because donor-advised funds have emerged and been developed based on criteria derived from marketing, accounting, law, taxation, fund raising, and donor relations, it is not surprising that they differ from foundation to foundation, from individual fund to individual fund, from agreement to agreement, for design and intent to implementation, and from theory to practice. Could it be that we are dealing with more than one type of donor advised fund? Would it be useful to distinguish funds as they vary in theory and in practice? Could there be a donor-advised fund where resources provided are treated as contributions? and a donor-advised fund where resources are provided as an agency transaction? As a beginning, how would each be described?

INDICATORS USEFUL FOR DISTINGUISHING TYPES OF DONOR ADVISED FUNDS

Indicator	Contribution	Agency Transaction
1. Approach, solicitation, fund raising	Foundation initiated	Donor initiate
2. Purpose of solicitation	Current foundation unrestricted grantmaking objectives and developing endowment	Fulfillment of donor objectives and developing fund for donor
3. Form of assets	Foundation changes form of assets	Donor may restrict assets
4. Investment decisions and management	Foundation fully controls	Donor makes suggestions
5. Distributions	Pattern and recipients resemble foundation grantmaking program; foundation has active, significant unrestricted program	Pattern and individual recipients may differ from foundation; foundation has weak or small unrestricted grantmaking program
6. Legal title	Foundation holds legal title	Foundation holds legal title
7. Variance power to modify	Considered in every case, often invoked	Used rarely and as exception
8. Distribution, grants	Foundation assesses needs, prepares distribution program, asks donor to review and advise	Donor assesses needs, initiates recommendations and advises foundation
9. Form of assets	Unrestricted	Temporarily, Permanently Restricted
10. Non-binding privilege to advise, make suggestions	Not specified, not implied	Specified in agreement
11. Period of time assets held	Permanent or term endowment	Quasi endowment or pass-through
12. Donor influence over resources and income from resources provided	Donor role limited to net income	Donor role also includes net return and and distributions of corpus
13. Knowledge of third party recipient, beneficiaries	Donor has knowledge only after decision to distribute effectively made	Donor has prior, specific knowledge
14. Donor intent as guide for foundation decisions on distributions	Foundation requests statement of general philanthropic philosophy, giving strategy	Foundation solicits specific advice and suggestions on recipients

Indicator	Contribution	Agency Transaction
15. Administrative Fees	Foundation assesses on funds for investment management	Foundation assesses on donor for donor services rendered, distribution, investment management
16. Administrative Support	Contributions sought separately from any fees	Contributions sought in conjunction with or in lieu of fees
17. Investigation, Needs	Foundation conducts assessments, receives requests, consults with advisors including donor, investigates recipients, and provides information on past, current, and prospective recipients to all donors	Donor and foundation share or donor surveys needs, recipients
18. Language, Metaphor	Trust, giving	Ownership, agency, accountability
19. Donor Relations	Foundation provides information on full range of giving options (private foundations, public endowments, supporting organizations, various lead and remainder trusts, community foundations)	Foundation provides information on community foundation options (advised, designated, field of interest funds etc.)
20. Relation between donor, foundation, and recipient	Independent	Common control, overlapping boards or management, shared facilities, common advisors

While history in some not-for-profit organizations may be so consistent and clear as to enable easy classification of "donor advised" funds as between contributions and agency transactions, we are more likely to find such wide variation between individual fund practices and agreements such that each "advised" fund will have to be classified individually based on facts and circumstances. Would these broader, but more specific, twenty indicators merged into Table 5.1, p. 30 of the Exposure Draft, make classification any easier? Donor advised funds have been designed and implemented to facilitate giving in communities. However, implementing them in practice and designing them in a legal and accounting environment which has provided few if any guidelines, has led to wide variations, varying public and private language, and reliance on pragmatism and doing "whatever it takes" to build permanent community capital and endowment for future generations.

What may be more important than the classification of existing donor-advised funds is likely to be the indicators and criteria which will guide the re-design of existing funds and the design of a next generation of advised funds.

Conclusion. Community foundations are the most important keystone and building block in contemporary philanthropy in the United States. They have been created to serve citizens and donors who want to benefit their communities and future generations. And they provide a philanthropic option that very few other organizations make possible --- that being a way in which donors with less than the level of assets advisable for funding and administering a private independent, corporate or family foundation can build permanent endowment and engage in serious philanthropy and strategic giving.

Some would establish this advisable level of giftable assets at $5,000,000; some as low as $1,000,000 at inception, but below these levels, in almost all communities across the United States, community foundations provide "the" alternative which enables most citizens to leave a legacy and create endowment which serves their communities.

And donor advised funds, in recent decades, have been the principal vehicle for making this all possible. Consequently, it is important that accountants and community foundations work through these issues in such a way as to ensure that:

- community foundations continue growing, strengthen endowment, and offer diverse funds tailored to the needs of donors (including "donor advised" funds in several forms); and

- community foundations are recognized as a unique and wonderful blend of not-for-profit organization, a blend that combines elements of private grantmaking foundations; federated fund raising organizations; and service-providing nonprofit associations.

I am grateful for the opportunity to comment and, hopefully, be helpful to the Committee's Audit and Accounting Guide.

Sincerely,

Dean Schooler

cc: Ms. Susan Weiss
Project Manager
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856-5116

151 S. Rose St., Suite 332
Kalamazoo, MI 49007

KALAMAZOO FOUNDATION

(616) 381-4416
fax (616) 381-3146

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AUG 15 1995

August 9, 1995

Mr. Joel Tanenbaum
Technical Manager, File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tanenbaum:

As the chief financial officer for the Kalamazoo Foundation, a community foundation, I wish to comment on the effect of variance power and donor advised provisions on the accounting for resources received under agreements that have those provisions. These comments were requested in the exposure draft of the proposed audit and accounting guide for not-for-profit organizations. I believe that the variance power, whether or not in combination with donor imposed restrictions, generally provides community foundations with sufficient discretion to recognize resources received as contributions. The history of exercising the variance power or deviating from the resource providers advise should not solely affect the answer to these questions.

The variance power is a unique feature of community foundations. It assists in the community foundation's mission to meet the changing needs of the community by allowing the governing body the discretion to determine the recipients of the foundation's assets. The governing body of the community foundation has the power to modify donor imposed restrictions if the restrictions become unnecessary, incapable of fulfillment, or inconsistent with the needs of the community. Donors rely on this power since it ensures them that their contributions will be used for the community's best interests.

The variance power of the Kalamazoo Foundation, which is encompassed in our corporate By Laws, provides "With regard to the use and distribution of funds and properties from time to time received and accepted by the Corporation, the Board of Trustees will use its own discretion in determining how donated funds are to be used. If funds or property is donated to the Corporation and the donor has made a request or suggestion concerning the Corporation's use of these funds or property, this is not binding on the Board of Trustees: however, the Board will consider a request or suggestion of a donor if it independently determines that this is the most beneficial purpose of the donated funds or property." Other community foundation's variance powers contain similar language.

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The Kalamazoo Foundation has exercised its variance power in several instances. The variance power was exercised to redirect a significant portion of undistributed income from an endowment fund designated for an arts agency to a health care agency. Several years after the grant to the health care agency the board of the arts agency requested that the fund be reimbursed for the distributed amount and earnings thereon. The foundation Board of Trustees upheld their original decision and refused the request. In another example an agency that requested a grant of the annual income from an endowment fund designated for its use was denied a portion of the requested distribution. The Board of Trustees exercised the variance power in this case since it did not believe that the agency was effectively meeting the needs of the community. Following this action the agency has reorganized its staff, board, and activities and entered a much needed capital fundraising campaign. Each of these cases indicates the importance of a community foundation's variance power in adjusting to the best needs of the community.

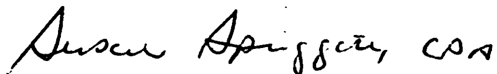
The circumstances surrounding the transfer of assets to the community foundation should be the factors considered in determining whether the transfer is a contribution or if the community foundation is acting as an agent, trustee, or intermediary. The factors to be considered in making this determination should include whether the language in the instrument establishing the fund is precatory or obligatory; whether the donor has retained the right, by written or tacit agreement, to withdraw the assets; whether the community foundation would exercise its variance power if conditions warranted; and whether the community foundation periodically reviews the needs of the community and the designated charities effectiveness in meeting those needs.

The history of the community foundation's exercise of the variance power should not be the sole determination in whether the variance power provides the community foundation with sufficient discretion to recognize resources received as contributions. What should be considered is whether, based on past experiences, the community foundation would likely exercise its variance power when conditions warrant such. The history of the governing body may not have provided opportunities for exercise of the power. The more important question is how would the governing body respond if an important community need or unusual circumstances arose that required funding and would the community foundation take appropriate action in response to events effecting a designated agency.

Besides the comments requested in the exposure draft I would like to point out several other detriments to an agency, which under the proposed rules, might be required to report as an asset funds held at a community foundation. First, I believe that readers of the financial statements will be misled as to the legal title of the assets. I am concerned that creditors of the agency might not understand that the funds held at the community foundation are not legally owned by the agency. Secondly, I am concerned that this misleading financial reporting may lead to an agency's creditors suing the community foundation for access to these assets. Although the legal title resides with the community foundation and therefore, these assets should be protected from an agency's creditors, the cost of defending against such a suit would divert the community foundation's assets away from the needs of the community.

I hope that these comments will result in the proposed audit guide including provisions for the circumstances under which the variance power, whether or not in combination with donor advised provisions, provides community foundations with sufficient discretion to recognize resources received as contributions.

Very truly yours,



Susan K. Springgate, CPA
Fiscal & Administrative Officer

SKS/wbk

Goodwill
Industries
International,
Inc.

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Rcv'd 8-15-95

August 14, 1995

Mr. Joel Tanenbaum
Technical Manager
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York City, NY 10036-8775

Dear Mr. Tanenbaum:

As operators of thrift stores, in this unique not-for-profit industry, we hereby collectively oppose the industry audit guide revision as it applies to inventory valuation. We request language in the guide that essentially exempts our organizations from the requirement to establish a value for contributions of inventory when received by the organization. We have strong conceptual differences, as well as concerns about the cost-benefit considerations involved with the issue of inventory valuation.

The obvious principal conceptual difference between our thrift stores and other organizations, including traditional retail stores, is that we do not purchase our inventory. Instead, we rely on donated goods from the general public for our supply of salable items, which have traditionally not been valued or valued at a nominal sum. If we were to place a value on inventory, there is the question of what to call the revenue later received from selling it: is the revenue "sales" or "contributions?" If this revenue is sales, then there is, of course, a cost of sales, which largely nets out the sales, with no impact on the bottom line.

Unlike retail stores that have invoices from their suppliers to establish the value of merchandise when received, thrift stores that sell donated merchandise cannot refer to an invoice to determine the value of its contributed merchandise. The task of determining fair value of donated merchandise in our industry is significantly more time consuming and difficult and far less accurate. A signification portion of what we receive in the form of donated goods is sold as salvage which represents significantly reduced revenue potential or as trash (no revenue potential, but involving cost of removal). Due to significant value-added processes embodied in material collection and processing, a fair value cannot be determined until the point of sale. We therefore recommend that recognition of revenue from contributed inventory occur at the point of sale and not when received. Fair value cannot be determined within reasonable limits at the point the contributed inventory is received.

9200
Wisconsin Avenue
Bethesda, Maryland
20814-3896
U.S.A.

Phone: (301) 530-6500
Fax: (301) 530-1516
TDD: (301) 530-9759

Another major conceptual difference is that a not-for-profit organization does not have the compelling interest in "profit" (excess of revenue over expenses) that a business does, as a measure of performance, etc. Since not recording inventory merely has the effect of deferring some revenue to the next accounting period (it would never be more than one period later), the difference in the long run is not significant. In fact, since the revenue deferred into a period at the beginning is largely offset by revenue deferred out of the period at the end, the income statement effects largely tend to offset within any given period. Since it is a reflection of how we meet our mission goals, the statement of activities is given much more emphasis by the users of financial statements.

Another major difference and concern for some of us is the perception of financial prosperity resulting from adding inventory to the balance sheet. This no doubt will significantly (adversely) influence major donors and public funders such as United Way by giving the appearance that our financial posture is much stronger than it really is. At a time when contributions to not-for-profit organizations are shrinking and competition for available donations is growing, such perception is not only undesirable but financially harmful.

The benefit of valuing inventory would be minimal. The cost and the task would be prohibitive for some locations. We ask that it not be required of our industry, for the reasons stated.

Endorsed by these not-for-profit organizations that represent a substantial portion of the thrift store industry:

Association of Christian Thrift Stores (ACTS)
Catholic Charities USA
Goodwill Industries International, Inc.
International Union of Gospel Missions
Sunshine Foundation
The Arc of the United States
The Salvation Army-National Headquarters
Society of St. Vincent De Paul
  Council of the United States
Waterfront Rescue Mission, Inc.

NOTE: THE POINT OF CONTACT FOR THIS LETTER IS DAVE SPARKS,
GOODWILL INDUSTRIES INTERNATIONAL, INC. AT (301) 493-0481 EXT. 261

THE CHURCH OF
JESUS CHRIST
OF LATTER-DAY
SAINTS

125
8-15-95

FINANCE AND RECORDS DEPARTMENT
Fifteenth Floor
50 East North Temple Street
Salt Lake City, Utah 84150

August 15, 1995

Mr. Joel Tanenbaum
Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tanenbaum:

On behalf of The Church of Jesus Christ of Latter-day Saints. I am writing in response to the invitation for comments on the exposure draft of the proposed AICPA Audit and Accounting Guide *Not-for-Profit Organizations.* My comments are specifically directed to the requirement to report contributions of inventory at fair value. (Exposure draft paragraph 7.03)

<u>Theoretical Considerations</u>
The Church operates thrift shops under the name of Deseret Industries. The purpose of our stores is to provide on-the-job training experience in various facets of business to those who are handicapped and others that may have difficulty gaining employment elsewhere. This experience enables them to become employed in industry. These stores routinely receive donations of used clothing, furniture and other personal goods which are held for resale.

Deseret Industries is <u>not</u> evaluated by donors on the basis of profit or loss because they know we are in the business of assisting people to earn their way. *The general public and members of the Church will continue to provide donations of inventoried items without regard to the profitability of Deseret Industries.*

<u>Cost vs Benefit</u>
Contrary to the position of the exposure draft, fair values of used donated inventory are not obtainable from published catalogs or vendors. Independent appraisals are not practical due to the volume of goods received and the relatively minor value involved.

If items had to be valued at the point of receipt, the process would be extremely time consuming, costly to implement, and would result in useless information since a significant portion of goods donated are unusable and discarded. In addition, fair value is not readily determinable until items are refurbished and repaired. Measuring the fair value of donated inventory would have no effect on the operations or management of the stores. These stores are merely recipients of donated goods and have no control over what is given.

Valuing year end donated inventory would be very time consuming and of little benefit. The effect of changes in inventory on the statement of activities would be insignificant compared to total sales and cost of goods sold. *We therefore, recommend that our type of industry be exempted from valuation of contributed year end inventory. We do however agree that any purchased inventory should be valued and reflected in the financial statements.*

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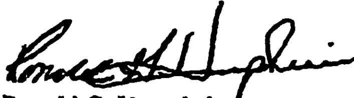
Conclusion
In summary, information regarding the fair value of used donated inventory is not relevant to management and users of financial statements, is not clearly measurable, and is not practical from a cost versus fit perspective. I recommend that contributions of used inventory be excluded from the requirement to be measured at fair value.

Sincerely,



Ronald G. Humphries
Church Controller

RGH/la

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AUG 18 1995

August 15, 1995

Mr. Joel Tanenbaum, Technical Manager
File 3605.AG, Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Tannenbaum,

Community Works is an organization that has worked to raise funds from employees who donate to charity through payroll deduction since 1982. As such, we are concerned with the contents of the **Proposed Audit and Accounting Guide for Not-for-Profit Organizations** dated April 14, 1995. Because this guide will have an impact on us, we would like to add our voice to the current discussion over it.

Community Works has received and studied the enclosed comments that the National Alliance for Choice in Giving made on the draft. We share the organization's concerns, their rationale for those concerns as well as their suggestions as to how those concerns might be addresed.

see letter #29

We appreciate the opportunity to make our observations known and hope that our participation assists you in your deliberations.

Sincerely,

Fran Froehlich

Fran Froehlich
Chair, Board of Directors

25 West Street • Boston, Massachusetts 02111 • (617) 423-9555 • (617) 338-3075

SAN FRANCISCO
SYMPHONY

HERBERT BLOMSTE[illegible]
MUSIC DIRECTOR

NANCY H. BECHTLE
PRESIDENT

PETER PASTREICH
EXECUTIVE DIRECTOR

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August 11, 1995

AUG 18 1995

Joel Tanenbaum
Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Tanenbaum:

This is a statement of comments on the Exposure Draft of the proposed Audit and Accounting Guide for Not-for-Profit Organizations Committee of the AICPA submitted for your consideration.

The San Francisco Symphony is the fourth largest symphony orchestra in the United States with an annual budget of $30-$35 million and total assets of approximately $90 million. Many issues covered in the proposed Audit and Accounting Guide affect us directly.

We agree with the majority of the draft and wish to state at the outset that we commend the Committee for extending the work begun by the FASB in trying to bring a sense of comparability to external financial reporting by not-for-profit organizations.

We do have comments on the following areas.

Presentation of an Intermediate Measure of Operations and the Presentation of Functional Expenses

During the course of the comment period and the public hearings for SFAS117, a major issue for the San Francisco Symphony and other performing arts groups was the continuing ability to present in our audited statements a result from operations conforming to our historical method of measuring operations. The FASB did not agree with our contention that we should be left free to present a separate *Statement of Operations*, but we were publicly assured that the freedom to present a measure of operations as defined by a single organization or industry would not be denied, as was made clear by the FASB in P112-114 of SFAS117.

DAVIES SYMPHONY HALL · SAN FRANCISCO, CA 94102-4585 · TEL: 415 552-8000 · FAX: 415 431-6857

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We see in P3.13 a tendency to be overly prescriptive in ways which would preclude the consistent application of our historical measurement of operations. It was a deliberate decision on the part of FASB not to prescribe a specific measure of operations nor to proscribe the measure of operations deemed most applicable by a given organization or industry just as long as the total change in net assets by class was retained. It would be inappropriate for the AICPA to attempt to change that decision. A possible result of such a move would be to force a large number of performing arts organizations to present unaudited information in their published annual reports and restrict the circulation of their audited statements.

We find a similar tendency in P13.23-13.41 concerning the presentation of expenses reported by their functional classification (the "matrix"). The overly prescriptive tone of this section goes well beyond the display requirements imposed by the FASB and in fact contradicts the express desire of the FASB not to require such explicit totals. Such a requirement **would be more stringent than display requirements for business enterprises and could inhibit meaningful financial reporting by not-for-profit organizations** (P116 of SFAS117, emphasis added). By requiring such totals, the Committee severs the necessary connection between the matrix and expenses as presented in the *Statement of Activities*. Without such an explicit connection presentation of expenses will become confusing. The proposed reconciliation offered by the Committee in P13.26 would only make the presentation more confusing.

In summary, we feel that it is inappropriate for the Committee explicitly to contravene the decision already made by the FASB not to require such specific totals. As such, P3.13 should be amended to make clear that an organization or industry is left free to determine the components of its own intermediate measure of operations, provided that this measure is clearly disclosed and that the change in total unrestricted net assets for the period is clearly reported. In addition, P13.24 should be amended to delete the words, "regardless of where they are reported on a statement of activities," from the first sentence.

<u>Recognition of Uncollectible Promises to Give</u>

As currently drafted, P5.52 would require the treatment of the initial estimate of uncollectible promises to give in the *Statement of Activities* as bad debt expense. We believe that this treatment is incorrect and that uncollectible promises to give (i.e., pledges) should be treated as a reduction of contributions received in the period in which the uncollectible pledge is recognized as such. There are two reasons for this method of treatment:

1. This situation is analogous to the treatment of accretion of discounted pledges addressed in SFAS116. While the FASB initially proposed that this accretion should be treated as interest income, they were persuaded that this accretion is in reality an integral part of the contributions. Similarly, pledges which might not be real in the first place and pledges made in good faith which cannot be fulfilled for whatever reason are, in the minds of donors and recipients, simply a reduction in contributions received.

2. Bad debt expense, as we understand it and have always used it, is the expense resulting from the loss of an asset resulting from a reciprocal transfer. It does not necessarily follow that the initial valuation of assets resulting from non-reciprocal transfers would result in an expense. It is more logical to treat the valuation process for non-reciprocal transfers (i.e., pledges receivable) as a component of contributions received in any given period.

If the AICPA contends that the reasons noted above are irrelevant, we believe that at a minimum the recognition of these pledge write-offs are losses as defined in SFAS5, *Accounting for Contingencies*, and therefore should be reported separately if material as losses.

Capitalization of Prepaid Fundraising Costs

There are two issues concerning fundraising costs that deserve further consideration by the AICPA:

1. Should institutions be allowed to capitalize prepaid fundraising costs (i.e., feasibility studies, materials design and production, etc.) to match such costs to the specific campaign for which they were intended?

2. What period of time is appropriate for expense recognition of prepaid fundraising costs?

P13.07 of the Exposure Draft and its related footnote prescribe that fundraising costs be expensed as incurred. This treatment is based on the flawed assumption that there is difficulty in assessing the ultimate recovery of the expenditure and that the practice of expensing costs as incurred is uniform in nature.

Contrary to AICPA's position, deferral of prepaid fundraising costs to match such expense against the campaign is the predominant practice of symphony orchestras. Sophisticated fundraising techniques and the use of experienced professionals for developing campaign strategies and materials provide organizations with the ability to access the effectiveness of a campaign and project reasonable ranges of anticipated return and cost recoverability. The increasing level of campaign sophistication suggests projected returns would be no more or less accurate than projected returns from direct advertising costs, as discussed in P13.10.

The San Francisco Symphony asks that the AICPA consider allowing the deferral (capitalization) of prepaid fundraising costs with the recognition of expense tied to the solicitation period of the campaign. Annual campaigns (i.e., a campaign for a specific fiscal year) should require recognition of the prepaid expense at the commencement of the campaign. For longer campaigns (i.e., capital campaigns), the prepaid expense should be recognized in an appropriate manner over the solicitation period, which is essentially the useful life of the campaign materials. For perpetual campaigns (i.e., campaigns that are ongoing and without a defined duration), we agree with the AICPA that such expenses should be recognized as incurred.

Clarification of Measurement Principles for Contributions

We believe from our reading of P5.51 that that paragraph appropriately states that an unconditional promise to give a non-cash asset should be recorded when the promise is received at the underlying asset's discounted expected fair value, and that no gain should be recorded for the underlying asset's increase in value until the asset is actually received. However we do not feel that this concept is as understandable as it could be. Perhaps if it were made clear that from the time the promise is received until the underlying asset is received, it is the promise that exists on the balance sheet of the organization and not the asset itself and that it would be inappropriate to increase the recorded value of the promise.

Similarly, we find P5.54 confusing. We believe that what is meant to be conveyed is that the organization's perception of the risk of uncollectibility (discussed in P5.52) is a measurement made separately from and prior to the organization's assessment of the risk-free rate of return. That rate is then used to discount the amount and is not changed once it is determined.

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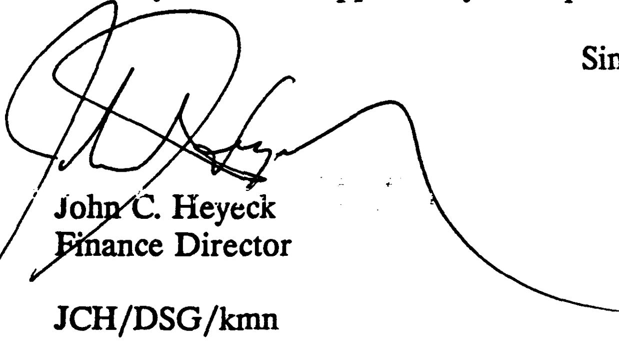
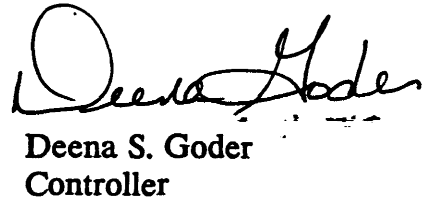
Thank you for the opportunity to respond to this exposure draft.

Sincerely,



John C. Heyeck
Finance Director



Deena S. Goder
Controller

JCH/DSG/kmn

The
Columbus
Symphony
Orchestra

ALESSANDRO SICILIANI
MUSIC DIRECTOR

SUSAN M. FRANANO
EXECUTIVE DIRECTOR

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AUG 18 1995

August 14, 1995

Mr. Joel Tanenbaum
Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tanenbaum:

This is a statement of comments on the exposure draft of the proposed audit and accounting guide for Not-for-Profit Organizations issued on April 14, 1995 by the Not-for-Profit Organizations Committee of the AICPA.

We agree with the majority of the draft and wish to state at the outset that we recommend the Committee for extending the work begun by the FASB in trying to bring a sense of comparability to external financial reporting by not-for-profit organizations. We do have comments in the following areas:

Presentation of an Intermediate Measure of Operations and the Presentation of Functional Expenses

During the course of the comment period and the public hearings for SFAS117, a major issue for the symphony orchestras and other performing arts groups represented by the American Symphony Orchestra League and CFO/Arts was the continuing ability to present in our audited statements a result from operations conforming to our historical method of measuring operations. The FASB did not agree with our contention that we should be left to present a separate statement of operations, but we were publicly assured that the freedom to present a measure of operations as defined by a single organization or industry would not be denied. This was made clear by the FASB in ¶112-114 of SFAS117.

We see in ¶3.13 a tendency to be overly prescriptive in ways which would preclude the consistent application of our historical measurement of operations. It was a deliberate decision on the part of the FASB not to prescribe a specific measure of operations nor to prescribe the measure of operations deemed most applicable by a

55 East State Street, Columbus, Ohio 43215
614/224-5281
Fax 614/224-7273

given organization or industry just as long as the total change in net assets by class was retained. It would be inappropriate for the AICPA to attempt to change that decision. A possible result of such a move would be to force a large number of performing arts organizations to present unaudited information in their published annual reports and restrict the circulation of their audited statements.

We find a similar tendency in ¶13.23-13.41 concerning the presentation of expenses reported by their functional classification (the "matrix"). The overly prescriptive tone of this section goes well beyond the display requirements for imposed by the FASB and, in fact, contradicts the express desire of the FASB not to require such explicit totals. Such a requirement "would be more stringent than display requirements for business enterprises *and could inhibit meaningful financial reporting by not-for-profit organizations*" (¶116 of SFAS117, emphasis supplied). By requiring such totals, the Committee severs the necessary connection between the matrix and expenses as presented in the Statement of Activities. Without such an explicit connection, presentation of expenses will become confusing. The proposed reconciliation offered by the Committee in ¶13.26 would only make the presentation *more* confusing.

In summary, we feel that it is inappropriate for the Committee to explicitly contravene the decision already made by the FASB not require such explicit totals. As such, ¶3.13 should be amended to make clear that an organization or industry is left free to determine the components of its own intermediate measure of operations, provided that this is clearly disclosed and that the change in total unrestricted net assets for the period is clearly reported. In addition, ¶13.24 should be amended to delete the words "regardless of where they are reported on a statement of activities" from the first sentence.

Paragraph 5.52

As currently drafted, this paragraph would require the treatment of the initial estimate of uncollectible promises to give in the statement of activities as bad debt expense.

We believe that this treatment is incorrect and that the initial estimate of uncollectible promises to give (pledges) should be allowed to be treated as a reduction of contributions received in the initial period in which the uncollectible pledges are recognized. The subsequent recognitions of uncollectible pledges should then be treated as a loss rather than an expense. There are several reasons for this treatment.:

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Columbus Symphony Orchestra
Exposure Draft Response

1. This situation is somewhat analogous to the treatment of accretion of discounted pledges addressed in SFAS116. While the FASB initially proposed that this accretion should be treated as interest income, they were persuaded that this accretion is, in reality, an integral part of the contribution process and should be recognized as additional contributions. Similarly, pledges which might not be real in the first place, are in the minds of donors and recipients, just a reduction in contributions received.

2. Bad debt expense, as we understand it and have always used it, is the expense resulting from the loss of an asset resulting from a reciprocal transfer. It does not necessarily follow that the initial valuation of assets resulting from non-reciprocal transfers would result in an expense or loss. It is more logical to treat the valuation process for non-reciprocal transfers (i.e. pledges receivable) as a component of the amount of contributions received.

3. If a bad debt expense were to be recognized, it would most logically be functionally included in fund raising expense for the period. This would create another unintended, negative effect. Fund raising expense is a very closely watched and comparable figure, especially as a percentage of total funds raised. The inclusion of the write off of pledges in the numerator rather than in the denominator of that percentage could result in misleading information. Since this percentage tends to be very comparable across different kinds of not-for-profits now, it is desirable to maintain this comparability. Treating pledge write offs as bad debt expense in fundraising expenses would seriously impair this desirable comparability.

Capitalization of Prepaid Fundraising Costs

There are two issues concerning fundraising costs that deserve further consideration by the AICPA:

1. Should institutions be allowed to capitalize prepaid fundraising costs (i.e. feasibility studies, materials design and production, etc.) to match such costs to the specific campaign for which they were intended?

2. What period of time is appropriate for expense recognition of prepaid fundraising costs?

Columbus Symphony Orchestra
Exposure Draft Response

¶13.07 of the ED and its related footnote prescribe that fundraising costs be expensed as incurred. This treatment is based on flawed assumptions that there is difficulty in assessing the ultimate recovery of the expenditure and, that the practice of expensing cost as incurred is uniform in nature.

Contrary to the AICPA's position, deferral of prepaid fundraising costs to match such expense against the campaign is the predominant practice in the performing arts and by symphony orchestras in particular. Sophisticated fundraising techniques and the use of experienced professionals for developing campaign strategies and materials provide organizations the ability to access the effectiveness of a campaign and project reasonable ranges of anticipated return and cost recoverability. The increasing level of campaign sophistication suggests projected returns would be now more or less than projected returns from direct advertising costs, as discussed in ¶13.10.

The Columbus Symphony Orchestra asks that the AICPA consider allowing the deferral (capitalization) of prepaid fundraising costs with the recognition of expense tied to the solicitation period of the campaign. Annual campaigns (i.e. a campaign for a specific fiscal year) should require recognition of the prepaid expense at the commencement of the campaign. For longer campaigns (i.e. capital campaigns) the prepaid expense should be recognized in an appropriate manner over the solicitation period, which is, essentially, the useful life of the campaign materials. For perpetual campaigns (i.e. campaigns that are ongoing and without a defined duration) we agree with the AICPA that such expenses should be recognized as incurred.

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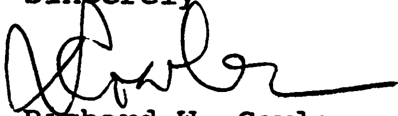
Similarly, we believe that ¶5.54 is confusing. We believe that what is meant to be conveyed is that the organization's perception of the risk of uncollectibility (discussed in ¶5.52) is a measurement made separately from and prior to the organization's assessment of the risk-free rate of return. That rate is then used to discount the amount and is not changed once it is determined.

Thank you for the opportunity to respond to this exposure draft.

Sincerely



Richard W. Cowles
Finance Director

MACPA

(129)

Mr. Joel Tanenbaum
Technical Manager, File 3605. AG
Accounting Standards Division
American Institute of CPAs
1211 Avenue of the Americas
New York, New York 10036-8775

AUG 18 1995

Dear Mr. Tanenbaum:

The Accounting Standards Committee and the Auditing Standards Committee of the Maryland Association of CPAs are pleased to respond to the Exposure Draft of the Proposed Audit and Accounting Guide for Not-for-Profit Organizations.

The Committees reviewed the exposure draft and felt that it provided the additional guidance needed to implement FAS# 116 & 117 as well as the outstanding exposure draft relating to current value accounting for investments. The issues raised in the Guide engendered much discussion, with the following results:

ISSUE 1

(1) The Committees believes that variance power does provide not-for-profit organizations (NFPs) with the discretion needed to recognize resources received as contributions. Since variance power allows the NFP to alter the distribution of assets based on the NFP's sole judgment, we believe this demonstrated level of control requires recordation of the gift as a contribution. Following this logic, the NFP's past actions regarding the exercise of variance power would not alter the decision.

(2) We recommend that the term "variance power" be more clearly defined. If the intended meaning is that not-for-profit organizations has discretion over the issue of the dollar amount distributed only (not dollar amount and a choice of to whom), some members felt the resource should be recognized as an agency transaction. We also recommend clarification as to the accounting for distributions which are withheld permantly from the designee.

(3) We believe donor advised provisions are instructive in assuring that contributions are utilized in a manner that would closely match the intent of the donor. When, however, the donor purposefully modifies his/her intent by providing the organization variance power to alter this intent, the organization should record the gift as contribution. Prior deviations from the donors intent by the NFP would not impact this logic.

Maryland Association of Certified Public Accountants, Inc.
1300 York Road, Suite 10
PO Box 4417
Lutherville, MD 21094-4417
Phone (410) 296-6250
1-800-782-2036
Fax (410) 296-8713

(4) After much consideration, the Committees concluded that income and the underlying perpetually held assets must have the same accounting. To do otherwise could confuse the financial statement user who attempts to assess rates of return, etc. Additionally, the Committees felt there were few instances in which consistent accounting would not be justified by the facts of the situation.

ISSUE 2

We believe the guide should offer specific guidance regarding the recordation of expenses as revenue offsets. In the example cited, the Committees felt strongly that revenue reductions occurring as a result of employee benefit programs such as tuition waivers are properly classified as expense. Scholarship and other forms of financial aid to those outside the school community are seen as revenue reductions needed to foster the purposes of the school. Providing benefits to employees was considered to be an employment expense.

The potential tax consequences of our recommended approach were considered, but reporting accuracy was considered to be the stronger issue.

The Committees would be pleased to discuss further our conclusions as well as the points raised above.

Sincerely yours,

James Schaefer

James S. Schaefer, CPA
Accounting Standards Committee Chair

Harvey Milhiser

Harvey I. Milhiser, CPA
Auditing Standards Committee Chair

HUGH WOLFF
MUSIC DIRECTOR

THE HAMM BUILDING • 408 ST. PETER STREET, SUITE 300 • ST. PAUL, MN 55102-1497
612/292-3248 • FAX: 612/292-3281

(130)

AUG 18 1995

August 14, 1995

Mr. Joel Tanenbaum
Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tanenbaum:

This is a statement of comments on the exposure draft of the proposed audit and accounting guide for Not-for-Profit Organizations Committee of the AICPA.

We agree with the majority of the draft and wish to state at the outset that we commend the Committee for extending the work begun by the FASB in trying to bring a sense of comparability to external financial reporting by not-for-profit organizations. We do have comments in the following areas:

Presentation of an Intermediate Measure of Operations and the Presentation of Functional Expenses

During the course of the comment period and public hearings for SFAS117, a major issue for the symphony orchestras and other performing arts groups represented by the American Symphony Orchestra League and by CFO/Arts was the continuing ability to present in our audited statements a result from operations conforming to our historical method of measuring operations. The FASB did not agree with our contention that we should be left to present a separate statement of operations, but we were publicly assured that the freedom to present a measure of operations as defined by a single organization or industry would not be denied. This was made clear by the FASB in ¶112-114 of SFAS117.

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CHRISTOPHER HOGWOOD
PRINCIPAL GUEST CONDUCTOR

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RESOURCE TRUST
CREATIVE CHAIR

AARON JAY KERNIS
COMPOSER-IN-RESIDENCE

GARY R. WOELTGE
CHAIR OF THE BOARD

BRENT ASSINK
PRESIDENT AND
MANAGING DIRECTOR

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such a move would be to force a large number of performing arts organizations to present unaudited information in their published annual reports and restrict the circulation of their audited statements.

We find a similar tendency in ¶13.23-13.41 concerning the presentation of expenses reported by their functional classification (the "matrix"). The overly prescriptive tone of this section goes well beyond the display requirements imposed by the FASB and, in fact, contradicts the express desire of the FASB not to require such explicit totals. Such a requirement "would be more stringent than display requirements for business enterprises *and could inhibit meaningful financial reporting by not-for-profit organizations*" (¶116 of SFAS117, emphasis supplied). By requiring such totals, the Committee severs the necessary connection between the matrix and expenses as presented in the Statement of Activities. Without such an explicit connection, presentation of expenses will become confusing. The proposed reconciliation offered by the Committee in ¶13.26 would only make the presentation *more* confusing.

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The Saint Paul Chamber Orchestra asks that the AICPA consider allowing the deferral (capitalization) of prepaid fundraising costs with the recognition of expense tied to the solicitation period of the campaign. Annual campaigns (i.e. a campaign for a specific fiscal year) should require recognition of the prepaid expense at the commencement of the campaign. For longer campaigns (i.e. capital campaigns) the prepaid expense should be recognized in an appropriate manner over the solicitation period, which is, essentially the useful life of the campaign materials. For perpetual campaigns (i.e. campaigns that are ongoing and without a defined duration) we agree with the AICPA that such expenses should be recognized as incurred.

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Thank you for the opportunity to respond to this exposure draft.

Sincerely,

Beth Villaume
Director of Finance and Administration

GOODWILL INDUSTRIES OF SOUTH FLORIDA, INC.

August 11, 1995

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Dennis Pastrana
President

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AUG 18 1995

Mr. Joel Tanenbaum
Technical Manager
File 3605.AG, Accounting Standards Division
ACIPA
1211 Avenue for the Americas
New York, New York 10036-8775

Dear Mr. Tanenbaum:

Regarding the AICPA exposure draft of the Audit and Accounting Guide for Non-profit Organizations, I would like to comment on the specific subject of inventory evaluation.

From 1972 to 1979, as Director of Finance and Management Information for the national office of Goodwill Industries in Washington, D.C., I was responsible for the development and implementation of a standardized fund/functional accounting program for 180 independent Goodwill member agencies. During this period, Goodwills were persuaded to adopt our current practices regarding donated goods inventory valuations. I have a sound awareness of Goodwill Industries practices throughout the United States, and I hope that my observations will be helpful.

Since 1972, all Goodwill Industries in the United States have followed the practice of assigning a nominal $1.00 valuation and acknowledged their existence of in the notes to the financial statements, for the inventory donated by the public to be sold in our thrift stores. We feel that given the special nature of our business, this is the most appropriate and conservative treatment of these inventories. The assignment of a fair value to these inventories as recommended in the new Audit and Accounting Guide for Non-Profit Organizations will only serve to:

> Inflate inventories on the balance sheet, thus misleading the public.
>
> Misrepresent the value of inventories which only have value so long as the Goodwill Industries is in operation, but have no value or an insignificant salvage value, if the Goodwill ceases operation.
>
> Will increase cost for the agency, without any corresponding benefits. This reduces resources needed to carry out the mission.

Goodwill Industries rarely receives real estate, works of art, antiques, collectibles or similar rare and expensive items as donations. Rather, we depend on collecting a very large volume of donated items comprised of great diversity lacking standardization and of nominal value items. The key to our business success is a very cost-efficient process of

sorting and grading items. We rapidly discard the unsalable then maximize sales by offering the remainder at bargain prices, providing high inventory turnover.

Determining the value of donations received is very difficult because of high volume and lack of standardization. The following will explain the system that our Goodwill Industries in Miami, Florida uses to collect, process and sell donated material. It is our hope that this explanation will provide an understanding of the difficulties faced in complying with the new Audit and Accounting Guide recommendations.

Here is how our annual donated goods sales break down by group and percent of total.

Textiles	$3,100,000	70%
Electrical/Mechanical	170,000	04%
Shoes	290,000	06%
Housewares	560,000	13%
Salvage	310,000	07%
Total	$4,430,000	100%

Donated goods are collected from two sources— 88% from donation centers (27 foot trailers located in 26 different shopping centers), and 12% collected at our 12 store locations. Donation centers fill up in about a week with about two tons of materials donated by about 180 donors. In a year we collect about 1,200 full trailers filled with 2,400 tons of donations that are brought by 243,360 donors (40% are repeat donors) at an average of 19.7 pounds per donor.

From this collection, 45% of the tonnage is unsalable and is discarded because it is trash, damaged or obsolete. We receive thousands of items that are not salable because technological advances have rendered them obsolete such as electric pop-corn poppers, toasters, telephones, and hair curlers. Others are discarded because of changes in taste, style and fashion which no longer have a demand such as bell bottom pants, polyester dresses, platform shoes, etc.

To simplify our explanation, we will focus on textiles which comprise 70% of our sales. After 45% of the donations are discarded as unsalable, textiles go through an additional sorting where another 40% is separated out because of low quality. This salvage, when mixed with unsold merchandise rotated from the stores, will have a salvage value at present of .08¢ per pound. Our Goodwill operates 12 retail stores which each carry an average of about 15,000 textile/garments. The stores are equipped with 1,250 lineal feet of hanging racks which are equivalent to 15,000 inches, one garment per inch, and this is how our textile inventory capacity is determined. There are 48 different garment types marketed. Each type is assigned an amount of rack space determined from its demand. To save labor costs, there are no individual prices. A menu board displayed on the walls provides the prices which average about $3.50 per item.

There is no certainty that garments are salable. Goodwill Industries receives some high quality items which we know in advance will sell. Only about 3% of all donations are of high quality. For the rest, there is no certainty . The only way to insure satisfactory volume is to expose the largest possible variety of items to the public. To accomplish this, we entrust our sales opportunities to a system that operates as follows:

Full trucks of merchandise are taken to the store, almost on a daily basis. After trash and salvage is separated, store employees categorize the clothing by item. If there is no space on the clothing racks, to make space they pull items that, in the judgment of the store employee, look less attractive. Frequently store employees pull items that were placed on the rack just a few days before. The task of removing unsold merchandise and replacing it with fresh ones is called "pulling" and it is performed daily. Complementing this system, the total store clothing racks are divided in about 20 different sections of about the same length and capacity (one for each day of the month except Saturdays and Sundays). Each day a different section of inventory is pulled and added to the materials to be sold as salvage at .08¢ per pound. This insures that no item will remain in the store more than a month.

Our 12 stores have a total inventory capacity for 168,000 garments, and they are fed approximately 55,000 garments weekly or 2.6 million garments annually. It should be noted that we have approximately 15.5 inventory rotations a year, sis to eight times more than regular department stores. Since there is no objective method of evaluating what is salable, after years of experience we have determined that the customer is the best judge, and we entrust our sales to their judgment. This is what makes Goodwill Industries business work, and it has been in evolution since the turn of the century when we established our thrift business store. Collecting massive volumes of merchandise of which close to one-half are not salable and having a continuous massive supply and rotation of inventory. A reduction in this massive inflow of merchandise and rotation will cause our sales to drop drastically.

We have on our Board of Directors members of the Burdine's Department Store organization who have observed that, on an average, we turn our inventories over seven times faster than they do and that the inventory of 50,000 garments which Goodwill supplies its stores, providing only $3.1 million is more than the inventory of garments Burdine's supplies its stores which do some $820 million in sales.

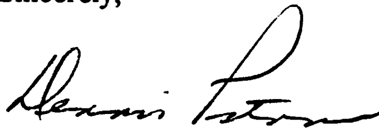
The ultimate test of any inventory is whether it can recover its costs once the business ceases operation. Based on this premise, the financial world lends money to businesses, and relies on the accounting profession to validate this inventory. In the case of Goodwill Industries, our inventory of donated goods does not meet this test. If we ceased operations, our inventories of clothing would have insignificant value or may even be worthless. For example, clothing that Goodwill Industries does not display in its stores or clothing that is pulled from the store racks is sold as salvage at .08¢ a pound. Based upon our own studies, there is an average of 2.5 garments per pound. Using an average price of $3.50 per garment, one pound has the retail value of $8.50 as long as the Goodwill

is in operation. However, that drops to .08¢ if Goodwill were to stop operation and may even be less—the local market for salvage material is very small, and having one Goodwill Industries going out of operation would cause a salvage glut that would decrease salvage prices immediately. Holding the clothing in storage for better prices is not an option because donated clothing presents a challenge because it is used and will rapidly develop very unpleasant odors if not sold quickly. The cost of dry cleaning it or preserving it under the proper air-condition and ventilation environment will exceed the possibility of any financial recovery. The cost of shipping to another market is also not feasible because salvage is bulky, heavy and the price is too low to afford additional shipping and handling.

I have used clothing as an example because it is the largest part of our business and is easier to explain. The same principal applies to shoes, electrical/ mechanical items, and houseware items which comprise the rest of our sales.

If adopted, the new Audit and Accounting Guide for Non-Profit Organization's recommendation on the treatment of donated merchandise will not serve any public reporting purposes, will be difficult to adhere to given the peculiar nature of our business and will create a hardship for Goodwill Industries and other organizations like the Salvation Army. We strongly recommend that you enable us to continue to follow the current practice of assigning a $1.00 valuation to our inventories, together with notes in the financial statements, to disclose their existence. This recommendation has been followed by all Goodwill Industries for over 20 years. It has been accepted by independent public accountants that have audited Goodwill Industries without any objection, after the auditors became aware of the peculiar nature of our inventory. It has become a universally accepted accounting practice.

Sincerely,



Dennis Pastrana
President

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Association for
Healthcare
Philanthropy

313 Park Avenue
Suite 400
Falls Church, Virginia 22046
(703) 532-6243
Fax (703) 532-7170

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AUG 18 1995

August 15, 1995

Joel Tanenbaum, Technical Manager
File 3605.AG, Accounting Standards Division
American Institute of Certified Public Accounts
1121 Avenue of the Americas
New York, NY 10036-8774

Dear Mr. Tanenbaum:

The Association for Healthcare Philanthropy (AHP) is pleased to provide comments on the "Proposed Audit and Accounting Guide: Not-for-Profit Organizations." AHP is the professional society for 2500 individuals who are dedicated to the advancement of health care institutions through philanthropy. The fund raising function of healthcare providers is the responsibility of AHP members. The new audit guide is specifically applicable to this role, either for fund-raising departments of healthcare providers or for separate organizations raising funds for one or several providers. We are sure you will want to consider the views on significant issues of these individuals filling this important role.

In summary, we believe:

-- Uncollectible pledges should be reductions of contributions, not bad debt expenses.

-- Guidelines for reporting contributions made and distributions of agency receipts need to be clarified.

-- The nature of the organization should be the only basis for distinguishing between revenues and gains.

-- The source of funds, not their use, should control classification.

-- The effective date should be for fiscal years beginning after December 15, 1995.

-- Flexibility in language and financial statement format allowed by the guide is desirable.

<u>Uncollectible pledges</u>

Paragraph 5.51 discusses unconditional promises to give (pledges), specifying that the amount recorded when the pledge is received is net of an allowance for uncollectible and the portion that is expected to be collectible is discounted to the present value of expected cash flows. Paragraph 5.55 states that amortization of the discount is recognized as contributions. Like the

discount to present value, the contributions, not bad debt expenses as specified in paragraph 5.52. For pledges with value that may change for reasons other than collectibility and the discount to present value, paragraph 5.51 specifies that increases are not recognized but decreases are recognized in the period the decrease occurs. Paragraph 5.51 should also specify that this decrease is as originally recorded should be recognized as an adjustment of contributions in the period when the adjustment is made. Recognizing bad debt expenses is appropriate in connection with exchange transactions but not for the type relationship that exists between a donor and donee.

Contributions made and agency receipts

A healthcare provider related foundation may receive funds that are to be distributed to the provider. If the receipts are properly classified as contributions, the distributions are "contributions made." Guidelines for reporting contributions made are unclear. Paragraph 5.02 says Chapter 13 discusses reporting of contributions made by not-for-profit organizations. The only references in Chapter 13 related to contributions made is in paragraph 13.11 (which simply refers to paragraph 10.06) and in paragraph 13.27 which implies that only federated fund-raising organizations may make contributions. Paragraph 10.06 does not deal with contributions made but rather deals with promises to give. Therefore, this subject is not adequately addressed. The best coverage of this subject is in paragraph 3.14 which says "awards and grants to others" are a natural expense classification. The various references to this subject should be coordinated and the content of 3.14 should be the theme of all conclusions on this subject.

If a healthcare provider related foundation received funds when acting as agent, the results of its solicitation effort should be reflected in its financial statement. One of the three methods of display shown on page 33 would appropriately be used by a foundation that receives agency funds. We favor a display such as the following for this type transaction:

Total contributed funds received	$10,000
Less amounts remitted to XYZ Provider in accordance with donor restrictions	4,500
Net unrestricted support	5,500
Other sources of revenues and gains	100
Total revenues, gains, and other support	$ 5,600

Paragraph 5.09 and 5.10, including the display alternatives, indicate that they are applicable only to federated fund-raising organizations (1) but the issues discussed are more broadly applicable and should not have this limitation.

Distinguishing between revenues and gains

Paragraphs 12.02 and 12.03 provide the appropriate distinction between revenues and gains in conformity with paragraph 79 of SFAC No. 6; that is, revenue is derived from the organization's ongoing major or central operations and gains arise from peripheral or incidental transactions. Paragraph 13.21 adds an additional, inappropriate criteria concerning whether "revenues or expenses are significant in relation to the organization's annual budget." An example will help illustrate why this additional criteria is inappropriate. A healthcare provider (independently or through a foundation) may conduct a capital campaign once every 20 years. In the year of the campaign, the revenues and expenses are significant in relation to the organization's annual budget in that year but looking at the budget for the 20 year span between campaigns, it is not significant to the organization's budget. This capital campaign is NOT part of ongoing major or central operations of the provider or foundation and therefore should not be reported as revenues and expenses. It would be reasonable for the guide to require that gains and losses of amounts that are significant in relation to the organization's annual budget be reported gross rather than net but such a requirement should not relate only to fund-raising activities.

Classifying contributed funds

Paragraph 5.09 states that contributed funds equal to the amount used to fund solicitation expenses and administer the organization should be classified as revenues other than contributions (2). This provision allows the use of funds to dictate their classification rather than reflecting the intent of the donor. Some of the amounts contributed may be used for program, some for administration and solicitation, and some may be added to reserves of the fund-raising organization. The entire amount received from donors should be classified as contributions regardless of how the funds are used.

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(1) Healthcare providers may be not-for-profit, investor owned, or governmental. Therefore, we recognize that there should be a single set of generally accepted accounting principles applicable all organizations. Paragraph 2.11 specifies some differences in reporting requirements based on type of organization. The effort of FASB (and, as a result, AICPA) to prepare different rules for the same transactions at different types of organizations is adding complexity without benefit. It is undesirable to establish rules that are applicable only to federated fund-raising organizations. If such selectively applicable rules are deemed essential, it is necessary to clearly define a federated fund-raising organization. It is possible, for example, for a charitable foundation to encourage and facilitate contributions to a number of providers; would such a foundation be a federated fund-raising organization? We believe the not-for-profit organizations proposed audit guide is already filled with examples of the complexity and confusion that results from efforts to apply rules to only certain types of organizations but not to other organizations that have identical transactions. We realize that such confusion originates with FASB and GASB, not AICPA, but we urge AICPA to avoid adding to the confusion by not formulating rules that are applicable only to federated fund-raising organizations.

(2) This provision is in a section of the guide specified for federated fund-raising organizations but this provision seems inappropriate, even for these organizations. As noted elsewhere in this letter, we oppose rules that are applicable only to one type of organization.

Effective date

The proposed effective date is for fiscal years beginning after June 15, 1995 (with a delay to December 15, 1995 for small organizations). There is no basis for the June 15 date and it is prior to the end of the comment period for the proposed guide. SFAS No. 116 and No. 117 are effective for fiscal years starting after December 15, 1994 (with a delay to December 15, 1995 for small organizations). There was no better guidance available on June 15, 1995 than there was on December 15, 1994, so an effective date before a new guide is issued makes no sense. There should be a commitment to complete the guide by December 15, 1995 and make it effective on that date. Large organizations will be operating without specific guidance for a year but the June 15 date does not correct that problem and simply adds confusion about when action must be taken.

Flexibility

Footnote 1 on page 18 specifies that terms such as "Statement of Financial Position ... serve as possible titles ... Other appropriately descriptive titles may also be used ... (such as) balance sheet ..." Similarly, paragraph 3.08 and footnote 1 on page 105 say the term "equity" is an acceptable synonym for "net assets." Footnote 2 on page 105 also mentions flexibility in terminology. These provisions are desirable, allowing the fund raising function of healthcare providers to follow a business style in their financial reports if they choose, thus communicating most clearly with business oriented contributors and portraying their business-like operations.

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The above comments reflect our views on the major issues raised by this proposed audit guide. In addition, an appendix provides our response to the specific issues identified in the proposal and makes a number of additional suggestions.

We will be pleased to discuss these comments with you and members of the Not-for-Profit Organizations Committee.

Very truly yours,

William C. McGinly, PhD., CAE
President, Chief Executive Officer

Enc.

APPENDIX

Response to the specific issues for comment

With respect to the questions on Issue 1:

-- Variance power transfers discretion over funds from the donor to the donee, thus making the receipt a contribution, not an agency transaction. Paragraph 5.02 and 5.04 properly state that the recipient of agency funds has little or no discretion concerning their use. Variance power gives the donee sufficient discretion to classify the amount as a contribution. The action of the donor establishes the classification of the receipt, not the action of the donee, therefore the donee's history with respect to exercising the discretion granted does not influence the classification.

-- The existence of variance power is a sufficient transfer of discretion from the donor to the donee to warrant recognition of the receipt as a contribution as noted in the previous point. A donor's action to "advise" rather than "direct" further underscores the transfer of discretion to the donee. As with the previous example, the history of action by the donee is irrelevant.

-- There is authority in the proposed guide for handling the principal of a gift differently from the earnings on that gift. For example, paragraph 8.08 specifies that when a donor contributes to an endowment, "the initial gift creates permanently restricted net assets; the investment income is temporarily restricted..." It is reasonable to recognize each aspect of this transaction consistent with the direction of the donor, even if one aspect is an agency transaction rather than being a contribution.

With respect to Issue 2, it seems reasonable to differentiate between a discount and an exchange transaction. The example in the issue description is reasonable. Something of value is provided and received and it is reasonable that the financial records should reflect this transaction.

Other comments

Paragraph 1.08 overstates the use of fund accounting by not-for-profit organizations in the past. At the minimum, the paragraph should say "... some not-for-profit organizations used fund accounting...:

Paragraph 3.08 says "Revenues, expenses, gains, and losses should be classified by (equity) class." The word "expenses" should not be included in this list, because paragraphs 3.10 and 13.03 properly specify that expenses may only affect unrestricted equity.

In table 5.2, the resource provider's records, if available, could serve as an additional indicator for distinguishing contributions from exchange transactions. Resource provider records that classify a transaction as a contribution or as a purchase are clear indications of intent. Similarly, the resource provider's records could help distinguish a promise to give from an intention to give. SFAS No. 116 requires a donor to recognize expenses when making a promise to give. Failure of a resource provider to record a contribution payable in the future is an indication that the communication represents a intention, not a promise.

Paragraph 5.39 seems to contain an error or is unclear. The condition described in section (a) of this paragraph seems to describe a situation in which the contribution would be classified as unrestricted.

It might be helpful for paragraph 5.43 to begin by saying "The fair value of contributed services..."

In example 2 on page 48, the sentence at the bottom of the page probably should say "Discount rates ranged from..."

The first sentence of paragraph 6.04 should be expanded to refer to "... part-contribution and part-exchange or part-agency transactions."

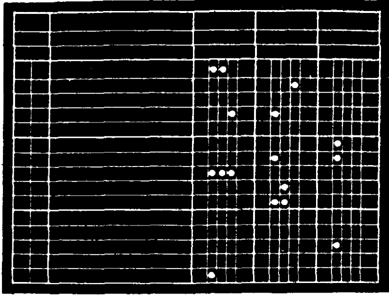
While we understand that the final guide must incorporate the guidelines concerning valuation of investments when they become final. This is referred to in paragraph 8.01. We wish to note, however, that we disagree with the proposal to apply different valuation standards to not-for-profit organizations than to other organizations. The provisions of paragraph 8.06 underscore the confusion that results from different rules for different organizations.

Footnote 1 on page 111 says SOP 87-2 is "the" AICPA statement applicable to allocation of costs among functions. SOP 87-2 discusses one specific allocation issue, not the subject of allocation generally. Paragraph 13.34 of the proposed guide discusses the many types of expenses that must be allocated. Footnote 1 on page 111 should be modified.

13.13 says that gains or losses on sale of buildings and equipment used in operations are gains or losses, not adjustments of depreciation recognized during the use of the asset. This provision reflects paragraph 25 of SFAS No. 117.

It might be helpful to describe how to differentiate between an adjustment of depreciation expenses and gains or losses on disposal of an asset.

13.36 says subsequent paragraphs provide information about cost allocation. Paragraph 13.37 is the only one that discusses this subject, so the reference in 13.36 might be clarified.



Ellie Rozinsky, CPA

15 Bradford Avenue
Hull, Massachusetts 02045

617 925-4185
Fax 925-6060

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AUG 18 1995

August 15, 1995

Mr. Joel Tanenbaum, Technical Manager
File 3605.AG, Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Tanenbaum:

I am writing to comment on the Exposure Draft, Proposed Audit and Accounting Guide for Not-for-Profit Organizations. My comments concern two issues: the recording of donor-designated funds received by federated fund-raising organizations and the functional classification of the fund-raising campaigns conducted by federated fund-raising organizations.

Recording of donor-designated contributions:

I believe that contributions to federal fund-raising organizations via workplace campaigns and other means are intended by the donors as donations to that organization, even though the majority of the funds are expected to be paid out as grants to "member" groups. The member groups generally conduct their own fundraising efforts and donors are able to contribute directly. By choosing, however, to contribute to the federated fund-raising agency, donors are supporting the work of the agency as well as the particular mix of member groups.

If the federated fund-raising agency omits revenue recognition, the organization understates the actual amount of contributions given to it. The agency must meet Internal Revenue Services qualifications, and must acknowledge to donors contributions over certain amounts, so the exposure draft seems to dictate conflicting dual reporting. A true federated fund-raising agency is legally independent of its member groups and is accountable to both its donors and member groups; including designated donations on its form 990 that are not included in audited financial statements could make all users suspect of both documents.

Functional expense reporting by federated fund-raising organizations:

Federated fund-raising organizations exist specifically to solicit funds on behalf of affiliated "member" groups. The fund-raising the agency does for this purpose is it's program, and the costs associated with workplace and other campaigns constitute a service to the member groups. Supporting services of the federated fund-raising agency would include fund-raising efforts on the agency's own behalf as well as the administration of all programs. It's critical to the success of all federated fund-raising organizations that there be this basic distinction between their program which is raising funds for other groups and supporting services which do not further their exempt purpose. Therefore, I believe the wording of paragraph 13.41 should be changed accordingly.

Thank you in advance for your consideration.

Sincerely,

Ellie Rozinsky

Deloitte & Touche LLP

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AUG 18 1995

Ten Westport Road
P.O. Box 820
Wilton, Connecticut 06897-0820

Telephone: (203) 761-3000
ITT Telex 66262
Facsimile: (203) 834-2200

August 14, 1995

Mr. Joel Tanenbaum
Technical Manager
Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

File Reference 3605.AG
Proposed Audit and Accounting Guide – Not-for-Profit Organizations

Dear Mr. Tanenbaum:

We are pleased to comment on the AICPA's Exposure Draft of the *Proposed Audit and Accounting Guide – Not-for-Profit Organizations* (the "Exposure Draft").

We support the issuance of the Exposure Draft as a final Audit and Accounting Guide (the "Guide"). However, we believe clarification on certain issues identified below would improve the usefulness of the Guide. Comments on the specific issues raised in the Exposure Draft are as follows:

Issue 1: Variance Power and Donor-Advised Provisions. The FASB has indicated its intent to address this issue; therefore, AcSEC should defer its deliberations until the FASB has completed its analysis.

Issue 2: Financial Aid Provided by a College and University. We agree with AcSEC's position that not all financial aid provided by a college and university is a tuition discount. There are instances where tuition discounts should be recorded as a reduction of revenue. There may be other instances, however, when the discount should be recorded as an expense. It may be helpful to rely on an industry group such as the National Association of Colleges and Universities Business Organizations (NACUBO), which is currently addressing the issue, to explore practice more fully. If sufficient information is available prior to the finalization of the Guide, guidance on this issue should be included. Alternatively, the guidance could be issued later in some other form, such as a Practice Bulletin.

Additionally, we recommend the Guide address the following points:

- Paragraph 5.39 states that, as required by FASB Statement No. 116, unconditional promises to give should be recognized as contribution revenue and receivables in the period in which the promise is received. It also provides guidance for determining how to classify the contribution revenue (i.e. unrestricted, temporarily restricted, permanently restricted). The Guide should also clarify how to determine whether the pledge receivable should be classified as a current or a noncurrent asset. For example, if an organization receives a promise to give to a building campaign, the pledge receivable should be classified as a noncurrent asset because it will ultimately be used to construct a long-term asset, rather than classified as a current asset because it will ultimately be settled for cash.

- Footnote 2 to paragraph 1.04 states that not-for-profit organizations that do not meet the FASB Statement No. 117 definition of a not-for-profit entity but are nevertheless required to follow this Guide should follow the guidance on accounting and reporting for investments included in FASB Statement No. 115, rather than the guidance included in Chapter 8 of the Guide. The Guide should clarify how such an entity would report changes in the market value of "available for sale" securities. FASB Statement No. 115 requires the unrealized holding gains and losses for available for sale securities be reported as a separate component of shareholders' equity until realized. The Guide should clarify how unrealized gains and losses would be presented in the net assets section of a not-for-profit entity's statement of financial position.

- Paragraphs 3.23 and 3.24 address the reporting of related entities. These paragraphs do not address how related foundations that do not meet the consolidation requirements of SOP 94-3 should account for promises to give that they receive on behalf of their related not-for-profit organizations. That is, if an unconsolidated foundation receives a promise to give on behalf of its related organization, should the foundation record the promise as an agency transaction or as a contribution? Chapter 5 addresses contributions received and agency transactions and provides indicators for distinguishing between the two. The following three indicators would assist in distinguishing contributions from agency transactions in unconsolidated foundations and should be added to Table 5.1:

  Length of holding period. In many cases, foundations may hold assets for distribution to a related organization for long periods of time. The amount of time during which those assets are held by an intermediary organization may be one indicator to distinguish contributions from agency transactions. A long holding period may be indicative that the transaction is a contribution.

  Discretionary rights. A foundation that raises funds for the benefit of a related organization may impose a restriction when it transfers those funds to that organization. For example, assume a foundation receives funds that were not restricted by the original donor to the foundation. The foundation's board may require the recipient related organization to use the funds to acquire capital equipment. When the right to impose a restriction exits, it may be indicative that the transaction is a contribution.

Specific-purpose solicitations. A foundation may raise funds for its related organization for a specific purpose, such as the construction of a new building. Promises to give may be made during a building campaign with the intent that the contribution be used for the stated purpose. Such promises to give should be accounted for as agency transactions. The absence of a stated purpose, for example, a general endowment, may indicate that the transaction is a contribution.

Paragraph 5.08 provides examples of how to apply the indicators in Table 5.1 to determine the appropriate asset classification. The examples should include an asset transfer to a related, but unconsolidated foundation.

- Paragraph 6.11 requires recognition of "changes in the value of split-interest agreements" for certain transactions and events. Paragraphs 6.07 and 5.54 require that the fair value of an unconditional promise to give be measured based on the discount rate determined at the time the promise is initially recognized and not be revised as market rates change. Paragraph 6.11 should reiterate that the discount rate should not change even though the amounts due or payable under the agreement are being remeasured because of certain transactions or events.

If you have any questions concerning our comments, please call Val Bitton at (203)761-3128 or Greg Kirk at (610)366-5113.

Yours truly,

Deloitte & Touche LLP

PLANTE & MORAN, LLP

27400 Northwestern Highway
P.O. Box 307
Southfield, Michigan 48037-0307

Certified Public Accounta
Management Consultant
810-352-2500
FAX 810-352-0018

August 11, 1995

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AUG 18 1995

Mr. Joel Tanenbaum
Accounting Standards Division, AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: File 3605.AG - Proposed Audit and Accounting Guide, Not-For-Profit Organizations

Dear Mr. Tanenbaum:

We are pleased to submit our response to the AICPA's request for comments on the exposure draft "Proposed Audit and Accounting Guide for Not-for-Profit Organizations." We generally agree with the issuance of the "combined" audit and accounting guide, although we have some concern that valuable guidance material for colleges and universities will be lost by elimination of the separate college and university guide. We offer the following for your consideration:

DEFINITION OF A NOT-FOR-PROFIT

Paragraph 1.02 of the exposure draft makes the statement that some organizations that have traditionally been considered not-for-profits and that followed existing AICPA audit guides do not meet the definition of a not-for-profit organization in FASB Statement No. 117. We find that conclusion troublesome for the following reasons:

1. The definition of a not-for-profit in FASB Statement No. 117 uses, word for word, the "distinguishing characteristics" of a not-for-profit included in FASB Concepts Statement No. 4. It is difficult for us to understand how restating the words from the concepts statement constitutes a change in the definition.

2. Whether an organization is a not-for-profit organization is not a judgment call, it is a question of fact. All one has to do is read the Articles of Incorporation to determine whether the organization is a not-for-profit organization. The suggestion that FASB intended for certain not-for-profits to be accounted for and reported on in a manner different than other not-for-profits is contrary to the stated objective of FASB Statement No. 117 to improve comparability between organizations.

3. There is not one mention anywhere in FASB Statement No. 117 that the Board was changing the definition of a not-for-profit and that the issuance of SFAS 117 would cause accounting changes for certain not-for-profits.

While the ED says certain organizations may no longer meet the definition of a not-for-profit, it never states what type of organizations they may be referring to and why those organizations would not meet the definition. Without providing that information, the ED creates confusion and uncertainty rather than providing guidance to the users of the guide. Moreover, since the guide requires all non-profits to follow the guide even if the organization does not meet the definition in SFAS 117, there seems to be little benefit in making the distinction. The only meaningful difference seems to be accounting and disclosure for investments, which becomes much less significant with the expected changes required by the FASB ED on accounting for investments by not-for-profits. If you must make the distinction, providing guidance similar to the Type A/Type B distinction made in the FASB Research Report, Financial Accounting in Nonbusiness Organizations, would be appropriate. (FASB Concepts Statement 4, paragraph 7, footnote 3)

Paragraph 3.15 in the ED also deals with the definition of not-for-profit issue, and reporting expenses on a functional basis. The last sentence of that paragraph suggests that there could be an organization that receives significant amounts of contributions from the general public that was not a not-for-profit organization. I am unaware of any organization that receives significant contributions from the public that would not be a not-for-profit organization.

GOVERNMENT GRANTS

There is a great deal of confusion in the not-for-profit community about the impact SFAS Statement No. 116 had on accounting for government grants. A significant majority of our not-for-profit clients receive government grants or awards in some shape or form. Nevertheless, paragraphs 5.20 and 5.21 contain precious little guidance with respect to interpreting the provisions of FASB Statement No. 116 as it relates to government grants. For example:

1. Many people believe that governments do not make contributions and, therefore, all government grants must be exchange contracts. Is that a true statement?

2. Many people believe that government grants related to specific projects always result in the resource provider receiving "potential direct benefits" since it helps the government serve the public at large, and, therefore, should be accounted for as exchange transactions. Is that a true statement?

3. Some people believe that government grants, while not traditionally considered a contribution, may meet the "definition" of a contribution in FASB Statement No. 116 and, therefore, should be accounted for as such. However, many of those people also believe that because of the governmental regulation involved, those contributions are always conditioned on being expended for the purpose for which the grant was made, and should not be accounted for as revenue until that condition is satisfied. Is that a true statement?

More guidance and specific examples with respect to recognition of revenue from government grants would be appropriate.

UNCONDITIONAL PROMISES TO GIVE

Paragraph 5.44 of the ED discusses contributed utilities, facilities, and use of long-lived assets. That paragraph states that a not-for-profit organization that receives the promise of the use of facilities, such as a building or office space, for an extended period of time should report that promise to give as contributions receivable and as restricted support. That conclusion results in recording an asset for the future use of property that is inconsistent with the requirements of FASB Statement No. 13, unless the promise meets the requirements for capital lease accounting, as later stated in that paragraph. We believe no asset should be recorded unless the promise results in an unconditional, noncancellable capital lease.

Paragraph 5.52 of the ED states that bad debt expense should be reported for the gross amount of promises to give that are expected to be uncollectible and should be reported in that asset class in which the contribution revenue is reported. We disagree with that conclusion. A promise to give that goes uncollected does not meet the definition of an expense in FASB Concept Statement No. 6. When a promise to give goes uncollected, the not-for-profit organization has had no actual or expected cash outflow or other using up of an asset. It merely had a bad estimate of the contribution revenue that ultimately would be collected and, therefore, should report it as an adjustment to contribution revenue. There is no need to have consistent reporting between uncollectible promises to give and uncollectible accounts receivable because, as the guide states in paragraph 5.62, contributions receivable and accounts receivable are not the same thing.

INVESTMENTS

We are generally in favor of fair value of reporting of investments for not-for-profit organizations. Since we do not believe that FASB Statement No. 117 changed the definition of a not-for-profit organization, we also do not believe that some not-for-profit organizations should account for their investments in accordance with FASB Statement 115 and others should account for them in accordance with this guide or the FASB Statement on Accounting for Certain Investments Held by Not-for-profit Organizations that will be issued soon.

We have one other comment with respect to the chapter on investments. It is unclear whether the disclosures identified in paragraphs 8.22 through 8.25 are intended to be disclosures about derivative financial instruments or represent the disclosures that should be made by all not-for-profit organizations about all investment securities.

NET ASSETS

Paragraphs 11.09 and 16.09 state that unrestricted net assets include those net assets whose use is not restricted by donors, even though their use may be limited in other respects, such as by contract or by Board designation. First of all, net assets restricted by contract and net assets limited by Board designation are two very different things. We believe that any financial statement that does not disclose material net assets restricted by contract is deficient. Net assets restricted by contract are, in fact, restricted and should be disclosed as such. To suggest that an organization will have to present a financial statement with net assets restricted by contract as a restricted portion of unrestricted net assets doesn't make sense.

VARIANCE POWER AND DONOR-ADVISED PROVISIONS

Based on the experience that we have had with community foundations, it is possible that variance power can provide the community foundation with sufficient discretion to recognize the resources received as contributions. In many cases the foundation easily surpasses the "little or no discretion" criteria in paragraph 53 of FASB Statement No. 116. In many cases, the community foundation has absolute discretion. In answering the question whether an organization's history of exercising its variance power should affect how the resources should be accounted for, we need to clearly define what "exercising its variance power" means. We do not believe it is important to know the number of times the foundation used its resources for something other than what the original donor had requested. We believe what is important is the extent to which the foundation evaluates the needs of the community, evaluates or reviews the designated charities and makes a conscientious decision about how the funds should be used. In that case, even if the foundation follows the wishes of the donor, the foundation has exercised its variance power by making grant decisions based on foundation developed criteria.

MISCELLANEOUS MATTERS

1. A number of not-for-profit organizations present their financial statements on a cash or modified cash basis. We believe the guide should provide guidance as to the financial statement format and disclosures required in financial statements presented on a comprehensive basis of accounting other than GAAP.

2. We believe the guide should clarify the definition of a voluntary health and welfare organization. In several different places the guide refers to the definition in FASB Statement No. 117. FASB Statement No. 117 took the definition from the AICPA's guide for voluntary health and welfare organizations. Many people have interpreted that definition literally. That is, if the organization does not have more than 50% of its revenue from contributions from the public, the organization would not be considered a voluntary health and welfare organization, irrespective of the underlying purpose of the organization. Since the statement of functional expenses is required for a voluntary health and welfare organization, I believe it would be appropriate to address which is more important in identifying voluntary health and welfare organizations, the purpose of the organization or the source of its revenue.

3. In paragraph 2.01 reference is made to tests and reports required by OMB Circular A-133 and reports that meet the requirements found in government auditing standards. Since any organization subject to A-133 would be subject to the Yellow Book, but not all organizations subject to the Yellow Book would be subject to Circular A-133, the order of those two references should be switched.

4. Paragraph 2.30 states that not-for-profit organizations that receive government financial assistance are required to have audits in accordance with government auditing standards, as specified in the Yellow Book. The word "are" in the first line should be replaced with the word "may."

5. We think footnote 4 on page 13 suggests that a program audit can only be conducted in accordance with a specific federal audit guide. Program audits can be conducted whether or not there is a federal audit guide. There are many state organizations that have audit guides.

6. The example in paragraph 5.10 would be much easier to follow if the contribution amount and the designated amount were not both $5,000.

7. Paragraph 12.05 states that some types of financial aid should be reported as a reduction of revenue. What types of financial aid is the guide referring to?

We appreciate the opportunity to participate in the AICPA's due process and appreciate your consideration of our comments. We would be glad to discuss our thoughts with you at your convenience.

Very truly yours,

PLANTE & MORAN, LLP

Gregory A. Coursen, Partner
Director of Professional Standards

:mro

NATIONAL
HEALTH
COUNCIL

1730 M Street, NW
Suite 500 • Washington, D.C. 20036-4505
(202) 785-3910 • Fax (202) 785-5923

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AUG 18 1995

August 14, 1995

Mr. Joel Tanenbaum
Technical Manager, File 3605.AG
Accounting Standards Division
American Institute of Certified Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Tanenbaum:

This letter is in response to the Proposed Audit and Accounting Guide, Not-For-Profit Organizations.

There are three major points on which we disagree with the Guide as it is currently written.

Bad Debt Expense (5.52)

We agree that the appropriate way to record pledges receivable is to show them net of an allowance for uncollectible amounts. However, we do not agree that any adjustment to the allowance should be shown as an expense.

We believe that when the allowance is adjusted to actual experience the difference, whether an increase or a decrease, should be recorded as an adjustment to contribution revenue. This treatment would be consistent with how FAS116 treats the amortization of the interest element when recording the present value of long term contributions receivable.

We believe that the treatment proposed would only confuse readers of the financial statements.

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Fund Raising Expenses (13.07)

We understand that there are occasions when it is not possible to assess the ultimate recoverability of some fund raising costs. However, there are circumstances in which it is very possible to predict the outcome with reasonable accuracy. In these cases it should be possible to match revenues and expenses.

Matching is a powerful tenant of accounting and should not be ignored easily. A better solution would be to allow the deferral of fund raising expenses when their recoverability can be confidently predicted and the return will occur within the next fiscal year.

A long period of time between investment and return, such as with expenditures related to Planned Giving, makes predictability much more difficult and we therefore agree that in these cases costs should be expensed as incurred.

In addition, it is not fact that this is "not a practice problem" as stated in the footnote on page 112. Practice is not uniform on this issue.

Presentation of Functional Expenses (13.24)

We believe that the requirement to functionalize all expenses, including donor benefits, goes beyond the requirements of FAS117.

Donor Benefit costs are not regarded as fund raising costs as they are essentially exchange transactions. Since they are neither fund raising costs nor costs which can be allocated to a program there is no rational way to functionalize them.

In addition, readers may be confused in trying to match expenses on the Statement of Activities with the Statement of Functional Expenses. It should be sufficient to add them to the total of the functionalized expenses.

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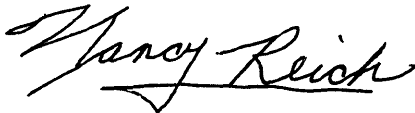
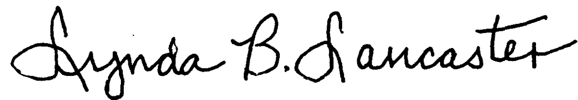
We appreciate the opportunity to comment on the Proposed Audit Guide. Please contact us if we can be of further assistance.

Very truly yours,





Nancy Reich
Director of Finance
National Health Council

Lynda B. Lancaster
Director, Membership Services
National Assembly of National Voluntary Health and Social Welfare Organizations

cc: Susan Weiss - FASB

Promoting Informed
Giving Since 1918

August 15, 1995

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Mr. Joel Tanenbaum, CPA
Technical Manager, Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

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AUG 18 1995

Re: File 3605 AG

Dear Mr. Tanenbaum:

My colleagues and I appreciated receiving the exposure draft of the proposed audit guide for non profit organizations and welcome the opportunity to respond. NCIB President James Bausch, Vice President Margery Heitbrink, two members of our Board of Directors-- Standards and Reports Committee Chair David Wagner and Treasurer Daniel Lipsky-- and I have reviewed the proposed draft with care, and Mr. Bausch has asked me to prepare these comments on behalf of all of us.

We submit our observations from the unique perspective as an advocate on behalf of the contributors to public charities, a role we have fulfilled since 1918. Accordingly, our comments are limited to the 501 (c)(3) category of non profits although we believe our observations are not inconsistent with the financial reporting obligations proposed for the entire spectrum of non profits contemplated by the guide.

Disclosure of the impact of non-cash resources

We believe the proposed guide and the underlying FASB Statements 116 and 117 offer a valuable opportunity to standardize and make more rational the financial accounting and reporting practices within the non profit community. We also believe that these timely efforts aimed at standardization and rationalization should also seek to better inform lay readers of the financial statements and inferred measures of financial efficiency that are frequently drawn from the published financial statements.

While we applaud the guidance provided with regard to non-cash contributions and donated services that forms the economic reality that public charities operate in, we continue to be concerned with the latitude accorded to charities by apparently continuing to facilitate unqualified representations to prospective donors and the media suggesting that their fundraising and management & general expenses

19 Union Square West
New York, NY 10003
(212) 929-6300
(212) 463-7083 fax

are relatively low in relation to total expenses. While gifts-in-kind and donated services provide substantial program leverage and we applaud the mandatory inclusion of those important program elements, acquisition of these non-cash contributed program elements usually require little, if any, fundraising expense. Yet, we find no requirement in the audit guide that requires the public charity to express cash contributions generated in relation to cash expended on fundraising activities Indeed, because of the absence of such requirements in the proposed guide, we are concerned that such silence may facilitate the further publication/promotion of misleading financial information by opportunistic non profit organizations.

We also applaud the standardization of rules for recognition and reporting of these important non-cash program activities, but, we believe that such reform should include a requirement calling for the obligatory presentation of expenses by function, further separated into cash and non-cash expenses, in the body of the statement of activities. Alternatively, and at a minimum, we would support an obligatory footnote disclosure of such relationships. We believe such required information will significantly enhance the meaningfulness of the financial statement information. Lay readers will have an opportunity to see the approximate percentage of cash generated as it is expended on program, fundraising and management & general expense. This type of presentation will also facilitate a standard reporting mechanism for various state regulators which in the absence of GAAP standards have been forced to develop their own formulae. In a sense, the proposed publication of these financial indices is not unlike the obligatory publication of earnings per share in commercial organizations in that this added information provides meaning to underlying financial information contained in the body of the financial statements.

It might be worth noting that non profit public charities generate over $126 billion per year in contributions. Contributions from lay individuals account for approximately $111 billion , or 88% of that total. Our objective is to stimulate that generosity even more and at the same time provide a better base of information for contributors to differentiate between competing public charities.

Disclosure of the impact of joint cost allocations on cash fund raising expenses

As you are probably aware, NCIB has long objected to the latitude accorded to public charities in the reporting of otherwise solicitation expense as "public education" expense. We believe that, in the hundreds of annual reports we have seen since the adoption of SOP 87-2, very few organizations fairly represent the legitimate costs of solicitation and have opted for allocation of a sizable portion of these costs to program expense under the guise of "public education". Simply stated, it is our view that the essential information provided to prospective contributors describing the need is an integral part of the solicitation and it is therefore wrong to create a construct that allows a public charity to prorate costs to program on the grounds that they are educating the public. The fact is this usually compelling information is provided to form the basis for the accompanying solicitation and the two are inseparable costs of solicitation and should be reported as fundraising. Our files are replete with evaluations of the annual solicitation campaigns of almost 300 public charities we evaluate and, of that population, about one-third of the organizations engage in joint-cost allocations. In most instances, after a thorough review of the solicitation materials and allocation workpapers, we have concluded that fundraising costs have been understated and program expenses overstated because the vagaries of SOP 87-2 allow for such interpretation.

We have responded to the proposed SOP relating to joint cost allocations and we regrettably conclude that we see little improvement in movement away from functional expense distortion. We believe our differences on this issue are profound and we will continue to take exception to what we regard as unreasonable allocation of solicitation costs to program expenses. We truly regret that we cannot conclude agreement on this matter, but we cannot stretch the sensibilities of the intended prospective contributors and ask them to appreciate fine lines of accounting distinction artificially drawn between program- public education and fundraising. We believe the real purpose served by the allocation of joint costs is the accomplishment of lower reported fundraising expense which is presumed to position the reporting charity in a more favorable comparative light.

Letter to Mr. Joel Tanenbaum, CPA
Technical Manager, Accounting Standards Division
American Institute of Certified Public Accountants
dated August 15, 1995- Continued...

<u>Other Comments</u>

<u>Indirect Cost Recovery</u>

After a thorough review of the exposure draft, we find no mention of the concept of indirect cost recovery as an element of revenue for the reporting non profit organization. Such unrestricted revenue is an important resource for a large number of charities involved with grants from U S Government organizations, state and local agencies and the even larger foundation and corporate donor community. While the Office of Management & Budget (OMB) has clearly specified the allowable formulae to be followed by the reporting organization and requires an audit of the rate and its application, there is no corresponding guidance for grant reporting within the foundation and corporate community. Traditionally, foundation and corporate donors have been reluctant to allocate a portion of their grant awards to "overhead" and when pressed will typically minimize the amounts assigned. The awardee is then faced with a dilemma of maintaining a dual indirect cost rate structure in those instances where it receives both government assistance and awards from foundations and corporations.

Since the scope of FASB 116 and 117 and the subject AICPA audit guide is inclusive of accounting and reporting practices of donor organizations as well, it seems appropriate to suggest that the subject of indirect cost recovery be fully addressed with the objective of standardizing the development and application of such rate for all donor organizations including foundations and corporate donors. We further suggest that the subject of indirect cost recovery be discussed in the audit guide in terms of revenue recognition and the timing thereof.

U S Government Grants and Contracts - (*ref para 3.27*)

In those instances where non profit organizations have received US Government grants and awards and are subject to the requirements of OMB A-133, we recommend that positive disclosure be required in the footnotes to the financial statements reporting upon the filing and acceptance of such reports by the cognizant agency, the period covered and amounts of any audit adjustment(s). As this disclosure requirement now stands in the draft audit guide, such disclosures would be made only when "significant" adjustments are proposed. In the interests of fuller disclosure, we suggest that such information be an obligatory part of financial statement disclosure. By extension, the status of completed grants and acceptance of final reports to foundation and corporate donors may be worthwhile including in such a note as well.

Exchange Transactions- ***(ref para 5.05)***

In light of the discussion provided in this section regarding pass-through transactions, we suggest additional clarifying language to identify the nature of IRS prohibited "conduit" transactions and the serious adverse consequences that the non profit organization faces, including loss of exemption if they are found to be engaged in such abuse. You may wish to add language explaining whether or not a recording of such restricted resources as an exchange transaction by a non profit constitutes a conduit within the meaning of that term as defined by the IRS.

Inventory- ***(Ref para(s) 7.2 & 7.3)***

The facts and circumstances of each non profit organization will of course dictate the impact that contributed tangible inventory has upon the reporting organization. While FASB 116 and 117 address the recognition of revenues arising from contributed inventory, NCIB believes that non profit organizations should be required to state a policy with respect to the recognition of expense arising from inventory disbursements to beneficiaries. Current practice varies and, absent a uniform requirement causing the reporting non profit to disclose the timing of expense recognition, it is possible to create unreasonable latitude in the management of reported results.

Fundraising Costs- ***(ref para 13.07)***

The proposed language of the audit guide asserts that all fundraising costs should be expensed in the year incurred. Such language readily admits that the result of such targeted expenditures may result in revenues that will be recognized in future periods, but such conservative expense recognition is prompted by the "difficulty of assessing their ultimate recoverability".

While the guidance provided may be correct and NCIB concurs in such guidance, we submit a good many sophisticated non profit organizations have an established base of experience and they know (and can support with factual experience) the future pay-back of current year investments in such activities as planned giving, television and radio creative development costs, list compilation costs etc. Accordingly, we suggest a rewording of the audit guide justification for expensing as incurred.

Program Services- ***(Ref para 13.29)***

NCIB has stated its objection to the concept of public education as a repository for shared solicitation costs. NCIB raises no objection to the costs of publications that truly inform the public about social needs, provided such messages are devoid of solicitations. We have observed, however, that some public charities which have beneficiary education as a legitimate program sector also include shared solicitation costs as an education expense as well. We believe that this aggregation of education expenses further exacerbates the issue and suggest guidance that would preclude donor education as a program expense as suggested earlier.

Management & General- ***(Ref para 13.31)***

NCIB questions the audit guide admonition to record " the costs of soliciting funds, other than contributions, including exchange transactions, (whether program related or not) and funds other than contributions solicited from governments, should be classified as management & general expenses".

While the draft admonition narrows the field considerably, it seems to us that the function of raising funds is sufficiently well defined and accounting systems broad enough to support the assignment of expenses and allocation of any effort expended to generate resources for the organization. Accordingly, NCIB strongly disagrees with the proposed reporting of otherwise fundraising expenses as management and general expenses.

Income Taxes ***-(Ref para 13.42)***

We concur with the required disclosure of income taxes which typically arise from UBIT, but could arise from taxable income generated by for profit subsidiaries as well. In light of the income tax impact, we further suggest such note be expanded to include the closed audit years and the amounts of any IRS adjustments, not unlike the note requirements for commercial organizations. To the extent that deferred income taxes represent substantial amounts, we suggest disclosure of the accounting/tax differences which give rise to such deferred liabilities.

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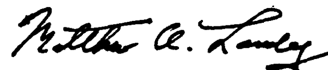
Letter to Mr. Joel Tanenbaum, CPA
Technical Manager, Accounting Standards Division
American Institute of Certified Public Accountants
dated August 15, 1995- Continued...

We further suggest that consideration be given to the disclosure of the impact of state and local taxes arising from the operations of unrelated business activity and/or for profit subsidiaries.

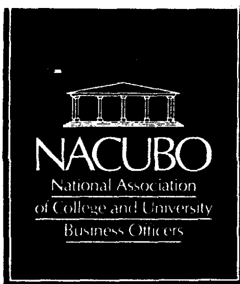
In conclusion, we would like to thank you again for sending the proposed audit guide to NCIB for our comments. We hope you find them helpful as you move toward finalization of the guide. If there is any additional information we can provide, please feel free to call us.

Sincerely,
For the National Charities
Information Bureau



Matthew A. Landy
Vice President

cc: Alice C. Buhl, Chair, NCIB Board of Directors
James J. Bausch, President



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AUG 18 1995

August 14, 1995

Mr. Joel Tanenbaum, Technical Manager
Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: File 3605.AG

Dear Mr. Tanenbaum:

The National Association of College and University Business Officers (NACUBO) appreciates the opportunity to respond to the American Institute of Certified Public Accountant's (AICPA) Exposure Draft (ED), Proposed Audit and Accounting Guide, *Not-For-Profit Organizations.* We have examined the ED extensively, and are submitting our comments for your consideration. NACUBO's membership comprises business officers and financial personnel at 2,100 institutions of higher education. We support the efforts of the AICPA to establish auditing and accounting guidance for not-for-profit organizations.

Our suggestions are based on the experience of our members in accounting and reporting for not-for-profit organizations, which includes our private institutions and their foundations.

General Observations

NACUBO commends the Not-for-Profit Committee (Committee) on the ED. Developing guidance that will cover a broad spectrum of not-for-profit organizations with different underlying purposes is an extremely difficult task. For this reason, NACUBO recommends that the Committee defer to the specific not-for-profit industries, through their associations, to develop industry guidance where these complex issues exist. For example, NACUBO is in the process of developing specific guidance for higher education regarding tuition discounts, government transfers and revenue and expense classifications, including defining the contents of these classifications. We feel that our association, directed by input from our members who deal with the issues daily, is more able to appropriately deal with the issues, both operationally and theoretically as they relate to our industry.

One Dupont Circle, Suite 500

Washington, DC 20036-1178

202/861-2500 FAX 861-2583

NACUBO has the following observations and concerns relating to the specific issues in the ED.

Issue 1:

Though not initially targeted as an issue of vital importance to the higher education industry, the distinction between agency transactions and contribution transactions is emerging as a significant concern for legally autonomous fundraising foundations that exist to raise funds for the benefit of a college or university. Our reading of Chapter 5 of this guide, taken together with paragraph 4 of FASB SFAS #116, has led us to conclude that many of the transactions received by legally autonomous fundraising foundations that raise funds for the benefit of a college or university may fall under the very broadly defined criteria for agency transactions. We are increasingly troubled about the expansive notion of "agency" that FASB put forward in FASB SFAS #116. It seems to us that FASB's use of the term "agent" is used to describe situations far beyond the more narrow legal definition of a principal/agent relationship. In fact, both SFAS #116 and this guide equate the terms "agent" and the broader undefined term of "intermediary" leading us to believe that there has been an unsubstantiated leap of logic in FASB's broadening of the accounting definition of agency.

We believe that circumstances such as an entity's control over assets, legal autonomy, degree of variance power and donor-advised provisions do affect the nature of the transaction in many cases. For example, many fundraising foundations whose mission is to raise money for a specific college are legally autonomous entities that are neither controlled by nor given implied powers to act on behalf of that college. Such circumstances, coupled with the discretion on when and how to transfer funds to the college, should be taken into consideration in determining whether the initial transfer of funds to the foundation constituted an agency or contribution transaction.

We recommend that the final draft of this audit guide include the FASB Staff Technical Bulletin that interprets paragraph 4 of FASB SFAS #116 as it applies to the variance power of various foundations.

Issue 2:

NACUBO agrees with the ED that all aid provided by a college or university is not a tuition discount. Certain types of financial assistance are expenses, rather than discounts. In fact, these expenses are often passed on to others who provide support to institutions, such as sponsors of research projects in which students participate. We also concur with the ED's presentation of the matter in paragraph 12. 05, which acknowledges that certain financial aid are discounts and requires net revenue presentation.

As the Committee is aware, NACUBO is in the process of developing a position on the issue of Tuition Discounting, which will be shared with the Committee and AICPA as soon as our due process is complete. We support the ED in remaining silent on the issue until the Committee has been made aware of NACUBO's position.

NACUBO has the following observations and suggestions regarding specific sections of the ED.

Chapter 3 - Basic Financial Statements

Paragraph 3.03:

NACUBO disagrees that the requirement to break out cash or other assets received with donor restrictions is necessary. The intent of FASB's SFAS #117's highly aggregated presentation is to show restrictions in net asset categories, rather than in separate line-item presentation. In reality, most institutions use a pooled cash concept which is a diversified investment pool for working capital. Segregating cash in this manner will place a burden on many not-for-profit organizations.

Paragraph 3.14:

NACUBO disagrees with the portion of the paragraph in bold. If an expense is a part of cost of goods in one statement, it should remain a part of cost of goods in all statements. Requiring a different classification between statements will be costly with little perceived benefit, and will cause the statements to not articulate.

Paragraph 3.24:

The AICPA Statement of Position 94-3, *Reporting of Related Entities by Not-for-Profit Organizations* provides guidance on related entity reporting. The FASB's *Preliminary Views on major issues related to Consolidation Policy*, gave slightly different guidance on related entity reporting. The ED now gives one more example of how a not-for-profit organization might determine related entity reporting. Since an ultimate reconciliation between the AICPA and FASB will be necessary when the final FASB Consolidation policy is determined, NACUBO does not believe it is necessary to include this guidance in the ED and the paragraph should be excluded.

General:

NACUBO believes that guidance within the ED on reporting of "an intermediate measure of operations" in the Statement of Activity is fragmented. For example, paragraph 3.13 states that "...revenues and expenses that are an integral part of an

organization's programs or mission and supporting activities should be included in that measure." Paragraph 13.23 defines program expenses as, "Those services are the major purpose for and the major output of an organization..." This indicates that all program revenues and expenses must be included in a intermediate measure of operations. If this is the case, then NACUBO believes that the guide should specifically so state. Likewise, paragraph 13.12 defines revenues and expenses as inflows and outflows from an organization's ongoing major or central operations or activities. This definition taken together with the definition of operations in paragraph 3.13 would mean that all revenues and expenses should be reported within a measure of operations. Is this the Committee's intent? If so, this would mean that a measure of operations would encompass everything that runs through the Statement of Activities except for gains or losses, extraordinary items, discontinued operations, etc. We recommend that the Not-for-Profit Committee consider a more integrated approach to setting parameters for determining what should be included in setting forth an intermediate measure of operations.

Chapter 4 - Cash and Cash Equivalents

NACUBO commends the Committee for using FASB SFAS #95's definition of cash and cash equivalents. This definition provides users with a consistent meaning of the numbers represented.

Paragraph 4.03:

NACUBO disagrees that the requirement to break out cash or cash equivalents held for others is necessary. The intent of FASB's SFAS #117's highly aggregated presentation is to show restrictions in net asset categories, rather than in separate line-item presentation. In reality, most institutions use a pooled cash concept which is a diversified investment pool for working capital. Segregating cash in this manner will place a burden on many not-for-profit organizations.

Chapter 5 - Contributions Received and Agency Transactions

Paragraph 5.04:

The guide makes a distinction between contributions and agency transactions, with emphasis on the extent of discretion held by the not-for-profit organizations in directing the use of the assets. There are cases where a not-for-profit organization has no discretion over use of assets, but has legal responsibility for administration of funds that may result in a liability for refunds. Highly restricted gifts for a specific instructor's salary or an endowed chair could easily fit the description of an agency transaction based on the discretionary criteria; however, this is clearly not an agency transaction. NACUBO believes that the ED should acknowledge that there may be instances that do not fit paragraph 5.04's definition of contributions and agency transactions.

NACUBO also feels that the guide should attempt a definition of an "affiliated organization" since it bears so often on several of the examples (paragraphs 5.08 and 5.43) and because of the possible distinction necessary in "agency" relationships.

Paragraph 5.08:

NACUBO would like to see an example involving colleges and universities. In prior comments to the committee, we suggested an example of a scholarship funded by a gift to the institution.

Paragraph 5.13:

NACUBO believes that the portion of the example that deals with the purchaser of the ticket buying it for less than the contribution acknowledged to the contributor should be accounted for as a loss rather than a reduction in contributions.

Paragraph 5.20 – 5.21:

Paragraph 56 of FASB's SFAS #116 states, "The Board believes that whether a grant is from a government agency, private foundation, or corporation, the difficulties in determining whether a transfer is an exchange transaction or a contribution are substantially the same. The Board acknowledges that to apply the provisions of this Statement requires a careful assessment of the characteristics of the transfers...." Paragraph 5.21 of the ED appears to follow the Board's comment concerning the classification of government transfers; however paragraph 5.20 appears to go too far in prejudging that "a research grant made by a foundation to a university would likely be a contribution if the research program is to be planned and carried out by the university and the university has the right to publish the results." In fact, the situation described in this example is the case in most federal awards. NACUBO believes that paragraph 5.20 should contain the same cautious tone that appears in SFAS #116 and in paragraph 5.21.

NACUBO intends to undertake additional research to provide more specific guidance to its industry regarding government transfers and their classification as exchange transactions or contributions.

Paragraph 5.31:

NACUBO agrees with the premise that a donor can restrict assets that the donor has not contributed; however this paragraph does not appear to provide enough clear guidance. We suggest that the paragraph be revised as follows: "Donors can place conditions on contributions that may result in ~~impose~~ restrictions on otherwise unrestricted net assets, as well as on their own contributions. For example, a donor may make a restricted contribution that is conditional on the not-

for-profit organization restricting a stated amount of its unrestricted net assets, such as a contribution conditional upon matching contributions. In reality, an institution will usually choose to restrict a portion of its unrestricted net assets, rather than lose the contribution." In light of the above, should the wording in paragraphs 11.06, 11.08, 11.09, 11.10 and 16.05 be modified to encompass this type of activity?

Paragraph 5.35:

NACUBO believes that this paragraph's example does much to clarify the confusing sentence in paragraph 17 of SFAS #117. We do suggest that the last phrase in the example be changed to include, "....promise to give or a cost reimbursement grant or contract."

Paragraph 5.41:

This paragraph's last sentence contains an example of wording that would preclude recording contributions. It has been NACUBO's experience that there are many methods being researched to allow not recording promises to give. NACUBO suggests that this sentence be deleted.

Paragraph 5.51:

This paragraph indicates that, "No additional revenue should be recognized if the fair value of the contributed asset has increased, beyond increases related to amortization of discounts, between the date the unconditional promise to give is recognized and the date the asset is received." If the promised assets are securities with readily determinable fair values, this paragraph contradicts FASB's ED, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, which does not allow "lower of cost or market" valuation for such assets.

Paragraph 5.52:

The paragraph states that, "...bad debt expense should be reported in the net asset class in which the contribution revenue is reported." This contradicts paragraph 3.10 which states that, "All expenses should be reported as decreases in unrestricted net assets", and paragraph 13.03's statement that, "Expenses should be reported in a statement of activities as decreases in unrestricted net assets."

NACUBO recommends that paragraph 5.52 be changed to allow contribution revenue to be recorded net of both bad debt expense and present value discounts in the appropriate net asset class.

Paragraph 5.62:

NACUBO suggests that the last sentence in this paragraph be changed to read, "...apply, ~~though the auditor may nevertheless decide to requiest confirmation of contributions receivable~~ and would not necessarily have to be confirmed unless the auditor is not satisfied with other audit procedures discussed in the Audit Considerations." NACUBO believes that this wording gives the auditor clearer guidelines that confirmation might not be necessary.

Chapter 6 - Split-Interest Agreements

Paragraph 6.05:

The paragraph states that, "If the third party has substantive discretion over when or to whom benefits are distributed, the agreement should be considered a conditional promise to give."

NACUBO believes that substantive discretion over to whom benefits are distributed does not constitute a promise to any specific organization, and, thus, agreements of this nature should not be considered conditional promises. The ability of a third party to unilaterally give assets to one organization or another does not constitute a promise to any one organization. Only if the split- interest agreement stipulates that the transfer of assets to not-for-profit organizations is dependent on the "occurrence of a specified future and uncertain event" should it be considered a conditional promise.

We suggest that the sentence by changed to read, "If a third party has substantive discretion over ~~when or~~ to whom the benefits are distributed, the agreement should not be considered a ~~conditional~~ promise ~~to give~~.

Paragraph 6.06:

This paragraph states that, "Revocable split-interest agreements should be accounted for as conditional promises to give."

NACUBO believes that when an agreement is revocable, a promise has not been made and such agreements should be considered communications of intent and not conditional promises.

Paragraph 6.34:

NACUBO suggests that a second instructive sentence be included in the paragraph that states, "Pooled income funds are usually in the form of a trust to meet Internal Revenue Service regulations."

Paragraph 6A.42:

Generally, a not-for-profit organization does not enter into third party irrevocable perpetual trust agreements. These are almost always agreements between a donor and some financial institution. Accordingly, NACUBO suggests that the first sentence be changed to read, "~~NPO B~~ Donor enters into an irrevocable perpetual trust agreement with ~~donor~~ a third party trustee with NPO B as the income beneficiary.~~whereby:~~"

Paragraph 6A.46:

We suggest that the description of the journal entry to record the "Contribution of Assets" be changed to, "(Assets recorded at fair value on date of receipt. ~~and~~ Contribution revenue measured at the fair value of assets to be received, discounted for ~~the~~ a term equal to the life expectancy of the ~~estimated time period until the~~ donor~~'s death~~)"
The journal entry for "Over the term of the agreement" should include an entry for handling capital gains and losses.

Chapter 8 - Investments

Paragraph 8.01:

This paragraph requires that investments in equity securities with a readily determinable fair value and all debt securities be reported at fair value, in anticipation of adoption of the current ED, *Accounting for Certain Investments Held by Not-for-Profit Organizations*. This paragraph should be contingent upon and consistent with whatever FASB adopts. For example, if FASB permits the use of amortized cost under "an intent and ability to hold to maturity", the option should not be precluded in advance by this guide.

Paragraph 8.22:

NACUBO strongly disagrees with the necessity of disclosing the organization's investment objectives and policies in the notes to the financial statements. This information belongs in a Management Discussion and Analysis, where subjectivity in meeting goals is appropriate. For-profit organizations are not required to disclose such information, therefore, requiring this disclosure for a not-for-profit organization is onerous.

Again, the ED appears to assume the current ED, *Accounting for Certain Investments Held by Not-for-Profit Organizations* will be adopted. The disclosures required by this paragraph should be contingent on the final FASB standard.

Paragraph 8.23:

NACUBO takes exception to requiring disclosure of contractual maturities of debt securities. While it may be appropriate to require reporting contractual maturities for debt securities classified as held-to-maturity and reported at amortized cost, we do not believe that this information is either appropriate or useful for debt securities reported at fair value.

General:

NACUBO believes that this chapter should include information on unitized investment pools. These pools are used frequently within higher education institutions and represent one of the more complex accounting and valuation issues in the investment area. If the Committee decides not to include information on this issue, we suggest that a reference be made to the NACUBO monograph, *Unitizing Investment Pools*.

Chapter 13 - Expenses, Gains, and Losses

Paragraph 13.04:

Paragraph 13.04 relates to reporting expenses by functional classification, **such as** major classes of program services and supporting activities. FASB's SFAS #117 in paragraph 26 uses the same language regarding major classes of program services and supporting activities. This appears to imply that these breakdowns are examples and not necessarily required; however, the guide seems to make the assumption that these classes are required. NACUBO assumes that the use of the term "such as" does not actually mean "shall"?

We believe that the classification and presentation of expenses as required in Chapter 13 could be the most problematic aspect of implementing this audit guide for higher education. Since the early review stages of FASB's SFAS #117, NACUBO has been uncertain and increasingly troubled about FASB's automatic categorization of expenses as either program or support. We believe that FASB's reliance on classifying expenses as either program or support resulted simply because that was what was recommended in existing twenty year old audit literature (SOP 78-10). Indeed, the IRS defaulted to this same expense classification for reporting expenses on the Form 990 when they revamped that form in the early 1990's for the very same reason--no other system existed.

While we have not concluded that segmenting expenses into program and support categories is totally illogical, we are uncomfortable about the standard-setting communities reliance on these categories that were developed so long ago when operations of many not-for-profit organizations , including higher education, were more simple. More to the point , it is now quite common for many private colleges and universities to annually reconfigure the amount of space,

administrative resources, student services, and cirriculum requirements to continuously re-engineer their products and services to respond to dynamic market conditions. Modern management theory has not-for-profit organizations focusing on dynamic processes rather than on more static programs and support functions. Since the distinctions between program and support activities are increasingly becoming outdated, the question becomes how to make the best out of this expense taxonomy until the newer, more relevant process concept gets implemented across not-for-profit organizations. NACUBO suggests the following recommendations:

- Revise the language contained in paragraph 13.30 to define support activities as those that relate only to specific centralized administrative support functions. In the higher education industry, these expenses are typically represented in the existing functional categories of institutional support, academic support, and institutional development. We recommend that the language in 13.30 be revised so that it is clear to both preparers and auditors that colleges and universities may use the support classifications of institutional support, academic support, and institutional development rather than the generic management and general and fundraising.

- Replace the current language contained in 13.31 which may lead some auditors and preparers to the conclusion that they have to reach into academic and research departments and attempt to untangle program versus management and fundraising expenses that may change character on an annual basis. If read literally, paragraph 13.31 could be interpreted as having GAAP require an extensive labor, materials, and space tracking system.

- NACUBO specifically objects to having the costs of soliciting research grants as management and general because that activity is so closely linked to research and instruction. Again, our recommendation is that support expenses be specifically identified only at the highest levels of the institution.

Paragraphs 13.28 – 13.31:

NACUBO believes that these paragraphs may have major ramifications for many not-for-profit organizations. They call for functional reporting of expenses. If definition of the functions is left to individual industry practice, NACUBO's objection would be minimized. However, if functional classifications are defined inappropriately, this could impose on not-for-profit organizations an administrative burden totally out of proportion to the potential benefits to users of the institution's financial statements. For example, colleges and universities engage in several different "lines of business": instruction, research, and public service, including provision of health care services. Yet the same faculty members who provide one of these services also provides the others. They are inextricably intertwined, often at the same time, for example, teaching medical students by

demonstrating techniques of patient care, or teaching research methods by carrying out experiments in the laboratory. Similarly, university facilities, technical staff, and administrators support these multiple activities simultaneously. Separating expenses of each activity could be extremely complex and costly, and would appear to provide little or no needed information to users of the financial statements. NACUBO suggests that the guide should make it clear that the definition of functional classification will be determined by industry practice and the guidance from their professional associations.

Paragraph 13.28 also includes the statement, "...reported by functional classification **should be** provided by *major* classes of program services and supporting activities." Specifically paragraph 26 of FASB's SFAS #117 uses the language, "reported by their functional classification, **such as** major classes of program services and supporting activities." NACUBO suggests that the wording in paragraph 13.28 be changed to correspond to paragraph 26 of SFAS #117.

Chapter 15 - Tax Considerations

The discussion of Unrelated Business Income Tax (UBIT) appears to be so limited that it does not give the reader any insight into the complexity of the issues. Certainly, recent increased attention by the IRS to this particular area of higher education should necessitate a more detailed discussion of UBIT issues in the guide. NACUBO believes that this chapter should be expanded to include a much more in-depth discussion of UBIT issues.
We also feel that this chapter should contain some mention of 403(b) benefit plan administration. These plans are peculiar to not-for-profit organizations and are an extremely high risk area.

Chapter 16 - Fund Accounting

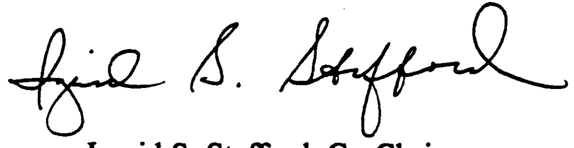
NACUBO believes that there should be some discussion, either in this chapter or Chapter 5 - Contributions Received and Agency Transactions, regarding lifting of restrictions versus spending restricted resources. Many institutions will report gifts as unrestricted while telling donors that the money has not been spent. The guide is heavily focused on accounting for contributions, but fails to address that fact that most institutions will report to their donors in a much more detailed and focused manner. This could result in significant exposure to the institution if it fails to meet donor expectations, even though theoretically restrictions have been lifted for financial statement purposes.

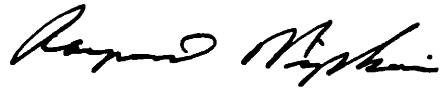
General Comments

Some of the higher risk areas in higher education are not addressed by the ED. For example, tax exempt debt and accountability to donors and others. NACUBO suggests that these areas be addressed by the guide.

NACUBO appreciates the opportunity of responding to the ED. We hope you will take our comments and suggestions into consideration as you undertake the revision of the final guide.

Sincerely,





Ingrid S. Stafford, Co-Chair
Accounting Principles Committee

Raymond P. Pipkin, Co-Chair
Accounting Principles Committee

Governmental
Training
Solutions

(139) AUG 18 1995

August 16, 1995

Joel Tanenbaum, Technical Manager
Accounting Standards Division
American Institute of CPA's
1211 Avenue of the America's
New York, NY 10036-8775

Delivered via facsimile
212-596-6128

RE: Industry Audit Guide ED, "Not-For-Profit Organizations"

Dear Mr. Tanenbaum:

I apologize for the delay in submitting my response on the Proposed Audit and Accounting Guide, Not-for-Profit Organizations" and I hope you can still include this response in your analysis.

Overall, the ED is a very well written document. The revisions necessary to include new provisions of FASB 116 and 117 are concise and well organized. The only general criticism I have is that the guide provides insufficient guidance about how to distinguish a governmental not-for-profit from a nongovernmental not-for-profit. I have reviewed the minutes from recent GASB discussions of NFP guidance and it seems that GASB, FASB and the AICPA are all waiting for the "other guy" to provide this guidance. The guidance in ¶1.2(c) of the ED for Health Care Organizations is, in my opinion, an excellent overview of the criteria that may identify a governmental organization. This paragraph could be expanded with examples, but it is valuable guidance as currently written, and it should be added to the NFP Audit Guide as well.

My specific comments about provisions of the audit guide are summarized in the attached narrative. I appreciate the opportunity to respond on this ED. If you have any questions, or need additional information, please do not hesitate to contact me at our Berea office.

Sincerely,

Betty A. King

Betty Pendergrass King, CPA
President

GTS\NFP9508

2431 Highway 1016 P.O. Box 547 Berea, Kentucky 40403 Phone/Fax (606) 986-7987
431 South Broadway Suite 321 Lexington, Kentucky 40508 Phone/Fax (606) 226-9682

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ISSUE 1: VARIANCE POWER AND DONOR-ADVISED PROVISIONS

1) Does variance power provide not-for-profit organizations with sufficient discretion to recognize resources received as contributions? Does the not-for-profit organization's history of exercising its variance power affect the answer to this question?

   Professional judgement will be required to determine whether the specific conditions of any donation provide benefits to the intermediary organizations in addition to the designations for the final recipients. However, to the extent that NFP's have the ability to retain material portions of the contributions or recover administrative costs associated with managing the resources, the resources should be recognized as contributions. The financial statements should clearly identify the fiduciary rights and responsibilities of the NFP as well as the potential financial benefits or burdens. Historical policies may be disclosed in the footnotes, but revenue recognition should be based on the terms of the contracts or agreements.

2) Do donor -advised provisions, in combination with variance power, provide not-for-profit organizations with sufficient discretion to recognize resources received as contributions? Does the not-for-profit organization's history of deviating from the resource provider's advice affect the answer to this question?

   Unless the written documents provide specific restrictions on the distribution or retention of contributions, the NFP's discretion over the use of the resources should require recognition of revenue. While certain donors can exercise significant influence over the distribution of resources, others may not have similar influence. Accounting policies should not be based on the personalities of individual donors, but these policies should focus on the economic characteristics of these resources.

3) Can the accounting for the income from resources that must be retained in perpetuity differ from the accounting for the resources held In perpetuity? For example, can the receipt of resources that must be retained in perpetuity be accounted for as a contribution if the income from the resources is accounted for an agency transaction?

   Accounting polices should reflect the terms of the contribution. Certainly if the provisions for the use of income from resources are different that the provisions for the resources, the accounting policy may also differ. As always, professional judgement should consider the objectives and intent of the donor for distribution and use of resources.

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ISSUE 2: FINANCIAL AID PROVIDED BY A COLLEGE AND UNIVERSITY

The accounting policies for financial aid should reflect the characteristics of the underlying transactions. For instance, waivers of tuition for employees is probably a fringe benefit, not a discount. Reduction of tuition for low-income students, on the other hand, does indicate a discount (reduction of revenue) or financial assistance (expense). The existence of legal or regulatory requirements for tuition waivers may also impact the character of the revenue recognition. Additional guidance in the Guide would be appropriate if the College and University audit guide is no longer published (this ED calls for superseding the C/U guide). If the C/U guide is retained as a separate publication, that guide should include specific guidance for revenues unique to colleges and universities and the NFP guide should reference this guidance.

OTHER COMMENTS

1) The Preface indicates that the revised NFP Audit guide will supersede the College and University Audit Guide. GASB Statement 15 relies on this audit guide to establish the principles of the "AICPA College Guide Model". If the effect of superseding the C/U audit guide is to replace the AICPA College Guide model with FASB 117 principles, the guidance suddenly becomes very confusing. GASB has issued guidance that prevents governmental entities from applying the provisions of FASB 117, but Statement 15 allows governmental colleges to use either the governmental model or the AICPA College Guide Model.

   Statement 15 does not specify an audit guide issued in a specific year, so readers must assume that they should follow amendments or revisions to the audit guide, as they are issued. This ED appears to replace the AICPA College Guide Model with FASB 117. If that is true and governmental colleges follow the new provisions of this audit guide, governmental colleges will adopt FASB 117 while governmental not-for-profits do not. It seems a bit unusual that governmental colleges will follow the AICPA guidance for not-for-profits, but governmental not-for-profits will not follow this guidance.

   If my rationale on this issue is incorrect, the wording in the Preface should be rewritten to clarify what guidance is applicable for governmental colleges until GASB finishes the reporting model project.

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2) Throughout the "Health Care Organizations" exposure draft, there are numerous references to conditions or requirements that are unique to governmental entities. These references would be helpful in the Not-for-Profit audit guide as well. NFP's frequently rely on funding resources from federal, state and local governments. While the specific guidance for governmental entities may be included in separate authoritative pronouncements, auditors should be alerted to the potential for these legal and regulatory compliance issues. It is not unusual to find a not-for-profit organization that minimizes its relationship with governmental entities in order to improve contributions from the private sector. And there are numerous examples of entities that operate in that gray area between governmental and nongovernmental. This ED seems to take the position that most NFP's are not governmental, when the real world classification is simply not that clear.

3) Page 8, ¶2.15 discusses internal control considerations, but it does not mention that SAS 55 is currently under revision. The provisions of the COSO report are significant and SAS 55 is clearly subject to changes. References and explanatory language in this audit guide should be expanded to include at least the COSO report, if not the final SAS (or potential SAS) which will replace SAS 55. ¶7.17 on page 79 also includes a reference to SAS 55 where the reader should be alerted to potential changes in this guidance.

4) The discussion on pages 11-12 regarding illegal acts and compliance should be expanded to discuss the impact of governmental financial assistance on the classification of an entity as governmental or nongovernmental. The guidance in the Health Care ED (¶1.2(c)) would also be appropriate for this section of the NFP audit guide. After reading the current provisions of the ED, it is not clear when an entity should follow GASB or FASB guidance.

5) The footnote on page xvi indicates that the guidance in SOP 92-9 will be included in the final version of the audit guide. However, ¶2.33 references SOP 92-9 directly. ¶14.15 on page 126 only includes two sentences related to special reporting under A-133, while the reporting requirements are complex and extensive. In my opinion, SOP 92-9 should either be presented as an appendix or a separate chapter of the Audit Guide (as was done in the State and Local Government Audit Guide for SOP 92-7). In my experience on the Ethics subcommittee responsible for governmental audits, many auditors simply are not aware of specific requirements for auditing governmental assistance. If the AICPA expands distribution of the appropriate guidance, perhaps audit quality will improve at a faster pace.

6) Footnote (1) on page 18 indicates that a statement may be labeled either *balance sheet* or *statement of financial position*. Are these terms interchangeable or do the criteria for each presentation differ? Will readers be confused by different titles for the same type of statements?

7) Footnote (6) on page 38 should be included in ¶5.20. The guidance should clearly establish that there are two types of asset transfers and the accounting treatment is different for each type.

8) Footnote (1) on page 133 indicates that fund balances are not the same as net assets. The differences should be explained so that auditors clearly understand the differences between the concepts in FASB 117 and the concepts of governmental GAAP.

EXPOSURE DRAFT

PROPOSED AUDIT AND ACCOUNTING GUIDE

NOT-FOR-PROFIT ORGANIZATIONS

NO. 800087

AUGUST 14, 1995

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AUG 18 1995

Comments by: Louisiana Society of CPAs
Audit and Accounting Standards Committee
Mary Sanders
Raymond Prince
Albert Roevens, Jr.
Keith Besson
Judson McCann, Jr.
Jon H. Flair, Chairman

Response Submitted by: Jon H. Flair

Issue 1 - Two committee members felt that both variance powers and donor-advised provisions provide NPO's with sufficient discretion to recognize resources received as contributions rather than as an agency transaction. They felt that the ultimate control of the use of the resource (whether exercised in variance, or in accordance with the donor's suggestion) required recognition as a contribution. One member further felt that no legal agency relationship existed in these cases, and that these types of transactions met the definitions of temporary and permanent restrictions in FASB 116.

In addition, both committee members felt that the NPO's history of exercising its variance power, or deviating from the resource provider's advice, should not affect the contribution recognition discussed above.

Nevertheless, an additional committee member pointed out that variance power is not usually invoked until many years after the resources were provided, and that the NPO usually tries to fulfill the wishes of the donor by finding suitable replacement donees. As this suggests that the NPO is still trying to fulfill the donor's original intent, the NPO is acting more as agent than as donor.

A fourth member felt that neither variance powers nor donor-advised provisions includes the intent for the intermediary NPO to recognize the resources as contributions.

Three committee members felt that accounting for the income from resources that must be retained in perpetuity can differ from the accounting for the resources held in perpetuity, because different circumstances and requirements can attach to the resources themselves, and the income therefrom.

Issue 2 - Three members expressing opinions felt that the Guide should address accounting for financial aid by colleges and universities.

Preface - Paragraph on Applicability - one member felt that this paragraph is confusing and wordy, and that it is a roundabout way of simply stating that the Guide applies to NPO's as set forth in the definitions in FASB 117, and to certain other organizations that do not meet the definition of NPO in FASB 117. Additionally, this member is concerned that this Guide, in Paragraph 1.02, creates a class of organization to which this Guide can apply, that FASB must have considered when drafting FASB 116 and 117, but chose to exclude from the definition of NPO.

Par 2.36 - One member felt that the discussion of planning stage materiality should be expanded, showing when each based (net assets, total revenues, etc.) is useful for making materiality decisions. In addition, this paragraph should deal with the concept of whether materiality should be set at the financial statement level of the NPO as a whole, or whether it should be set at the level of each class of net assets (unrestricted, temporarily restricted, etc.).

General - All responding committee members felt that the extensive use of indicator tables in Chapter 5, and audit objective/procedures tables in other chapters, were very helpful.

Chapter 5 - Community Foundations - Notwithstanding any of the comments made above, we have a community foundation client that is very concerned about the provisions of this guide regarding agency transactions. They are working with the Council on Foundations to have the agency transaction provisions not apply to community foundations. The questions that arise for them include: 1) Will the community foundation that accepts or has accepted resources held for another agency be considered a financial institution subject to the laws and regulations that apply to financial institutions? 2) How is a legal document between the resource provider and the community foundation overlooked when accounting for the transactions contemplated in this document? (This is a matter of substance over form.) 3) What effect will the failure to adopt these provisions of SFAS 116 have on their ability to attract future resources? This question assumes that the opinion on their financial statements will be qualified or adverse.

The guide should specifically state if these provisions are waived for community foundations.

JOHNS HOPKINS
UNIVERSITY

Office of Vice President for Business Affairs
230 Garland Hall / 3400 N. Charles Street
Baltimore, MD 21218-2688
(410) 516-7253 / FAX (410) 516-5448

John J. Lordan
Vice President

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AUG 18 1995

August 16, 1995

Joel Tannenbaum
File 3605-AG
Accounting Standards Division
AICPA
1211 Avenue of the America
New York, NY 10036-8775

Dear Mr. Tannenbaum:

This is in response to a letter to you from Professor Bob Anthony, dated August 8, 1995.

While Johns Hopkins is in the process of preparing 1995 financial statements in compliance with SFAS 116 and 117, we share Dr. Anthony's dismay over standards that require recording and reclassification of transactions into "classes", and the absence of FASB standards for separating operating transactions from other transactions. Hopkins will cope with the classes, even though we fail to see their value for the users of our financial statements, and we will follow the lead of the Accounting Standards Division in reporting operating transactions. But anything you can do to support Dr. Anthony's call for reconsideration of SFAS 116 and 117 would be greatly appreciated by higher education.

These standards, coupled with the FASB's inability to resolve the jurisdictional

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question of public vs. private university financial reporting, give us little hope that higher education issues will ever get adequate or effective consideration by the FASB.

Sincerely,

John J. Lordan

JJL:pc

c: Dr. Robert N. Anthony

BERUEA
COLLEGE
Berea, Kentucky 40404
Office of Business and Financial Affairs
Telephone: 606-986-9341
Fax: 606-986-4506

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AUG 18 1995

August 16, 1995

Mr. Joel Tanenbaum
Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: File 3605.AG

Dear Mr. Tanenbaum:

I appreciate the opportunity to respond to the American Institute of Certified Public Accountant's Exposure Draft (ED), Proposed Audit and Accounting Guide, *Not-For-Profit Organizations* . As a member of the AICPA who has worked as the chief financial officer of a private, not-for-profit college for the past 31 years, I appreciate the efforts that the AICPA has made to revise the Audit Guide. Based upon my review of the Exposure Draft, I would like to make the following suggestions and observations.

Issue 1:

In my experience, college and universities receive very little, if any, funds that have variance power or contain donor-advised provisions. Accordingly, I have no comments concerning issues related to transfers of this type.

Issue 2:

I agree with the ED that all aid provided by a college or university is not a tuition discount. Certain types of financial assistance are expenses, rather than discounts. Accordingly, I concur with the ED's presentation of the matter in paragraph 12.05 which acknowledges that certain financial aid are discounts and requires net revenue presentation.

In addition to the above comments relating to the specific issues raised in the ED, I also have the following observations and suggestions regarding specific sections of the ED.

Chapter 5-Contributions Received and Agency Transactions

Paragraph 5.31:

I strongly disagree with the premise that a donor can restrict assets that the donor has not contributed. Certainly, management can designate unrestricted assets for specific uses and donors can condition their contributions on matching resources; however, allowing donors to restrict other than their own contributed assets does not appear to be within the definition of restricted net assets contained in FASB's SFAS #117.

Paragraph 5.51:

This paragraph indicates that, "No additional revenue should be recognized if the fair value of the contributed asset has increased, beyond increases related to amortization of discounts, between the date the unconditional promise to give is recognized and the date the asset is received." If the promised assets are securities with readily determinable fair values, this paragraph contradicts FASB's ED, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, which does not allow "lower of cost or market" valuation for such assets.

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The paragraph states that, ". . .bad debt expense should be reported in the net asset class in which the contribution revenue is reported." This contradicts paragraph 3.10 which states that, "All expenses should be reported as decreases in unrestricted net assets", and paragraph 13.03's statement that, "Expenses should be reported in a statement of activities as decreases in unrestricted net assets."

I would recommend that paragraph 5.52 be changed to allow contribution revenue to be recorded net of both bad debt expense and present value discounts in the appropriate net asset class.

Chapter 6 - Split-Interest Agreements

I have worked extensively with the Not-for-Profit Committee on the contents of this particular chapter. I would like to commend them for the fine job that they have done. I would, however, like to make the following suggestions:

Paragraph 6.05:

> The paragraph states that, "If the third party has substantive discretion over when or to whom benefits are distributed, the agreement should be considered a conditional promise to give."
>
> I believe that substantive discretion over to whom benefits are distributed does not constitute a promise to any specific organization, and, thus, agreements of this nature should not be considered conditional promises. The ability of a third party to unilaterally give assets to one organization or another does not constitute a promise to any one organization. Only if the split-interest agreement stipulates that the transfer of assets to not-for-profit organizations is dependent on the "occurrence of a specified future and uncertain event" should it be considered a conditional promise.
>
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Paragraph 6.06:

> This paragraph states that, "Revocable split-interest agreements should be accounted for as conditional promises to give."
>
> I believe that when an agreement is revocable, a promise has not been made and such agreements should be considered communications of intent and not conditional promises.

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> I would suggest that a second instructive sentence be included in the paragraph that states, "Pooled income funds are usually in the form of a trust to meet Internal Revenue Service regulations."

Paragraph 6A.42:

Generally, a not-for-profit organization does not enter into third party irrevocable perpetual trust agreements. These are almost always agreements between a donor and some financial institution. Accordingly, I would suggest that the first sentence be changed to read, "~~NPO B~~ Donor enters into an irrevocable perpetual trust agreement with ~~donor~~ a third party trustee with NPO B as the income beneficiary. ~~Whereby:"~~

Paragraph 6A.46:

I would suggest that the description of the journal entry to record the "Contribution of Assets" be changed to, "(Assets recorded at fair value on date of receipt. ~~and~~ Contribution revenue measured at the fair value of assets to be received. discounted for ~~the~~ a term equal to the life expectancy of the ~~estimated time period until the~~ donor~~'s death~~)"

The journal entry for "Over the term of the agreement" should include an entry for handling capital gains and losses.

Chapter 8 - Investments

Paragraph 8.01:

This paragraph requires that investments in equity securities with a readily determinable fair value and all debt securities be reported at fair value, in anticipation of adoption of the current ED, *Accounting for Certain Investments Held by Not-for-Profit Organizations*. This paragraph should be contingent upon and consistent with whatever FASB adopts. For example, if FASB permits the use of amortized cost under "an intent and ability to hold to maturity", the option should not be precluded in advance by this guide.

Paragraph 8:22:

I strongly disagree with the necessity of disclosing the organization's investment objectives and policies in the notes to the financial statements. This information belongs in a Management Discussion and Analysis, where subjectivity in meeting goals is appropriate. For-profit organizations are not required to disclose such information, therefore, requiring this disclosure for a not-for-profit organization is onerous.

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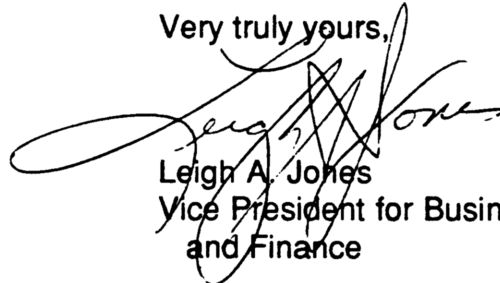
I take exception to requiring disclosure of contractual maturities of debt securities. While it may be appropriate to require reporting contractual maturities for debt securities classified as held-to-maturity and reported at amortized cost, I do not believe that this information is either appropriate or useful for debt securities reported at fair value.

Chapter 13-Expenses, Gains, and Losses

Within the general guides of reporting functional classification of expenses, I believe that the Audit Guide should not be prescriptive but be flexible to permit the various industry groups to determine the best way to present their expenses. In a document such as the Audit Guide to be relatively prescriptive in how functional expenses should be reported, does not seem appropriate to me inasmuch as the various industry groups within the not-for-profit sector have various specific reporting needs and these industries should be given an opportunity to determine how best this information should be displayed.

Thank you very much for this opportunity to respond to the ED.

Very truly yours,



Leigh A. Jones
Vice President for Business and Finance

5

(143)

August 14, 1995

AUG 18 1995

Mr. Joel Tanenbaum, Technical Manager
File 3605.AG, Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tanenbaum:

America's Charities, Inc. is a federation of national charities that participate in workplace giving campaigns. Our primary activities are accessing workplace campaigns in the federal, state and local public sector and private sector for our member charities; providing public information initiatives for our member charities; and providing fiscal agent services to our member charities for funds received from accessed campaigns. As our primary mission is to provide services to our member charities, the above activities are recorded in our financial statements as program services.

After reviewing the AICPA's Exposure Draft dated April 14, 1995, Proposed Audit and Accounting Guide for Not-For-Profit Organizations, I am concerned about the functional presentation of "fund-raising" and certain other expenses incurred by federated fund-raising organizations as "fund-raising" vs. "program". Paragraph 13.41 states that:

> "Federated fund-raising organizations solicit and receive designated and undesignated contributions and make grants and awards to other organizations. The fund-raising activities of these organizations, including activities related to fund-raising on behalf of others, should be reported as fund-raising expenses."

Federated fund-raising organizations purpose is to raise funds on behalf of, and to distribute funds to, other unrelated member charities who share a common commitment to a particular cause or issue. To classify these expenses as "supporting services" will result in financial statements that are seriously misleading to the reader and subject to vast misinterpretation by the general public.

"Fund-raising" conducted by a federated fund-raising organization on behalf of affiliated member charities is frequently the primary, if not only, service that is provided to donors, affiliates, and the community at large. Included in these fund-raising efforts are costs associated

Formerly NIISA • 12701 Fair Lakes Circle, Suite 370 • Fairfax, Virginia 22033 • 703-222-3861 • 800-458-9505 • FAX 703-222-3

with research, maintaining relationships with existing campaigns and employees through which payroll fund-raising campaigns are currently conducted, gaining access to new employers, review and recruitment of new member charities, the operation of campaigns, distribution of funds raised in campaigns to member charities and others, and an assortment of other related activities which are not typical of fund-raising expenses in the general not-for-profit community. Broadly speaking, these expenses are fund-raising in nature, but in the context of federated fund-raising organizations are central to the programmatic purposes for which the federated fund-raising organization was established and granted tax exempt status.

Readers of not-for-profit financial statements have consistently evaluated the "effectiveness" of a charity by comparing "fund-raising" and "administrative" expenses to "total revenues". This comparison, referred to as FRA percent, is the main and sometimes only basis for allowing federated fund-raising organizations and charities to participate in workplace giving campaigns. For example, the Combined Federal Campaign (the federal employee workplace campaign) have regulations that restrict access for charities with an FRA greater than 25% of total revenues.

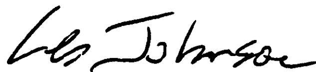
Industry practice is to accept "fund-raising" expenses incurred by federated fund-raising organizations as "program" expenses rather than "supporting" expenses. To report these expenses as fund-raising is misleading to the reader of the financial statements.

The impact on America's Charities of reclassifying program expenses as fund-raising expenses would be to severely restrict our effectiveness in providing services to our member charities, the donors, the campaign sponsor(employer) and the communities in which our charities provide services.

I do agree that expenses incurred by federated fund-raising organizations for raising funds for the federations exclusive use and to fund internally administered programs, should be reported as "fund-raising" expenses.

In light of the above information, I request that the present language contained in paragraph 13.41 be appropriately changed. Should you have any questions concerning my comments, please do not hesitate to contact me.

Sincerely,



Les Johnson
America's Charities, Inc
Assistant Executive Director/Controller

NJSCPA
New Jersey Society of Certified Public Accountants

425 Eagle Rock Avenue
Roseland, New Jersey 07068-1723
(201) 226-4494
Fax (201) 226-7425

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AUG 18 1995

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August 18, 1995

Joel Tanenbaum, Technical Manager
File 3605.AG, Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr Tanenbaum:

The Auditing and Accounting Standards Committee (the "Committee") of the New Jersey Society of Certified Public Accountants ("NJSCPA") is pleased to submit its comments on the AICPA's Proposed Audit and Accounting Guide entitled ***"Not-for-Profit Organizations"*** (the "Guide"). The views expressed in this letter represent the majority of the members of the Committee and are not necessarily indicative of the full membership of the NJSCPA.

Specific Issues for Comment

Issue 1 - Variance power and donor-advised provisions:

The Committee believes that variance power provides not-for profit organizations with sufficient discretion to recognize resources received as contributions regardless of the organization's history of exercising its variance power.

The Committee surmises that donor advised provisions, in combination with variance power, provide not-for-profit organizations with sufficient discretion to recognize resources received as contributions regardless of the not-for-profit organization's history of deviating from the resource provider's advice.

The Committee concludes that accounting for the income from resources that must be retained in perpetuity should be consistent with the accounting for the resources held in perpetuity.

Issue 2 - Financial aid provided by a college and university:

The Committee believes that the Guide should not be silent on this issue, since lack of guidance could result in misunderstanding by the user of the college and university's financial statements. Benefits provided in exchange for services, such as free tuition for employees, should be accounted for as expenses.

General Conclusion Relating to the Guide:

This proposed audit and accounting guide for not-for-profit organizations is generally well written.

Multiple examples could be added to clarify certain issues, as was done in SOP 78-10, "***Accounting Principles and Reporting Policies for Certain Nonprofit Organizations***". Overall, it has the potential to be an excellent and useable guide.

In many instances, the wording is somewhat confusing and difficult to follow. Additional rewrites in a significant number of areas is required. The following specific comments are some of the areas for improvement:

Preface: Adequate.

Chapter 1:

Paragraphs 1.02 and 1.03 could be switched.

Rewrite paragraph 1.02 as follows:

> Although FASB Statement No. 117 excludes certain organizations from its definition of not-for-profit organizations, the Statement does contain broad guidelines that would enable them to prepare meaningful financial statements. These organizations, which were covered by the now superseded American Institute of Certified Public Accountants (AICPA) pronouncements (industry audit guides and audit and accounting guides) noted in the preface (Impact on Other Literature), are covered under this Guide.

Moreover, isn't paragraph 1.02 and the last sentence of paragraph 1.03 redundant with the preface (Applicability)?

If paragraphs 1.02 and 1.03 are switched, remove the word "Accordingly" in paragraph 1.03. If they are not switched, replace the word "Accordingly" with "Based on the preceding paragraph".

Remove from paragraph 1.04: "are not not-for-profit organizations and". It is unnecessary and adds confusion.

Remove from paragraph 1.05: "that meet the definition of a not-for-profit organization in FASB Statement No. 117, as well as some that do not meet that definition but do have ownership interests like those of business enterprises or have operating purposes other than to provide goods and services at a profit,". It is unnecessary and adds confusion.

Rewrite paragraph 1.07 in table format.

Why quote a textbook (Montgomery's Auditing) for the definition of a fund in paragraph 1.09? Could a more authoritative reference be found?

Chapter 2:

In general, this chapter is not a requirement, since a Certified Public Accountant should know this information. However, it is not necessary to remove this chapter.

The section on illegal acts (paragraphs 2.26 to 2.29) should include a paragraph discussing the requirements under Omnibus Budget Reconciliation Act of 1993 (OBRA 93) relating to the substantiation of contributions by a contemporaneous written acknowledgement to the donor.

Chapter 3:

The example found in paragraph 3.14 could be better illustrated in showing an example of the matrix format. At the very least, a reference should be made to paragraphs 13.24 to 13.26.

Paragraphs 3.18 and 3.19 should be switched. This would allow the topic of the statement of cash flows to proceed from the general to the specific. The reference to paragraph 3.19 in paragraph 3.18 would no longer be necessary.

Chapter 4: Adequate.

Chapter 5:

Beginning of first sentence of paragraph 5.07 appears to be redundant with the first sentence in paragraph 5.05. Rewrite as: "Agency transactions should be reported as increases in assets and liabilities; ...".

In paragraph 5.19, the term "future services" should be clarified by a footnote.

Paragraph 5.44 should be split into two paragraphs, the second paragraph starting with the sentence: "Contributed facilities may be required to be capitalized based on the guidance in FASB Statement No. 13, ***Accounting for Leases***".

Paragraph 5.53 should be placed before paragraph 5.51. Redundancies in paragraph 5.51 should be removed.

Referring to paragraphs 5.62 and 5.63, even though contributions receivable does not fall into the category of accounts receivable under SAS No. 67, ***The Confirmation Process***, the Guide should strongly suggest that the auditor request confirmation of contributions receivable as long as it would not hamper future contributions (ie. the general public).

Chapter 6:

The term "accretion" means the growth or increase in size by gradual external addition or accumulation. In paragraphs 6.11, 6.21, 6.28, 6.29, 6.33 and 6.37, in "Audit Considerations" and in "Appendix - Journal Entries", the term is used in the phrase, "accretion of the discount", which would imply an external increase in the discount. However, in most cases, the discount would actually reduce over time and there are no external factors involved (at least, not in a charitable lead trust, as discussed in paragraph 6.21). Therefore, the term "accretion" is inappropriate in these paragraphs. "Amortization" is a more appropriate term.

Chapter 7: Adequate

Chapter 8:

Bold type paragraph 8.06.

Chapter 9:

Paragraphs 9.02 and 9.10 should refer to paragraph 5.44 (and subsequent paragraph, if suggestion to split paragraph is accepted) at their respective statement relating to capital leases.

Chapter 10:

In paragraph 10.09, the first item should read, "Noncompliance with donor-imposed ***or legal*** restrictions on contributed assets". Also, refer to Chapter 15 regarding unrelated business income.

Chapter 11: Adequate

Chapter 12:

Why are there no "Audit Considerations" for this chapter?

Chapter 13:

Allocation of expenses, as discussed in paragraphs 13.37 and 13.38 should include illustrations on how to allocate joint costs using incremental, stand-alone, single-step and multi-step allocation methods with single and multiple cost drivers. See AICPA Statement of Position 87-2.

Chapter 14: Adequate.

Chapter 15:

An additional paragraph should be made at the end of the "Introduction" section, that discusses the requirements under Omnibus Budget Reconciliation Act of 1993 (OBRA 93) relating to the substantiation of contributions by a contemporaneous written acknowledgement to the donor. If the suggestion to include this paragraph in chapter 2 is accepted, a reference to that paragraph is acceptable.

Chapter 16: Adequate.

Very truly yours,

NEW JERSEY SOCIETY OF CPA'S

Raymond Temple
Chair, Auditing and Accounting
Standards Committee

THE PHOENIX SYMPHONY
James Sedares, Music Director

145
8-21-95

August 16, 1995

Mr. Joel Tanenbaum
Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10035-8775

Dear Mr. Tanenbaum:

This is a statement of comments on the exposure draft of the proposed audit and accounting guide for Not-for-Profit Organizations issued on April 14, 1995 by the Not-for-Profit Organizations Committee of the AICPA. Although we are not large in terms of our numbers, we are nonetheless impacted by the provisions of SFAS 116 & 117 and the proposed audit guide. As the largest performing arts organization in Arizona, The Phoenix Symphony reflects a tradition of excellence dating back nearly 50 years. From humble beginnings of four concerts in our inaugural year, The Phoenix Symphony has grown to a schedule of more than 160 performances across the state each year. We have a $5.4M budget and employ 75 musicians and 24 staff members.

We agree with the majority of the draft and wish to state at the outset that we commend the Committee for extending the work begun by the FASB in trying to bring a sense of comparability to external financial reporting by not-for-profit organizations. We do have comments in the following areas:

Presentation of an Intermediate Measure of Operations and the Presentation of Functional Expenses

During the course of the comment period and the public hearings for SFAS117, a major issue for symphony orchestras and other performing arts groups represented by the American Symphony Orchestra League and by CFO/Arts was the continuing ability to present in our audited statements a result from operations conforming to our historical method of measuring operations. The FASB did not agree with our contention that we should be left to present a separate statement of operations, but we were publicly assured

Joan H. Squires • President and CEO
3707 NORTH SEVENTH STREET • PHOENIX, ARIZONA 85014 • (602) 277-7291 • FAX (602) 277-7517

that the freedom to present a measure of operations as defined by a single organization or industry would not be denied. This was made clear by the FASB in ¶112-114 of SFAS117.

We see in ¶3.13 a tendency to be overly prescriptive in ways which would preclude the consistent application of our historical measurement of operations. It was a deliberate decision on the part of the FASB not to prescribe a specific measure of operations nor to prescribe the measure of operations deemed most applicable by a given organization or industry just as long as the total change in net assets by class was retained. It would be inappropriate for the AICPA to attempt to change that decision. A possible result of such a move would be to force a large number of performing arts organizations to present unaudited information in their published annual reports and restrict the circulation of their audited statements.

We find a similar tendency in ¶13.23-13.41 concerning the presentation of expenses reported by their functional classification (the "matrix"). The overly prescriptive tone of this section goes well beyond the display requirements imposed by the FASB and, in fact, contradicts the express desire of the FASB <u>not</u> to require such explicit totals. Such a requirement "would be more stringent than display requirements for business enterprises *and could inhibit meaningful financial reporting by not-for-profit organizations"* (¶116 of SFAS177, emphasis supplied). By requiring such totals, the Committee severs the necessary connection between the matrix and expenses as presented in the Statement of Activities. Without such an explicit connection, presentation of expenses will become confusing. The proposed reconciliation offered by the Committee in ¶13.26 would only make the presentation *more* confusing.

In summary, we feel that it is inappropriate for the Committee to explicitly contravene the decision already made by the FASB not to require such explicit totals. As such, ¶3.13 should be amended to make clear that an organization or industry is left free to determine the components of its own intermediate measure of operations, provided that this is clearly disclosed and that the change in total unrestricted net assets for the period of clearly reported. In addition, ¶13.24 should be amended to delete the words "regardless of where they are reported on a statement of activities" from the first sentence.

Paragraph 5.52

As currently drafted, this paragraph would require the treatment of the initial estimate of uncollectible promises to give in the statement of activities as bad debt expense.

The Phoenix Symphony
Exposure Draft Response

We believe that this treatment is incorrect and that the initial estimate of uncollectible promises to give (pledges) should be allowed to be treated as a reduction of contributions received in the initial period in which the uncollectible pledges are recognized. The subsequent recognitions of uncollectible pledges should then be treated as a loss rather than an expense. There are several reasons for this treatment:

1. This situation is somewhat analogous to the treatment of accretion of discounted pledges addressed in SFAS116. While the FASB initially proposed that this accretion should be treated as interest income, they were persuaded that this accretion is, in reality, an integral part of the contribution process and should be recognized as additional contributions. Similarly, pledges which might not be real in the first place, are, in the minds of donors and recipients, just a reduction in contributions received.

2. Bad debt expense, as we understand it and have always used it, is the expense resulting from the loss of an asset resulting from a reciprocal transfer. It does not necessarily follow that the initial valuation of assets resulting from non-reciprocal transfers would result in an expense or loss. It is more logical to treat the valuation process for non-reciprocal transfers (i.e. pledges receivable) as a component of the amount of contributions received.

3. If a bad debt <u>expense</u> were to be recognized, it would most logically be functionally included in fund raising expense for the period. This would create another unintended, negative effect. Fund raising expense is a very closely watched and comparable figure, especially as a percentage of total funds raised. the inclusion of the write off of pledges in the numerator rather than in the denominator of that percentage could result in misleading information. Since this percentage tends to be very comparable across different kinds of not-for-profits now, it is desirable to maintain this comparability. Treating pledge write offs as bad debt expense in fundraising expenses would seriously impair this desirable comparability.

Capitalization of Prepaid Fundraising Costs

There are two issues concerning fundraising costs that deserve further consideration by the AICPA.

1. Should institutions be allowed to capitalize prepaid fundraising costs (i.e. feasibility studies, materials design and production, etc.) to match such costs to the specific campaign for which they were intended?

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The Phoenix Symphony
Exposure Draft Response

2. What period of time is appropriate for expense recognition of prepaid fundraising costs?

¶13.07 of the ED and its related footnote prescribe that fundraising costs be expensed as incurred. This treatment is based on flawed assumptions that there is difficulty in assessing the ultimate recovery of the expenditure and, that the practice of expensing cost as incurred is uniform in nature.

Contrary to the AICPA's position, deferral of prepaid fundraising costs to match such expense against the campaign is the predominant practice in the performing arts and by symphony orchestras in particular. Sophisticated fundraising techniques and the use of experienced professionals for developing campaign strategies and materials provide organizations the ability to access the effectiveness of a campaign and project reasonable ranges of anticipated return and cost recoverability. The increasing level of campaign sophistication suggests projected returns would be no more or less accurate than projected returns from direct advertising costs, as discussed in ¶13.10.

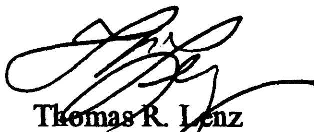
The Phoenix Symphony asks that the AICPA consider allowing the deferral (capitalization) of prepaid fundraising costs with the recognition of expense tied to the solicitation period of the campaign. Annual campaigns (i.e. a campaign for a specific fiscal year) should require recognition of the prepaid expense should be recognized in an appropriate manner over the solicitation period, which is, essentially, the useful life of the campaign materials. For perpetual campaigns (i.e. campaigns that are ongoing and without a defined duration) we agree with the AICPA that such expenses should be recognized as incurred.

Clarification of Measurement Principles for Contributions

We believe from our reading of ¶5.54 is confusing. We believe that what is meant to be conveyed is that the organization's perception of the risk of uncollectibility (discussed in ¶5.52) is a measurement made separately from and prior to the organization's assessment of the risk-free rate of return. That rate is then used to discount the amount and is not changed once it is determined.

Thank you for the opportunity to respond to this exposure draft.

Sincerely,



Thomas R. Lenz
Director of Finance and Administration

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COUNCIL OF BETTER BUSINESS BUREAUS, INC.

4200 Wilson Boulevard
Arlington, VA 22203-1804
703.276.0100
703.525.8277 *(fax)*

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8-24-95

Via Express Mail
August 23, 1995

Mr. Joel Tanenbaum
Technical Manager
File No. 3605.AG
Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York NY 10036-8775

Dear Mr. Tanenbaum:

The Philanthropic Advisory Service (PAS) of the Council of Better Business Bureaus (CBBB) appreciates the opportunity to respond to the AICPA's Exposure Draft of the "Proposed Audit and Accounting Guide for Not-for-Profit Organizations." CBBB is a business membership organization that serves as the national office of the Better Business Bureau system. Each year, CBBB's Philanthropic Advisory Service reports and reviews the audited financial statements and other requested materials from several hundred nationally soliciting charitable organizations and determines their compliance with the voluntary CBBB Standards for Charitable Solicitations.

PAS reports on national charities for one major reason -- public demand. Individuals contact Better Business Bureaus for factual and impartial information on publicly-soliciting charitable organizations. While PAS does not comment on the worthiness of any charity or cause, the materials we produce are intended to help donors make informed giving decisions.

Those who contact PAS for assistance frequently emphasize the importance of obtaining basic facts about a charity's finances. The charity audit report is clearly a vital and essential tool for this purpose.

The following reflects PAS' views in relation to our experience with charity audit reports and also reflects issues that have been brought to our attention by inquirers, charitable organizations, and others.

Comment Summary

Overall, we are most pleased with the scope and depth of the Proposed Guide and would like to offer our compliments to the AICPA for an excellent draft. We are particularly impressed with the chapter on Split Interest Agreements, an area that was in great need of guidance from the accounting profession. Our major recommendation for improvement is to include more display examples within the text in order to further clarify the presentation as it would appear within the financial statements.

The name Better Business Bureau is a registered service mark of the Council of Better Business Bureaus, Inc.

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General Auditing Considerations

We applaud the recognition given to the potential risks in planning the audit. As stated in paragraph 2.13, one example notes "An attempt to appear as efficient as possible may increase the likelihood of misstatement of allocation of costs between program services and supporting activities." This is an area of continuing concern in our reviews of charity audited financial statements. We are pleased that the Proposed Guide has included this warning for auditors.

Basic Financial Statements

As noted in paragraph 3.14, voluntary health and welfare organizations are required to include a detailed schedule or matrix of expenses by natural classification (salaries, rent, electricity, etc.) that identifies the portion of such expenses incurred for each major program and supporting activity.

This particular detailed schedule is very significant for donors and other users of charity audit reports. Inquirers often contact PAS to seek assurance that a charity is carrying out its activities in accordance with donor expectations. While the total expense figures for the functional categories of program services, fund raising and management and general are helpful, they do not provide sufficient detail to enable the reader of the audit to determine how a charity is carrying out a particular activity. (For example, does the disaster relief charity's program expense category include medical and food assistance expenses as mentioned in the organization's appeals for support?)

In view of its importance to users, we urge the AICPA to include a sample detailed functional breakdown within the final version of the Proposed Guide. We also hope that the guide might incorporate the definition of voluntary health and welfare organizations as defined in appendix D from FASB Statement No. 117.

Such additions will provide the Guide with further clarity and completeness on this issue. The sample detailed matrix of expenses will also help the AICPA fulfill its stated goal to "encourage... other not-for-profit organizations to provide information about expenses by their natural expense classification."

PAS also will encourage other not-for-profit organizations to include this matrix. One of CBBB's voluntary standards specifically calls for such a detailed schedule of expenses in order to provide donors with adequate information to serve as a basis for informed decisions. We will continue to make such recommendations to publicly soliciting charities whether or not they fall within the FASB Statement No. 117 definition of a voluntary health and welfare organization.

Contributions Received and Agency Transactions

In this section of the Proposed Guide, we have several recommendations about the recognition of Gifts In Kind.

Paragraph 5.12 states that "Fair value should be based on the quantity received after any applicable discounts have been considered." We recommend that the AICPA add "quality and condition" as additional significant factors on which to base fair value. In certain circumstances, "quantity" alone (without also considering the quality and condition of the items received) might result in an overstatement of the fair value of gifts-in-kind. Although some might conclude that the reference to "applicable discounts" covers other factors, we believe additional clarification is needed.

In addition, we also recommend that the Gifts In Kind guidance also explain the impact of a donor stipulation that the donated goods not be resold. As stated, we believe it is unclear what impact this restriction would have. For example, if the charity, as a result of donor restriction, is not permitted to sell the donated goods can it be recognized? Some may interpret the current "clothing and furniture" example in 5.12 of the Proposed Guide as referring to items that were "unavailable" for sale due to their condition as opposed to any donor restriction.

We also recommend that this section include some type of required disclosure, such as in the notes to the statements, that would identify the nature and major types of donated goods, how they were valued, and how they further the charity's activities. We have seen circumstances in some national charity audit reports where the donated goods were recognized as revenue and as a program expense but had no connection to the stated mission and programs of the charity. In certain circumstances, the absence of a further description of the nature and use of the donated goods can result in a presentation that misleads financial statement users.

Split Interest Agreements

As noted earlier, we are most pleased that the AICPA has provided information on this growing area of charity activity. We recommend that this chapter also offer guidance on where the expense of valuation adjustments stemming from split interest agreements should be recorded in the statement of activities. To our surprise, PAS has seen circumstances where national charity audit reports have identified such expenses as a program service activity. In our view, such expenses should be classified as a supporting service expense. We encourage the Proposed Guide to provide clarification.

Expenses, Gains and Losses

We recommend that the section titled "Reporting the Cost of Special Events and Other Fund-Raising Activities" (paragraphs 13.17 through 13.21) provide additional clarification by illustrating display alternatives as they would appear within a Statement of Revenue and Expenses. This is a very significant area for charities, especially smaller organizations. The more clarity provided, the better the implementation of the guidance.

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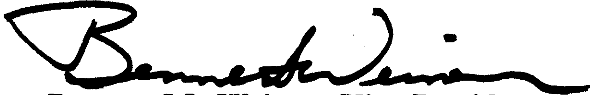
Paragraphs 13.27 and 13.30 refer to the fact that, for some organizations, more than a single functional reporting may be appropriate for the three categories of program services, fund raising, and management and general. For example, a charity may have more than one major program service activity and/or the charity may decide to disaggregate the fund raising expense category into several line items. However, the specific name provided to a major expense category (for example, Activity A, Activity B, etc.) may not necessarily reveal which of the three major expenses categories it falls under. In view of this, we recommend that the AICPA require such disaggregations to clearly specify the appropriate functional reporting area. A display example might look as follows:

<u>Program Services:</u>		
Activity A	$xx,000	
Activity B	$xx,000	
Activity C	$xx,000	
<u>Supporting Services:</u>		
<u>Fund Raising</u>		
Activity D	$xx,000	
Activity E	$xx,000	
<u>Management and General</u>	$xx,000	
<u>Total Expenses</u>		<u>$xxx,000</u>

Thank you again for the opportunity to comment on the Exposure Draft. We hope our comments are helpful to you.

Sincerely,



Bennett M. Weiner, Vice President
Philanthropic Advisory Service

Enclosure: CBBB Standards for Charitable Solicitations

cc: Irvin A. Alexander, III, PAS Director

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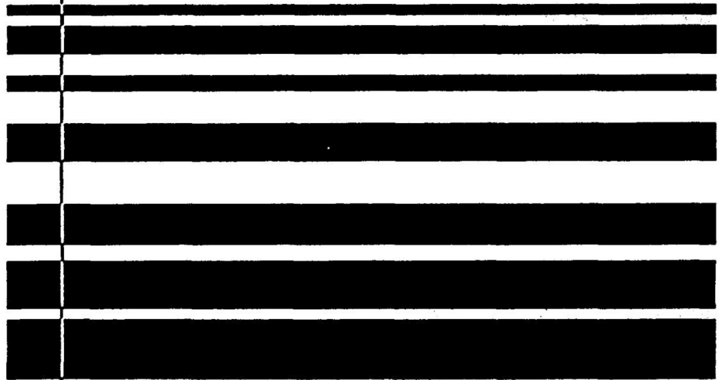
The COUNCIL of BETTER BUSINESS BUREAUS'

STANDARDS FOR CHARITABLE SOLICITATIONS



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4200 Wilson Boulevard
Arlington, VA 22203

Philanthropic Advisory Service
Council of Better Business Bureaus, Inc.
4200 Wilson Boulevard
Arlington, VA 22203
(703) 276-0100

Revised
Standards for Charitable Solicitations
January, 1982

AICPA

American Institute of Certified Public Accountants

Division for CPA Firms

1211 Avenue of the Americas
New York, NY 10036-8775
(212) 596-6200
Fax (212) 596-6213

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rec 8/28/95

August 23, 1995

Joel Tanenbaum, Technical Manager
Accounting Standards Division, File 3605.AG
American Institute of CPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft of Proposed Audit and Accounting Guide *Not-for-Profit Organizations*

Dear Mr. Tanenbaum:

One of the objectives that Council of the American Institute of CPAs (AICPA) established for the Private Companies Practice Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective.

TIC has reviewed the proposed guidance contained in the above referenced exposure draft and is pleased to provide the following comments and suggestions.

Overall

TIC commends the Accounting Standards Executive Committee (AcSEC) and the Not-for-Profit Organizations Committee on the production of such a useful and relevant guide. However, the omission of illustrative financial statements in the guide is a significant omission for local firms and might even hinder the potential contribution the guide makes to improving professional practice. TIC understands AcSEC's desire to issue the guide as soon as possible, however, TIC urges AcSEC to prioritize the development of a comprehensive set of illustrative financial statements for issuance through a Statement of Position or some other document to amend the guide. In the interim, it would be helpful if unofficial

illustrative financial statements could be provided though such sources as the Accountant's Forum or a Financial Statement Preparation Manual.

Specific Issues for Comment

After discussing the questions listed on page v. related to variance power and donor-advised provisions, TIC concluded that, in practice, the not-for-profit organizations audited by local firms typically do not receive resources with "variance power" or "donor-advised" provisions attached to them. These not-for-profit organizations usually are either given complete discretionary power over the resources received or none. However, if these not-for-organizations did receive resources with such provisions, then the history of exercising that power would be an important factor in determining whether resources received are contributions. In addition, TIC agrees that 1) income from resources that must be retained in perpetuity can be accounted for differently than underlying resources held in perpetuity and 2) resources that must be retained in perpetuity can be accounted for as a contribution, even though the income from the resources is accounted for as an agency transaction. For example on this last point, resources may be contributed to a community organization for maintenance with the restriction that the income generated from those resources be distributed to another organization.

Chapter 2 - General Auditing Considerations

The last sentence of paragraph 2.12 refers to the Committee of Sponsoring Organizations (COSO) report, *Internal Control - Integrated Framework*. This is inconsistent with the rest of the guide which uses the language provided by Statement on Auditing Standards (SAS) Number 55, *Consideration of the Internal Control Structure in a Financial Statement Audit*. Because COSO is not authoritative professional literature, the guide should refer to the appropriate sections of the professional auditing literature on internal controls.

If the proposed auditing standard that amends SAS Number 55 by replacing the definition and description of internal control structure currently contained in that standard with the definition and description contained in the COSO report is adopted for the guide, then appropriate conforming changes will need to be made

throughout the guide to the applicable sections. For example, the phrase "related control policies and procedures" on line 6 and 7 of paragraph 2.14 would need to be "related control activities" and the heading before paragraph 2.15 would need to have the word "structure" inserted into it to read "Internal Control Structure Considerations." In addition, the three elements of an entity's internal control structure listed in paragraph 2.15 would need to be replaced with the five components of internal control structure described in the proposed amendment to conform SAS 55 to the COSO report.

An appendix listing available resources for obtaining industry-wide data that the auditor can use in implementing analytical procedures on the engagement as discussed in paragraphs 2.21-.22 would be helpful for users seeking reference material. In addition, the term "operating costs" on line 6 of paragraph 2.21 conflicts with FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*, which avoids the use of the term "operations." TIC suggests that perhaps a term such as "program costs and supporting services" would be more appropriate.

TIC encourages AcSEC and the Not-for-Profit Organizations Committee to consider the feasibility of providing more specific guidance in the area of planning stage materiality in paragraph 2.36. Additionally, the paragraph's focus on controlled balanced budgets and zero operating margins implies that single measurements of materiality can be set. TIC believes the guidance on materiality during the planning stage of the audit would be more appropriate if it conveyed broader information about the issues of stewardship faced by not-for-profit organizations, in addition to the discussion about the budget environment. Though not-for-profit organizations function in such environments, the purpose of the audit is not to test every transaction within the materiality threshold. The discussion in the paragraph appears to exceed the materiality requirements of auditing standards.

The third bullet in paragraph 2.46 lists insufficient funds to meet donor's restrictions as an example of a condition or event that might indicate there could be a substantial doubt about the organization's ability to continue as a going concern. This occurrence is also an example of a possible illegal act. TIC suggests that the following parenthetical comment be added to the bullet: (The auditor should be alert to the fact that the use of

restricted funds for unrestricted purposes may be an illegal act.)

Unlike the other chapters in the proposed guide, chapter 2 contains no grid at the end on audit considerations. TIC believes such a grid would be beneficial to users and also recommends that specific audit guidance on risks and uncertainties be added to the chapter.

Chapter 3 - Basic Financial Statements

TIC believes it would be useful for local firms if the discussion on the statement of activities contained in paragraphs 3.08-.13 of the guide included a brief comment on the concept of matching expenses with donor-imposed restricted contributions, similar to that contained in paragraph 165 of FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*. This question will arise frequently in practice because the use of deferred revenue accounting is now prohibited for restricted contributions.

The discussion in paragraphs 3.26-.28 on noncompliance with donor-imposed restrictions is also applicable for noncompliance with contractually imposed restrictions. Therefore, TIC suggests that these paragraphs cover both situations. A possible solution would be to refer through out the paragraphs to "donor or contract imposed restrictions."

Chapter 5 - Contributions Received and Agency Transactions

The list of indicators in Table 5.1 for distinguishing contributions from agency transactions is very helpful. However, AcSEC may wish to add a footnote to the bottom comment in the column on "Agency Transactions" mentioning consolidation of the entities should be considered.

Paragraph 5.13 requires that gifts in kind, like tickets and works of art, which are received and used for fund-raising purposes, be "reported as contributions and measured at fair value when received;" that "the difference between the amount received for those items from the ultimate resource providers (recipients) and the fair value of the gifts in kind, when originally contributed to the organization, should be recognized as contributions when the items are transferred to the ultimate resources providers (recipients)." TIC believes that there could be a potential

implementation problem with this required accounting treatment because, in practice, gifts in kind used for fund-raising auctions are often difficult to value at the time of transfer because of the nature of the items. Though tickets to an event are easily assessable, other items such as autographed baseballs are not. An alternative would be to require that gifts in kind for fund-raising purposes be recognized as contributions at the time they are received if their value is known, otherwise, at the time of transfer during the fund-raiser.

Paragraph 5.21 discusses how to differentiate between exchange transactions and contributions. The inclusion of specific examples in addition to the indicators would contribute to making the guide more useful for local firms. An earlier draft version of the guide included a sentence that stated governmental grants are exchange transactions. In practice, the members of TIC are not aware of any governmental grants that were considered contributions. If it is possible for a governmental grant to be a contribution, then it would be useful to include an example of one. If not, then TIC recommends that a positive statement be made in the guide that all governmental grants are, in fact, exchange transactions. In addition, on the fourth line of paragraph 5.22, the word "or" should be "on."

Paragraph 5.31 states that "donors can impose restrictions on otherwise unrestricted net assets, as well as on their own contributions...[which] result in a reclassification of unrestricted net assets to restricted net assets." TIC disagrees with the conclusion that reclassification is necessary. The statement implies a not-for-profit organization can not accept such a gift unless it currently has funds that can be restricted. An alternative approach for the not-for-profit organization would be to use unrestricted funds received in the future to match the specified amount. A broader question that TIC would like to propose AcSEC consider is why must the actual funds be restricted? An alternative approach would be to require such funds be so designated while classified in the unrestricted funds.

Paragraph 5.51 requires increases in the fair value between the date an unconditional promise to give is recorded and the date the asset is received not be recognized. In contrast, the guide requires decreases in the fair value during that period be recognized in the period(s) in which the decrease occurs. TIC

believes the inconsistent treatment of accounting for increases and decreases in the fair value of unconditional promises to give should be eliminated.

Chapter 6 - Split-Interest Agreements

TIC would like to commend AcSEC and the Not-for-Profit Organizations Committee for providing much needed guidance on split-interest agreements in chapter 6 of the proposed audit and accounting guide. The appendix to this chapter will be especially helpful and useful to local firms.

Chapter 7 - Other Assets

The second sentence of paragraph 7.03 lists ways to determine the estimated fair value of contributed inventory. TIC suggests that "subsequent sales" be added to this list. For example, a store that historically turns over its inventory approximately every three weeks, could at year end base the value of its inventory on the sales for the first three weeks of the subsequent year.

Paragraph 7.12 of the guide requires a not-for-profit organization that does not capitalize its collection to report the costs of its collection on the face of its statement of activities. The determination of such costs may be difficult for some not-for-profit organizations. For example, a natural history museum that excavates its collection from the earth through archeological digs, some of which result in the finding of fossils but many others which do not. TIC believes it would be beneficial if the guide further explored the different circumstances that can affect a not-for-profit organization's ability to determine the cost of its collection.

Chapter 8 - Investments

Paragraph 8.02 of the guide differentiates between investments (equity securities with readily determinable fair value and all debt securities) that are covered by the recent FASB exposure draft (ED), *Accounting for Certain Investments Held by Not-for-Profit Organizations*, and those investments that are not covered by the ED (investments in real estate, mortgage notes, venture capital funds, partnership interests, oil and gas interests, and equity securities that do not have a readily determinable fair value, among others).

It labels those investments not covered by the ED as "other investments." However, this differentiation between investments covered by the ED and "other investments" seems to be abandoned by the guide when it describes the required financial statement disclosures for investments, resulting in all of the disclosures required by the ED to also be applicable to the "other investments" not covered by the proposed standard. TIC recommends that AcSEC and the Not-for-Profit Organization Committee consider whether the distinction between the two should also be maintained when discussing disclosures. In addition, it would be useful if a cross-reference was provided to the professional standard requiring the disclosures listed in the guide. For example, the guide as drafted requires that when investments are carried at market value, their cost be disclosed. This requirement appears to exceed that of the ED. If cross-references were included, then it would be easier to identify the source requiring a disclosure.

Chapter 10 - Debt and Other Liabilities

Paragraph 10.06 of the guide requires that "if payments of the unconditional promise to give are to be made to a recipient over several fiscal periods and the recipient is subject only to routine performance requirements, a liability and an expense for the entire amount payable should be recognized and measured at the present value of the amounts to be paid." It would be helpful to local firms if the guide provided assistance on how to measure the present value of the unconditional promise to give, specifically as it relates to selecting an appropriate interest rate for the calculation. Paragraph 5.54 of the guide requires that an unconditional promise to give be measured by the recipient at the present value of estimated future cash flows using a risk-free rate of return. Since these two paragraphs are referring to the measurement of the same type of transaction, but one a receipt/receivable and the other a disbursement/liability, then one would expect both sides of the transaction to use the same method for measuring their value. TIC recommends that paragraph 10.06 either cross-reference paragraph 5.54 or else repeat that paragraph's description of the method of measurement. If the same method of measurement is not intended for the receivable and the liability resulting from an unconditional promise to give, then an explanation of why identical treatment is not appropriate would be useful to eliminate any confusion surrounding the matter.

The sentence in paragraph 10.09 of the guide as currently drafted implies that the two examples listed are the only possible FASB Statement No. 5 contingencies that the auditor has to be concerned about. To eliminate this possible misreading, TIC recommends that the phrase "material contingencies, including but not limited to" be inserted in the second line between the words "for," and "the."

The chart of audit considerations at the end of chapter 10 does not contain an example of selected control procedures for the financial statement assertion of valuation.

Chapter 13 - Expenses, Gains, and Losses

Paragraph 13.07 of the guide requires fund-raising costs be expensed as incurred, even if such cost may result in contributions that will be received in future years. Although it seems pragmatic to violate the concept of matching revenues and expenses when it is difficult to assess ultimate recoverability from fund-raising costs, when recoverability is reasonably assessable it does not make sense to expense such costs as they are incurred. Organizations should be allowed to exercise judgment in such situations by allowing fund-raising costs to be capitalized when recoverability is assessable. Not allowing capitalization adds further complication to situations where it is difficult to determine whether a cost should be classified as fund-raising or advertising. For example, a video tape about a not-for-profit organization may be circulated to various companies. The tape is advertisement in that it promotes the not-for-profit organization, but at the same time it is fund-raising because resources are solicited from the viewers of the tape. Because direct-response advertising costs are allowed to be capitalized and advertising costs deferred until the first time the advertising takes place, the classification of the expense as fund-raising or advertising will result in different accounting treatments of the costs, expensed as incurred or capitalized, respectively. If AcSEC chooses to retain the requirement currently in the draft guide that cost be expensed as incurred, TIC recommends that the last half of the sentence on the difficulty of assessing recoverability be deleted.

The last sentence of paragraph 13.17 is confusing. Deletion of its ending phrase, "that is, that result in gains or losses," would help clarify the sentence.

Chapter 14 - Reports of Independent Auditors

TIC suggests that the word "ordinarily" in line 6 of paragraph 14.05 be deleted.

The title, "Reporting on Supplementary Information," which precedes paragraphs 14.09 and .10 of the guide, is not descriptive of their contents. The paragraphs discuss nonmonetary data, not supplementary information. Though many local firms have a policy to avoid including "gratuitous" non-required disclosures in their clients financial statements, the conclusion that including such information is always inappropriate has never come to the attention of the members of TIC. TIC is concerned about the possibility the information in paragraph 14.10 on nonmonetary information may create a potential practice problem if the paragraph is interpreted to apply as equally well to other, less egregious, non-required information sometimes included as supplementary information.

The requirement in paragraph 14.12 to include a paragraph restricting distribution, when an auditor issues a special report on financial statements prepared in conformity with governmental regulatory agency requirements, is problematic if the auditor's report is a matter of public record and, therefore, accessible by law. It would be beneficial to users to include an explanation on why an auditor's report that is public should contain a distribution restriction, if such legal or other reason exists necessitating the requirement.

* * * * * * *

We appreciate the opportunity to present these comments on behalf of the Private Companies Practice Section. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Robert O. Dale, Chair
PCPS Technical Issues Committee

ROB:rbb

cc: PCP Executive and PCPS Technical Issues Committees

Arthur Hurand G 4300 W. Pierson Rd. • Flint, Michigan 48504

Rcv'd 9-1-95

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August 30, 1995

Mr. Joel Tannenbaum
Tech. Mgr, File 3605
A.G.
Accounting Standards DIV, AICPA
1211 Ave of the Americans
New York, NY 10036-8775

Dear Mr. Tannenbaum:

Anyone who has followed the formation and the growth of community foundations has to be impressed with the accomplishments that these organizations have and are contributing to our American way of life. Not only are they meeting the needs of our community, but they are in a position to contend with the changing tides that communities require.

A cross section of community foundations will reveal that the leadership and the trustees who are active in these organizations come from a group of people dedicated to their communities and are also diverse in their accomplishments and in their positions in society.

My reason for writing is that if something is good - why change it? There is no question that the community foundations are doing their job. I am concerned that movements are afoot to change the structure of how these organizations work. All community foundations are based on public knowledge and this knowledge is broadly disseminated to the entire community. There is no place to hide assets in the structure of a community foundation. Banks and individual trusts have an entirely different formula. In fact many banks and individual trusts allocate funds to community foundations because of their expertise and exposure to the changing times.

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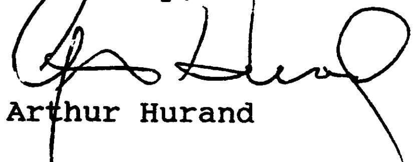
Proposed changes by AICPA will do community foundations little or no good and in many cases might harm these organizations because they would interject a position where the confidence of donors would be compromised because many of their wishes might not be able to be carried out. The encouragement of philanthropic giving is something that is "all powerful" in America and everything we do should be directed into that direction. This letter is being written to you so that you will, hopefully, investigate and use your influence to make sure that we do not create a situation that will materially effect and interfere with the great work of community foundations.

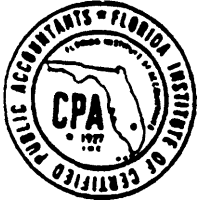
I appreciate your reading this letter.

Sincerely,



Arthur Hurand

AH/rjh



FLORIDA INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

325 WEST COLLEGE AVENUE • P.O. BOX 5437 • TALLAHASSEE, FLORIDA 32314
TELEPHONE (904) 224-2727 • FAX (904) 222-8190

August 29, 1995

rcv'd 9-1-95

(149)

Joel Tanenbaum, Technical Manager
File 3605.AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tanenbaum:

The Accounting Principles and Auditing Standards Committee of the Florida Institute of Certified Public Accountants(the Committee) has reviewed and discussed the Exposure Draft entitled "PROPOSED AUDIT AND ACCOUNTING GUIDE NOT-FOR-PROFIT ORGANIZATIONS" dated April 14, 1995.

As to the Specific Issues for Comment on page V of that document, our comments are as follows:

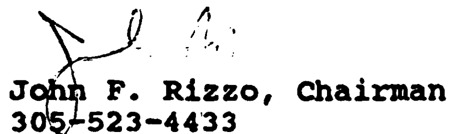
Issue 1: AcSEC has identified a complicatated, perplexing issue faced by many non-profit organizations identified in the explanatory introduction. Our response to the questions raised in the last three bullet paragraphs is yes to the first question raised in bullets one and two and no to the second question of both those bullets, since we believe that the organization's past history should not be a factor. As to bullet three, we agreed that the accounting for the resources and the income therefrom should not differ from each other.

Issue 2: We agree that the Guide should address the issues raised and not remain silent about them. Guidance is needed and should in the very least address the areas of employees, students and regular employees and address the correct method to be used and how to disclose such methods that are used.

As an example, we concluded that financial aid in some situations could constitute an exchange transaction that should be treated as an expense.

We appreciate the opportunity to share our views with you. Members of the committee are prepared to discuss any questions you may have about this communication.

Committee on Accounting Principles and Auditing Standards
Florida Institute of Certified Public Accountants



John F. Rizzo, Chairman
305-523-4433

Task Force to Coordinate Response:
William J. Odendahl, Jr. Chair 904-620-0035
James Edward Grossman, 813-687-4010
Harry James Reamy III, 407-234-8484

605 Third Avenue
New York, NY 10158-0142
212 599-0100
FAX 212 370-4520

August 31, 1995

Grant Thornton
GRANT THORNTON LLP Accountants and Management Consultants
The U.S. Member Firm of Grant Thornton International

Mr. Joel Tanenbaum
Technical Manager
File 3605.AG
Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Sir:

We are pleased to submit our comments related to the Exposure Draft, dated April 14, 1995, of the Proposed Audit and Accounting Guide (A&A Guide) entitled Not-for-Profit Organizations.

General Comments

We believe that the proposed A&A Guide provides excellent accounting and financial reporting guidance. However, it appears that the auditing guidance is almost an after-thought. We believe that the auditing guidance in the proposed A&A Guide is vague, incomplete, and not focused. Further, we believe that the cited examples of selected control and auditing procedures are not sufficiently specific.

We believe that much needed auditing guidance and internal control structure considerations, contained in the existing AICPA Audit and Accounting Guides covering the various types of not-for-profit organizations, will be lost.

We are also concerned that certain conclusions, contained in the proposed A&A Guide, which are related to, but not explicitly addressed by FASB Statements No. 116 and 117 and other authoritative literature, effectively amend those statements. We question whether the proposed A&A Guide is the appropriate document to amend existing authoritative literature. Further, we are concerned about the appropriateness of the due process.

In conclusion, we oppose the issuance of the proposed A&A Guide, in its present form. We would support its issuance, as an accounting and financial reporting document, if, the proposed guidance related to auditing and control procedures is deleted.

Specific Comments

1. *Preface (Applicability) and Chapter 1 (Scope - Paragraphs 1.01 to 1.05) and Chapter 8 (Paragraph 8.06)*

We believe that there is a significant practice problem regarding the interpretation of the definition of a not-for-profit organization, as contained in FASB Statement No. 117. We are receiving many inquiries in our practice regarding the applicability of FASB Statements Nos. 115, 116, and 117 to certain organizations, e.g., trade associations and performing arts organizations. Many entities believe (not necessarily shared by our Firm) that, because these organizations do not receive contributions from the public, they do not meet the aforementioned definition. Prior to the issuance of the proposed A&A Guide, we suggest that Accounting Standards Division request the staff of the FASB to clarify, sharpen and focus the aforementioned definition.

2. *Preface (Effective Date and Transition)*

Because the proposed A&A Guide provides significant accounting and financial reporting guidance regarding certain areas which are significant to certain not-for-profit organizations ,e.g., accounting and financial reporting of agency transactions and split interest agreements, we suggest that the provisions of the proposed A&A Guide be effective as of the same dates as FASB Statements No. 116 and 117. Accordingly, it might be prudent for the Accounting Standards Division to petition the FASB to postpone the implementation of FASB Statements No 116 and 117. If the provisions of the proposed A&A Guide and the FASB Statements No. 116 and 117 are implemented at different dates, entities will be required to report changes in accounting principles and financial reporting practices in two different reporting periods.

We believe that repeated changes to the accounting principles and financial reporting practices employed by an entity, irrespective of the reason for such changes, brings into question the credibility of the financial statements of the entity. We also believe that such repeated changes may negatively impact the not-for-profit sector's perceptions of the accounting profession.

3. *Chapter 2*

a. We believe that the reference to SAS No. 55 should be revised in consideration of the exposure draft of a proposed Statement on Auditing Standards to revise SAS No. 55.

b. We suggest that the discussion of analytical procedures, in paragraphs 2.20 to 2.21, be revised to indicate the various data bases available to be used by the auditor in applying analytical procedures.

c. We suggest that paragraph 2.34 be expanded to:

(1) Caution the auditor that the use of service bureaus by not-for-profit organizations may be substantially greater than by business entities because of the presence of such items as significant investment portfolios, student financial aid payments, etc.;

(2) Provide guidance to the user auditor when the reports on the processing of transactions by service centers cover periods which do not coincide with the period covered by the financial statements being reported on by the user auditor;

(3) Indicate that the auditor may also be required to obtain service center reports when the not-for-profit organization uses a service center to process investment transactions, not only when it uses a service center for discretionary investment management services, as cited in paragraph 2.34 of the proposed A&A Guide.

(We understand that the Auditing Standards Division is preparing an Auditing Procedure Study to interpret SAS No. 70. Many of our aforementioned suggestions may be more appropriately included in this Auditing Procedure Study.)

d. We suggest that the threshold amounts in footnote 5 to Chapter 2 be eliminated because such amounts are subject to change.

e. We believe that the guidance regarding materiality in paragraphs 2.36 and 2.37 is lacking. We suggest that materiality thresholds be discussed in these paragraphs. Further, we suggest that the question of the appropriateness of judging materiality, based on the impact on individual classes of net assets, versus the appropriateness of judging materiality, based on the impact on total assets, net assets, etc. of the entity, be discussed. We believe that the proposed A&A Guide should state that auditor's measure of materiality relates to the financial statements taken as a whole, rather than each class of net assets. Accordingly, we believe that the auditor need not apply procedures as extensive as would be necessary to express an opinion on each class of net assets separately. Only in the unusual circumstances in which the separate classes of net assets are presented in the form of separate financial statements would materiality be measured with respect to each individual class of net assets. In those circumstances, the scope of the audit should be increased sufficiently to enable the auditor to report on each of the separate classes of net assets.

f. We commend the preparers of the proposed A&A Guide on the inclusion of the guidance in paragraph 2.43 to paragraph 2.46. We believe that this guidance will be very helpful to auditors.

4. Chapter 3

a. We believe that paragraph 3.24 will effectively amend SOP-94-3. We question whether the proposed A&A Guide is the appropriate document to amend an existing SOP. Further, we are concerned about the appropriateness of the due process.

b. We suggest that Chapter 3 discuss the applicability, provisions, etc., of FASB Statement No. 121 to not-for-profit organizations.

c. Because of the significant impact that SOP 94-6 will have on financial reporting, we suggest that it be elaborated upon further. In our opinion, paragraph 3.29, regarding risks and uncertainties, is vague and incomplete. Specific examples, of how SOP 94-6 will impact financial reporting by not-for-profit organizations, would be helpful to preparers and auditors of financial statements.

d. We suggest that the accounting for interfund borrowings, including the need to charge interest on monies borrowed by unrestricted funds from temporarily restricted and/or permanently restricted funds, be discussed in this Chapter.

e. We suggest that the accounting for income earned on unspent temporarily restricted resources be discussed in this Chapter.

5. Chapter 5

a. We suggest that paragraph 5.09 be expanded to include auditing guidance regarding the number of judgments which must be made by preparers of financial statements in determining whether the receipt of assets should be reported as contributions or agency transactions.

b. We believe that the guidance, regarding gifts in kind (paragraphs 5.11 to 5.13) should be expanded to:

(1) Consider the guidance prepared by various industry groups, such as the Interagency Gift-In-Kind (GIK) Standards; and

(2) Indicate factors to be considered in determining the fair value of gifts in kind, e.g., retail value, wholesale value, shelf life and dating of commodities, subsequent sales, etc.

c. We believe that the guidance in paragraph 5.18 should be revised to indicate that where *deminimus* amounts exist, there is no need for an allocation between contributions and exchange transactions, e.g., dues.

We strongly believe that a single dues transaction of a trade or professional association should not be split into two components, as paragraph 5.18 suggests. We believe that many members of trade and professional associations, as well as those of labor unions and lobbying organizations, do not intend to make a contribution when they pay dues, i.e., they do not have any "donative intent." In order to avoid confusion and unnecessary accounting, e.g., arbitrary allocations, and auditing problems, we believe the aforementioned organizations should be exempt from the guidance in paragraph 5.18.

d. We suggest that paragraph 5.30 be expanded to indicate that the contents of contribution solicitation material may impact the reporting of contributions, e.g., contributions received in response to solicitation materials, which indicate that contributions will be used for a specific program, should be reported as temporarily restricted contributions, and contributions received in response to solicitation materials, which indicate that contributions will be added to the "endowment" of the not-for-profit organization should be reported as permanently restricted contributions.

e. We suggest that the last paragraph of Example 2, on pages 48 and 49, be deleted because of the difficulty in auditing this information.

f. We believe that the auditing guidance in paragraphs 5.60 to 5.63 should be more explicit and comprehensive. We suggest the comparable guidance, in the Audit and Accounting Guide - Voluntary Health and Welfare Organizations, be substituted for the aforementioned guidance.

g. We believe that the conclusion in the last sentence of paragraph 5.62 is "splitting hairs" and unnecessary and is not helpful to the auditor.

h. We believe that the "Auditing Considerations," on pages 52 to 56, should be revised. We believe that "Examples of Selected Control Procedures" and "Examples of Auditing Procedures" are vague and too general and should be more specific.

i. We believe that Chapter 5 should contain more detailed guidance regarding the accounting for, and auditing of, government grants and contracts.

j. We suggest that paragraph 5.48 be revised to indicate that subsequent sales may be useful in determining fair value.

6. *Chapter 6*

While we believe that the suggested accounting for charitable gift annuities is appropriate, we have significant concerns with the suggested accounting for other gifts received under split-interest agreements, as follows:

a. Depending on the particular organization's experience, we believe that assets received under revocable split-interest agreements may be appropriately reported between liability and net assets in the statement of financial position, similar to the financial reporting required by the staff of the Securities and Exchange Commission for preferred stock with a mandatory redemption feature.

b. We suggest that paragraph 6.06 distinguish between those assets which are held by the not-for-profit organizations and those which are held by others. In our opinion, assets held by entities, other than the not-for-profit organization, should not be recorded in the financial statements of the not-for-profit organizations. Further, in many instances, the not-for-profit organization does not have access to financial information regarding assets held by other entities, which would preclude it from complying with the guidance in paragraph 6.06.

c. In accounting for charitable trusts, we believe that the not-for-profit organization should be permitted to consider the projected revenue stream to be earned on the assets of the trust, over its life, in measuring the present value of the liability. We also suggest that the example in "Appendix - Journal Entries" be, accordingly, revised.

d. The accounting for assets received under a trust agreement, which does not guarantee a specific income to the donor, should be discussed in the proposed A&A Guide. A number of not-for-profit organizations solicit contributions under trust agreements which state that the beneficiary of the trust receives only the income earned without any guarantee as to income levels.

e. We disagree with the suggested accounting for perpetual trusts held by third parties. We believe that the appropriate accounting for such trusts is that stated in paragraph 122 of SOP 78-10.

f. We believe that the accounting for pooled (life) income funds is convoluted and overly complex.

g. Our comment, regarding "Auditing Considerations" on page 65 to 67, is similar to our comment 5(h) above.

h. We believe that "Appendix - Journal Entries" should be revised to consider our suggestion 6(c) above.

i. The last sentence of paragraph 6.30 states that "...the assets received are held as general assets of the not-for-profit organizations,...." From our experience, this statement may not always be accurate, depending on the various state insurance laws.

j. In our opinion, the accounting suggested for all gifts received under split-interest agreement is driven by the principles presently employed to account for gifts received under charitable gift annuity agreements. We do not believe that the accounting principles and financial reporting practices, employed for gifts received under charitable gift annuity agreements, are always appropriate to account for gifts received under other types of split-interest agreements.

7. *Chapter 7*

a. We suggest that paragraph 7.16 indicate that, when collection items are not capitalized, under certain circumstances, e.g. when the internal control structure is weak, the auditor may be required to perform substantive auditing procedures to provide evidence supporting the disclosure required by paragraph 27 of FASB Statement No. 116, particularly where numeric information is presented in notes to the financial statements, if such information is not labeled "unaudited" or "not covered by the auditor's report."

b. Our comment, regarding "Auditing Considerations" on pages 80 to 85, is similar to our comment 5(h) above.

8. *Chapter 8*

a. Because the guidance in this Chapter will be impacted by the issuance of the proposed Statement of Financial Accounting Standards - Accounting for Certain Investments Held for Not-for-Profit Organizations, we have attached a copy of our comments to the Financial Accounting Standards Board regarding that proposed statement.

b. We believe that the disclosures, suggested in paragraphs 8.22 to 8.25, go beyond the disclosures suggested by the aforementioned proposed Statement of Financial Accounting Standards. Based on our reading of paragraphs 8.22 to 8.25, we believe that the disclosure requirements of these paragraphs apply to all investments held. However, we believe that the comparable disclosure requirements of the aforementioned Statement of Financial Accounting Standards apply only to certain investments.

c. Our comment regarding "Auditing Considerations" on pages 92 and 93, is similar to our comment 5(h) above.

d. We believe that the Appendix, on page 94, should discuss Statement of Financial Accounting Standards No. 121.

9. Chapter 9

a. Paragraph 9.02 indicates that property and equipment includes library books. From our experience, this is normally true of the cost of research library books, maintained by public libraries and colleges and universities, but not necessarily true of the cost of circulating library books maintained by public libraries. We believe that the cost of circulating library books is normally expensed due to the limited life of such books.

b. We disagree with the conclusion in paragraph 9.04 because we believe that, if such assets are not capitalized and depreciated over the life of the applicable contract, the periodic cost of the contract may be misstated. We are aware of a number of not-for-profit organizations, which receive government funding of projects that require the acquisition of fixed assets which remain the property of the government. These organizations treat these "assets" as other long-term assets (or deferred charges), with a contra credit to deferred revenue, on their balance sheets in order to account for the full transaction and to fairly present their income statements. These organizations normally assign the life span of the contract as the economic useful life of the asset and depreciate its cost over that period, recognizing an amount, equal to the depreciation, as income. We suggest that the proposed A&A Guide comment on this accounting.

c. We suggest that the accounting for property, described in paragraph 9.13, be discussed more directly. We believe that paragraph 9.13 is vague and somewhat convoluted.

d. Our comment, regarding "Auditing Considerations" on pages 99 and 100, is similar to our comment 5(h) above.

10. <u>*Chapter 10*</u>

a. We suggest that the term "routine performance," as used in paragraph 10.06, be defined. We also believe that examples would help to illustrate the guidance in this paragraph.

b. From our experience, the items listed in paragraph 10.09 are much too limited. There are many other contingencies which a not-for-profit organization may encounter.

c. Our comment, regarding "Auditing Considerations" on pages 103 and 104, is similar to our comment 5(h) above.

11. <u>*Chapter 13*</u>

Our comment, regarding "Auditing Considerations" on page 121, is similar to our comment 5(h) above.

12. <u>*Chapter 15*</u>

a. We commend the preparers on the inclusion of Chapter 15 in the proposed A&A Guide. We believe it will provide basic, useful guidance and tax awareness to auditors and preparers of financial statements.

b. The information in paragraphs 15.05 and 15.08 seems to address only not-for-profit organizations which are exempt from taxes under Section 501(c)(3) of the IRC. Organizations which are exempt from taxes under other IRC sections should also be considered, e.g. organizations which are exempt from taxes under Section 501(c)(6) of the IRC may lobby and benefit the private interests of their members. Accordingly, we suggest that these paragraphs be revised.

c. We believe that the second sentence may be inaccurate. Our understanding is that organizations, other than those that are exempt from taxes under Section 501(c)(3), are subject to these rules. Further, we suggest that this paragraph indicate that this a complex area, which may result in significant tax liabilities, and is difficult to audit.

d. We suggest that paragraph 15.11 indicate that, engaging in partisan political campaign activities, may result in the loss of the tax exemptions of public charities.

e. We suggest that paragraph 15.19 indicate that investment income, resulting from debt financed activities, may be considered unrelated business income.

f. We suggest that there should be some indication that not-for-profit organizations may be subject to certain local taxes.

g. We suggest that, under "Examples of Selected Control Procedures" and "Examples of Auditing Procedures," the term "Tax Returns" be revised to "Tax and Information Returns." Our understanding is that Form 990 is an informational return versus a tax return.

13. *Chapter 16*

a. We commend the preparers on the inclusion of the guidance in Chapter 16 in the proposed A&A Guide. We believe that it will provide very useful guidance for preparers and auditors of financial statements.

b. We suggest that paragraph 16.19 indicate where the assets and liabilities of agency (custodian) funds should be classified in the financial statements, i.e., temporarily restricted or unrestricted.

14. *Other*

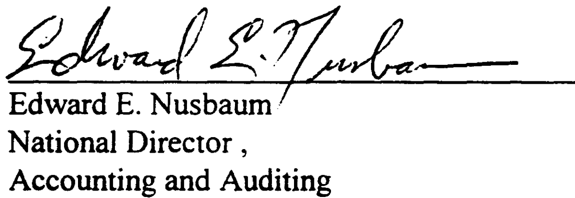
a We believe that illustrative financial statements, by type of entity (similar to the illustrative financial statements contained in SOP 78-10), would be useful to preparers and auditors of financial statements.

* * * * *

We would be pleased to discuss these matters with you further. If you have any questions of comments regarding the foregoing, please call the undersigned in our Firm's New York Office at (212) 599-0100.

Sincerely yours,

GRANT THORNTON LLP



Edward E. Nusbaum
National Director,
Accounting and Auditing

John J. O'Leary
Chairperson,
Exempt Organizations Committee

505 Third Avenue
New York, NY 10158-0142
212 599-0100
FAX 212 370-4520

Attachment

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July 5, 1995

GRANT THORNTON LLP Accountants and Management Consultants
The U.S. Member Firm of Grant Thornton International

Director of Research and Technical Activities
File Reference No. 147-C
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Sir:

We are pleased to submit our comments related to the Exposure Draft, dated March 31, 1995, of the Proposed Statement of Financial Accounting Standards (SFAS) -- Accounting for Certain Investments Held by Not-For-Profit Organizations.

GENERAL COMMENTS

Our Firm generally supports the issuance of the proposed SFAS.

ISSUES

Issue 1

We believe that the scope of the proposed SFAS should be expanded to include standards for measuring all investments held by not-for-profit organizations. While we are aware of the possibility of valuation problems with certain investments, we believe that the users of financial statements of not-for-profit organizations would be better served if all investments were valued at fair value in order to present all assets, under the stewardship of management, at fair value. Investments, whose fair value is not readily determinable, may be valued using quoted market prices of similar assets, market value appraisals, data related to recent purchases, and sales of comparable assets between unrelated parties, geological reports, replacement values, the present value of estimated future cash flows, and subjective valuations by the governing board based on appropriate documentary support, etc. (Reference is made to the valuation methods suggested in the AICPA Audit and Accounting Guide -- Audits of Investment Companies, and the SEC's Codification of Financial Reporting Policies).

Issue 2

We do not believe that the three categories of investments, used in SFAS No. 115, are necessary for not-for-profit organizations.

Issue 3
A not-for-profit organization should not report debt securities, that the organization has both the intent and ability to hold to maturity, at amortized cost, rather than fair value. We believe that this standard should not be based on the intent of management. If this standard is based solely on intent, the accounting would be subject to manipulation by management of the organization. Accordingly, we believe these investments should be recorded at fair value.

Issue 4
We believe that the flexibility, which the proposed SFAS would allow organizations to determine the amount of detail and the manner of presenting most required information, is appropriate.

Issue 5
For our experience, sophistication (and perhaps the size) of the particular organization determines if the information needed to make the required disclosures is readily available. We believe that the information required to be disclosed would generally be useful to the users of the financial statements of a not-for-profit organization.

Issue 6
We believe that realized gains and losses and unrealized gains and losses should be reported separately in the statement of activities, or otherwise disclosed, because the nature of realized gains and losses are significantly different from unrealized gains and losses.

Issue 7
We concur with the proposed standards, adopted by the Board, for reporting losses on investments of endowment funds.

SPECIFIC COMMENTS

1) Referring to paragraph 14(a), we suggest that the term "tolerance of investment risk" be defined in the Glossary in Appendix E.

2) Referring to paragraph 14(c), we suggest that the term "risk of physical loss" be defined in the Glossary in Appendix E. Further, is it the intention of the Board that risk of physical loss includes loss due to physical loss of certificates due to weaknesses in the controls over custody of the securities, loss due to misappropriation as a result of fraud, irregularities, defalcations, etc., and loss due to "acts of God"?

3) We believe that certain of the disclosures suggested by paragraph 14 will be difficult to audit, due to a lack of guidance in the current auditing literature, e.g. investment objectives, etc.

4) We believe that the term "investment income", referred to in paragraph 16(a), should be defined in the Glossary in Appendix E, or should be replaced by the term "interest and dividends". Many organizations consider investment income to include interest, dividends, and capital gains.

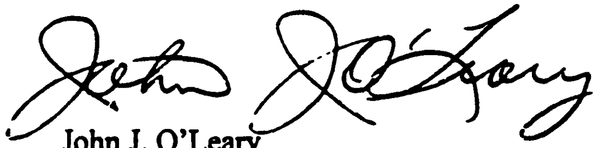
5) We understand that there is some confusion in the not-for-profit sector as to the applicability of SFAS 115, and of the proposed SFAS, to investments held by not-for-profit organizations. We are receiving many questions in our practice regarding the applicability of FASB Nos. 116 and 117 to certain organizations, e.g. trade associations and performing arts organizations. Many believe that, because these organizations do not receive contributions, they are not subject to FASB Nos. 116 and 117. We suggest that the definition in FASB No. 117 be clarified, sharpened, and focused, perhaps by the issuance of a Technical Bulletin. Further, we suggest that the Board elaborate on its applicability in the proposed SFAS.

****

We would be pleased to discuss these matters with you further. If you have any questions or comments regarding the foregoing, please call the undersigned in our Firm's New York Office at (212) 599-0100.

Sincerely yours,

GRANT THORNTON LLP



Edward E. Nusbaum
National Director,
Accounting and Auditing

John J. O'Leary
Chairperson,
Exempt Organizations Committee

KPMG Peat Marwick LLP

599 Lexington Avenue
New York, NY 10022

Telephone 212 909 5400

Telefax 212 909 6899

August 23, 1995

R- 9-11-95
151

Mr. Joel Tanenbaum
Technical Manager
File 3605 AG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, N.Y. 10036-8775

Dear Mr. Tanenbaum:

KPMG Peat Marwick LLP (KPMG) is pleased to respond to the Exposure Draft (ED) - Proposed Audit and Accounting Guide, Not-for-Profit Organizations, dated April 14, 1995. We commend the Not-for-Profit Organization Committee (NFP Committee) for their efforts in producing this ED in such a short period of time. The final Guide will provide much needed guidance in certain areas (e.g. Chapter 6 - Split Interest Gifts). We are, however, concerned that the ED has certain shortcomings which must be corrected to make it useful to practitioners and a step forward in improving the financial reporting of not-for-profit organizations.

Our major concerns include the following:

1. There is an unevenness in the document. Certain chapters - e.g. - Chapter 6 - Split Interest Agreements and Chapter 14 - Report of Independent Auditors are well-done. Other Chapters - most notably - Chapter 5 - Contributions Received and Agency Transactions, Chapter 8 - Investments and Chapter 13 - Expenses, Gains and Losses require extensive revision and/or addition of new material before the Guide is finalized. As now drafted, much of the guidance in those chapters will confuse preparers, auditors, and users of financial statements of not-for-profit organizations.

2. The ED adds a level of prescription to the financial reporting of not-for-profit organizations which is diametrically opposed to the basic thrust and spirit of FASB Statement No. 117 (Statement No. 117). In Statement No. 117, the FASB concluded that, generally, standards for presentation of the financial statements of not-for-profit

organizations should be no more stringent than they are for business enterprises. The ED violates that test because it adds a number of new highly prescriptive requirements to general purpose financial statements prepared under Statement No. 117. We understand that the rationale for such "amplifications" of Statement No. 117 is the perceived needs of certain practitioners and organizations for more specific rules to deal with the flexibility in format permitted by Statement No. 117. We believe Statement No. 117 as issued, with its minimum requirements, brings a high degree of discipline and uniformity to not-for-profit financial reporting. Operating within the provisions of Statement No. 117, organizations should be free to exercise judgment as to questions of format and not be proscribed by unnecessarily prescriptive Level B GAAP. If practitioners or organizations desire more specific guidance on format, that guidance should be included in either industry position papers, similar to those prepared by professional organizations in the college and university and community foundations sectors.

3. We appreciate that the scope and certain conclusions in Chapter 8--Investments result from a decision not to impinge on the current FASB deliberations on a proposed statement, Accounting for Certain Investments Held by Not-for-Profit Organizations (the FASB ED). However, the guidance in Chapter 8 needs to be clarified in certain areas, e.g., the accounting for certain investments in debt and equity securities held by trade and membership associations and labor unions and expanded in other areas, such as the issues related to the implementation of AICPA Statement of Position (SOP) 94-3, Reporting of Related Entities by Not-For-Profit Organizations, and the inconsistencies which persist in accounting for other investments not covered by the proposed FASB statement.

The body of our letter expands on these concerns focusing on chapters 5, 8, and 13 which, we believe, require extensive revision. Attachment 1 to our letter addresses matters of lesser concern which should be addressed during the revision of the ED. Attachment 2 addresses the issues raised in the separate section, Exhibit - Specific Issues for Comment, on page v of the ED.

Chapters of the Guide Requiring Extensive Revision

Chapter 5 - Contributions Received and Agency Transactions, which is one of the most important in the ED, is deficient in a number of respects. First, the guidance offered on distinguishing contributions from other transactions needs to be strengthened and clarified. In particular, Paragraphs 5.05 to 5.13, Agency or Intermediary Transactions need almost complete revision to address the following deficiencies.

- The discussion fails to address the fundamental questions involved in determining whether certain transfers of resources are contributions. Does the recipient of the resources have an asset as that element of financial statements is defined in FASB

Concepts Statement No. 6, Elements of Financial Statements (Con 6)? If so, does the recipient simultaneously also have a liability as that element is defined in Con 6?

- The entire section, generally, and paragraph 5.05, in particular, use very loose language in defining and describing transactions. The term "agent" is used to describe situations far beyond the common legal definition of an agent. The term "intermediary" is used without being defined. Finally, the two terms-"agent and intermediary"-are used interchangeably when, for most purposes, they have different meanings.

- The entire section does not address the issue of transfers of resources to community foundations which are subject to a variance power. For example Table 5.1, Indicators Used for Distinguishing Contributions from Agency Transactions, does not address the variance power. Moreover, paragraph 5.08 includes eight examples illustrating how the indicators in Table 5.1 would be applied - none of the examples address community foundations and their variance power. The discussion in paragraphs 5.09 and 5.10 is limited to federated fund-raising agencies. There are material differences between the characteristics of transfers of resources to community foundations and federated fund raising agencies.

We appreciate that AICPA, recognizing certain of these deficiencies, asked the NFP committee to add in a separate section of the ED, Exhibit-Specific Issues for Comment, a brief discussion of the variance power and donor-advised provisions and asked respondents to comment on the accounting for resources received under agreements that have these provisions. Attachment 2 to our letter separately addresses these issues. In addition, at a meeting on May 31, 1995, the FASB agreed to issue a Staff Technical Bulletin interpreting paragraph 4 of FASB Statement No. 116 (Statement No. 116) as it applies to the variance power of community foundations. The final Guide needs to incorporate the guidance issued by the FASB staff as well as input received from respondents on Specific Issue # 1.

We appreciate that the NFP Committee is offering guidance based on its interpretation of paragraph 4 of Statement No. 116. The discussion in paragraphs 5.05 to 5.13 demonstrates the need for FASB to reconsider paragraph 4 and paragraphs 52-54 of Statement No. 116. Clearly the FASB needs to clarify what it meant by the discretion discussed in those paragraphs After such clarification and/or amendment of Statement No. 116, the final Guide should mirror FASB's revised conclusions.

Our final concern with this chapter relates to paragraph 5.62 of the Auditing section. That paragraph notes that "confirmation of accounts receivable is a generally accepted auditing procedure and there is a presumption that the auditor will request the confirmation of accounts receivable except under certain specified circumstances". The paragraph indicates that Statement of Auditing Standards (SAS) 67 does not include contributions receivable in its definition of accounts receivable. Based on that definition, the ED concludes:

> ..... Contributions receivable are not accounts receivable to which that presumption would apply .....

Notwithstanding that conclusion, we believe a presumption that contributions receivable will be subject to confirmation procedure should be present for the following reasons. The rationale set forth for not confirming (i.e. on the basis that "contributions" receivable are not "accounts" receivable as defined in the SAS) is a very tenuous one. It would appear that the SAS 67 definition of accounts receivable, like much of the professional auditing and accounting literature issued prior to Statements No. 116 and 117, was primarily written with business enterprises in mind. In the not-for-profit environment where contributions may be the principal source of financial support (and very much the counterpart of sales of goods in for-profit entities), we think there is ample rationale for considering such items as the equivalent of the SAS 67 "accounts" receivable.

Moreover, the absence of a presumption to confirm contributions receivable may seriously impact practice and increase the difficulty and risk of auditing not-for-profit organizations. Indeed, it has been found in recent practice that some donors may not clearly understand the firm nature of contribution commitments. Confirmation of contributions receivable held by not-for-profit organizations has always been a sensitive process. Organizations have been fearful that sending confirmations to donors will offend them. Confirmation, however, has proven to be an effective procedure in providing information useful to the auditor in assessing the existence of such receivables. We recommend that the presumption of SAS 67 be made applicable to contributions receivable. That should be accomplished in the simplest way possible, either through a technical amendment of SAS 67 or a conclusion in the Guide that confirmation of contributions receivable is presumed to be necessary unless the auditor can justify that it will not be effective or there are more effective alternative procedures (this would include adding confirmation to the chart on page 52 as an example of auditing procedures).

Chapter 13 - Expenses, Gains and Losses

Chapter 13 of the ED includes many very prescriptive requirements that go beyond the specific requirements of Statements No. 116 and 117. The intent throughout the chapter appears to be to limit preparer and auditor judgment as a way of ensuring uniformity. The result, however, is a set of highly confusing prescriptive rules, which are open to

alternative interpretations and produce information of dubious value to users of the financial statements of not-for-profit organizations. Moreover, implementation of many of these rules may be costly without any commensurate benefit.

Paragraph 13.22 and the entire section, Functional Reporting of Expenses, contain provisions which significantly modify Statements No. 116 and 117. Specifically, the requirement in paragraph 13.22 to somewhere functionalize investment expenses netted directly against investment revenue is inconsistent with the treatment required under Statement No. 117. It is also confusing whether this paragraph is limited to voluntary health and welfare organizations or is applicable to all organizations. The paragraph uses the phrase "separate statement that reports information about expenses by their natural classification". Is that phrase intended to apply, for example, to a college or university that presents expenses by natural classification either on the face of the statement of activities or in a note thereto?

Similarly, we object to the requirement of paragraph 13.24 that:

> "information about all expenses should be provided by their functional classification, regardless of where they are reported in a statement of activities"

The requirement to somehow get to total expenses by function is not in Statement No. 117. In fact, this requirement is contrary to the objective of that Statement to foster flexibility in reporting information about an organization's activities and service efforts and to the suggestion (see footnote 6 to paragraph 27 of Statement No. 117) that reporting can be enhanced by showing revenue/expense relationships directly in the statements. Moreover, the requirement (as illustrated in paragraphs 13.25 and 13.26) will confuse users by introducing financial statements that do not articulate. It should be deleted.

Paragraphs 13.28 and 13.29 also misconstrue and misinterpret Statement No. 117. For example, in paragraph 13.28, Statement No. 117 is not quoted accurately. In Statement No. 117, major classes of programs and activities are cited as examples of functional classifications, but not necessarily the only possible ones as this section of the Guide states. Also, Statement No. 117 includes no requirement similar to paragraph 13.29 that total program costs be disclosed. Certain types of not-for-profit organizations now allocate expenses functionally without coming to total program costs and total support costs. Users have not complained about the absence of such totals because the division of costs into program and supporting categories, while a key indicator for users in certain sectors (principally charities largely supported by contributions), is in other sectors (e.g., colleges and universities) not viewed as important. In these latter types of organizations, which are largely supported by fees for services, other methods of functionalizing expenses have proved more informative to users. Absent research to the contrary, we see

no reason why the Guide should change these practices. We agree with those who believe that the development of definitions of functions is best left to industry groups (consisting of preparers, users and auditors). We agree with the notion that the overall standards for not-for-profit organizations should be similar and believe Statements No. 116 and 117 achieve that objective. Within that common framework, however, it is appropriate for there to be differentiation between industry segments based on the nature of activities and user needs. Functionalization of expenses to meet the requirements of paragraphs 26 to 28 of Statement No. 117 is an area where such differentiation is appropriate.

We have the same philosophical problem with the requirements of paragraphs 13.31 and 13.32 to disclose the totals of "management and general activities" and "fund raising", respectively. Again, we believe the ED strives for a uniformity in treatment among all not-for-profit organizations which is neither present in fact nor helpful to users of financial statements. The net result is a loss of information and poorer financial statements. For example, we question whether "management and general" is a necessary or desirable category in an academic setting where there is both academic administration (e.g., departmental chairmen, deans) and general administration (e.g. controller, financial v.p.). The current division between academic support and institutional support should be retained. Such division would clearly be permitted under the flexibility permitted in Statement No. 117. To proscribe it, which is the result of the highly prescriptive guidance of paragraph 13.31, illustrates how at odds the ED is from FASB's overall objective in Statement No. 117.

Chapter 8 - Investments

Investments is an important area for many not-for-profit organizations. Unfortunately, it is currently often an area of confusion due to the differences in accounting treatments in the three existing audit guides as well as the options available within each guide. We appreciate that the current FASB project on investments imposes certain limits on AICPA. The FASB project notwithstanding, we believe that Chapter 8 needs to be clarified or expanded in the following areas.

- Footnote 2 in Chapter 1 discusses the exclusion of certain organizations, such as country clubs, trade and membership associations and labor unions from the definition of not-for-profit organizations and indicates that:

> "entities that do not meet the FASB Statement No. 117 definition of a not-for-profit organization but are nevertheless required to follow this Guide should follow the guidance on accounting and reporting for investments included in FASB Statement No. 115 rather than the guidance included in Chapter 8 of this Guide to the extent

that the guidance in Chapter 8 conflicts with the guidance in FASB Statement No. 115."

Based on remarks by a FASB representative at the AICPA not-for-profit organizations conference this July and informal discussions with FASB staff, it is not clear that FASB is in agreement with this view. Moreover, we do not agree that all trade and membership associations and labor unions do not, per se, fall within the Statement No. 117 definition of a not-for-profit organization. FASB and AICPA in finalizing the Guide, need to jointly clarify guidance in this area. We would recommend that trade and membership associations and labor unions follow the guidance that results from finalization of the FASB ED.

- SOP 94-3, Reporting of Related Entities by Not-For-Profit Organizations has the same effective date as Statements No. 116 and 117. Our experience, to date, suggests that SOP 94-3 will provide as many, if not more, implementation issues than Statements No. 116 and 117. Unfortunately, matters related to this SOP are excluded from the scope of Chapter 8. Not-for-profit organizations and their auditors need guidance on such issues as the presentation of the separate component of equity related to investments when consolidating a for-profit subsidiary that has adopted FASB Statement No. 115. In addition, many large not-for-profit organizations hold majority interests in for-profit entities in their permanently restricted endowments. Not-for-profits may receive majority interests in operational real estate and oil and gas ventures as contributions to permanently restricted endowment funds. Chapter 8 does not address the issues involved in displaying such operating ventures that are part of permanently restricted endowments. We recommend that Chapter 8 be expanded to present guidance for these complex investments.

- Chapter 8 of the ED continues the guidance for investments not covered by the FASB ED in the three current audit guides. Besides resulting in three sets of inconsistent rules, this decision continues practices that in many cases are archaic and potentially misleading. In the absence of FASB guidance, we recommend that AICPA undertake in the near future, a project to improve guidance in this area.

Conclusion

We appreciate this opportunity to comment on the ED and hope AICPA finds our comments helpful. If there are any questions or a need to clarify any matter discussed in our letter, please contact Herb Folpe at (212) 909-5534.

Very truly yours,

KPMG Peat Marwick LLP

Other Comments

We present the following comments by Chapter.

Chapter 1:

Paragraph 2.15 discusses the elements of internal control as described in SAS 55. As SAS 55 is being amended to include COSO definition of internal controls, we recommend that this section be updated consistent with COSO.

Footnote 2 discusses the Student Financial Aid Guide. This guide was revised in June 1995, and the reference should be updated to the Compliance Audits (Attestation Engagements) of Federal Student Financial Assistance Programs at Participating Institutions.

Chapter 3

Paragraph 3.15 discusses reporting of expenses by organizations that do not meet the definition of not-for-profit organizations in Statement No. 117. We recommend that this discussion be expanded to indicate that such an organization, choosing not to report expenses by function, should use only a natural classification and not a combination of functional and natural (as discussed at the AICPA conference.) The NFP committee should also consider if this discussion is properly placed in Chapter 3 or should be moved to Chapter 13.

Chapter 4

The discussion of original maturity in footnote 1 should indicate that it is the original maturity to the entity holding the investment as explained in footnote 2 to SFAS 95.

Chapter 6

Paragraph 6.24 deals with a perpetual trust held by a third party. The last sentence of this paragraph indicates that "adjustments to the amount reported as an asset, based on an annual review using the same basis as was used to measure the asset initially (emphasis added), should be recognized as permanently restricted gains or losses." It is unclear why the emphasized language is necessary. Generally, the initial recording of the asset will be based upon valuations provided by a third party and subsequent revisions to the carrying value will also be based upon information provided by the third party. It is not clear whether the emphasized language requires something more than this. If it does, it should be clarified. If it doesn't it should be eliminated. Perhaps the last sentence should be

revised to read:" Adjustments to the amount reported as an asset should be made at least annually based upon information provided by the third party holding the assets."

Chapter 10

Paragraph 10.03 is the only place in the Guide where SFAS 109 is mentioned. We recommend that SFAS 109 be addressed in Chapter 15.

Attachment 2

Specific Issues for Comment

Issue 1: Variance Power and Donor-Advised Provisions

Question: Does variance power provide not-for-profit organizations with sufficient discretion to recognize resources received as contributions? Does the not-for-profit organization's history of exercising its variance power affect the answer to this question?

Response:

Transfers of resources to designated funds of community foundation which are subject to the foundation's variance power should be accounted for as contributions. The variance power, which is included or incorporated by reference in the written statement establishing designated funds, vests community foundations with immediate control and discretion over designated funds at the time the funds are transferred to them. As required by Treasury regulations, community foundations possess the variance power at all times with respect to all funds held by them from the moment of inception of such funds. The exercise of the variance power is at the sole discretion of the community foundation; it is not within the control of the designated beneficiary.

Community foundations have in place governing structures which include, in most cases, a distribution committee of the Board. That body is charged with reviewing community needs and aligning the foundation's grant policy with those needs. In exercising that responsibility, the distribution committee or similar body in a community foundation may consider exercising the foundation's variance power to redirect all or a portion of a designated fund's income.

The frequency with which the variance power is exercised differs among community foundations. The existence of the power rather than the frequency of its use is the relevant factor in answering the question posed for the following reasons:

- The variance power is included in each gift instrument and is agreed to by the donor.

- In certain cases, it may well be the reason the donor has given the contribution to the community foundation rather than the designated charity.

- The variance power imposes on community foundations an important supervisory responsibility to monitor individual grants and their relationship to overall community needs.

We believe the variance power is similar to the power, recognized by the FASB in Statement No. 117 to spend net appreciation on gifts to permanently restricted

endowments. The treatment in Statement No. 117 is to reclassify such appreciation to other unrestricted or temporarily restricted net assets based solely on the power granted the board to expend such appreciation under certain circumstances. FASB explicitly rejects the notion that the frequency of spending such appreciation should enter into the accounting for such appreciation. We agree and believe the variance power issue should be similarly resolved.

Giving accounting recognition to the variance power also affects the classification of contributions of designated funds. Such funds should be classified as unrestricted rather than temporarily restricted to accurately reflect the nature of the contribution made.

Question: Do donor-advised provisions, in combination with variance power provide not-for-profit organizations with sufficient discretion to recognize resources received as contributions? Does the not-for-profit organization's history of deviating from the resource provider's advice affect the answer to this question?

Response:

When a donor creates a donor-advised fund within a community foundation , the donor is granted a privilege, not a right, to suggest uses for the distribution of income from the fund. As a result, donor advised funds are by definition unrestricted, i.e. they do not have a particular purpose other than to carry out the general charitable mission of the community foundation. As such, the community foundation can use such funds as its governing body sees fit. Accordingly, the variance power does not come into play with these funds and is irrelevant in this situation.

Question: Can the accounting for the income from resources that must be retained in perpetuity differ from the accounting for the resources held in perpetuity? For example, can the receipt of resources that must be retained in perpetuity be accounted for as a contribution if the income from the resource is accounted for as an agency transaction.

Response:

We believe that the accounting may differ for the two transactions; however, we see no reason for such divergence. Moreover, the accounting suggested by the question would unnecessarily confuse readers and is also conceptually unsound. It suggests that an entity holds a resource which should be given recognition as an asset, but that cash flows from such an asset are the asset of another entity. We believe such a notion of an asset is self-contradictory and at variance with FASB Concepts Statement No. 6.

Issue 2: Financial Aid Provided by a College and University

Question: AcSEC believes that not all financial aid provided by a college and university is a tuition discount. For example, benefits provided in exchange for services, such as free tuition for employees, are expenses rather than discounts. However, the proposed Guide is silent concerning this issue. Respondents are asked to comment specifically on this issue and whether the Guide should be silent concerning it.

Response:

We concur with AcSEC that not all financial aid provided by a college and university is a tuition discount. We understand that the Natural Association of College and University Business Officers (NACUBO) has formed a special committee to address this issue. We believe that the final Guide should incorporate the guidance developed by the college and university community.

GAILE M. PARENT
Retired

ROBERT W. DOTT
Retired

JOHN A. HAIDER
President

STANLEY P. SCHIERECK
Vice President-Taxation

DOUGLAS S. MATHISON
Vice President-
Audit/Accounting

KENNETH L. O'CONNELL
Supervisor

LARRY E. WINTER
Supervisor

DANIEL C. BARTELT
Supervisor

DEBRA L. TOWNE
Secretary/Receptionist/
Computer Operator

CAROL L. WETZEL
Data Processing

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R-9-11-95

September 8, 1995

Mr. Joel Tanenbaum
Technical Manager
File 3605.AG
AICPA Accounting Standards Division
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Joel:

Thank you for the information you provided regarding the Not-For-Profit exposure draft. As I stated in our conversation, I am having some problems with paragraph 6.10 relating to charitable remainder trusts where the assets are held by third parties. We have this situation with our clients and I think it will be very difficult to obtain the information necessary (beneficiary age, payment terms, investment returns, etc.) to calculate the present value. Historically, we have been informed of these arrangements on a hit and miss basis, with minimal information. Obtaining detail information relating to the beneficiary(s) has generally been very difficult if not impossible. In addition, there may be other charitable remainder trusts established where we would not be informed that we are the remainder man until the death of the donor.

I am also concerned that we will be required to take on additional responsibility regarding the third party trustee. If our client is showing a material receivable as a result of the charitable remainder trust will we have to perform audit procedures similar to third party trustees of client owned investments?

It seems to me it may be more practical to show potential future contributions from charitable remainder trusts through footnote disclosure only.

The information relating to appropriate discount rates discussed in 5.52 through 5.55 would be very much enhanced if examples could be provided. These examples should include situations in which a risk-free rate would be determined to be appropriate and an example when a higher rate would be determined.

I think the exposure draft is excellent. As always, I would like to have more specific examples of how to handle various situations, however, I realize that it is difficult to develop these.

Sincerely,

PARENT, DOTT & COMPANY, LTD.

Doug

Douglas S. Mathison, CPA

CORNER OF NORTH SPRING & WEST THIRD • POST OFFICE BOX 516 • BEAVER DAM, WISCONSIN • 53916-0516
TELEPHONE 414-885-3388 • FAX 414-885-5008
MEMBER OF AICPA DIVISION FOR CPA FIRMS - PRIVATE COMPANIES PRACTICE SECTION AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS/WISCONSIN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Colorado Society of
Certified Public Accountants

September 1, 1995

(153)
9-11-95

Joel Tanenbaum, Technical Manager
File 3605.AG, Accounting Standards Division
American Institute of CPA's
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Tanenbaum:

Below are comments developed by the Not-for-Profit Committee of the Colorado Society of CPA's on the **Exposure Draft - Proposed Audit and Accounting Guide for NOT-FOR-PROFIT ORGANIZATIONS.**

Issue 1:

Donee variance power does seem to provide sufficient discretion to recognize resources as contributions, provided the expenditure of resources is in furtherance of the not-for-profit (NFP) organization's tax exempt purpose.

Donor advised provisions, in combination with donee variance power, do seem to provide NFP organizations with sufficient discretion to recognize resources as contributions, provided a history of donee control over resources received exists. This history could be obtained by reviewing past deviations from donor advice.

We do not believe there can be a difference in accounting for resources retained in perpetuity. Recording such resources as an asset and net assets would be misleading as there is and never will be any benefit to the organization. When the percentage benefit to the organization is greater than zero but less than 100%, we believe some proportionate amount of the assets should be recognized as contributions, as the organization now has an economic interest in the future income stream from the assets. We suggest use of 50% as a cut-off, as frequently control over assets is determined at that threshold.

7979 East Tufts Avenue, Suite 500 Denver, Colorado 80237-2843
303/773-2877 800/523-9082 FAX 303/773-6344

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Chapter 1:

This chapter would be better understood if clarification was provided as to what organizations this guide applies to; this fact should be stated initially and concisely. Address the issue of when an organization receives a "significant" portion of charitable revenue; could this include exchange transaction revenue from governmental grants, etc.

Explain inconsistencies between NFP's under FASB 117 and other NFP's. Give guidance toward other Audit Guides for NFP organizations not covered here.

Chapter 2: No comments

Chapter 3:

¶3.02 - We recommend financial statement examples such as from the FASB 117 Training Manual.

¶3.03 - Use of term "long-term purposes" should be defined further.

¶3.18 - Using the term "acquisition" implies that there has been a purchase of tangible assets. We suggest you investigate an alternative phrase, such as "acquisition or otherwise obtained".

Chapter 4: No comments

Chapter 5:

In presenting agency transactions in the statement of financial position, it is unclear which net asset classification is appropriate in a multi-columnar format - unrestricted or temporarily restricted.

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Chapter 5 (Cont'd):

¶5.12 - ¶5.13 - we suggest an alternative be allowed to record contribution revenue when items are sold or consumed with appropriate disclosure of this accounting policy in the footnotes. This is intended to lessen the clerical burden the paragraph may impose.

¶5.27 - Additional guidance is requested in distinguishing between conditions and restrictions. The example provided at the bottom of the paragraph struck the committee as a restricted grant - not conditional since the expenditure(s) were within the control of the NFP organization.

Further guidance is requested in how to handle accounting matters within related foundations. Are contributions received by a related foundation agency transactions on the foundation's books? When can a related foundation record contribution revenue? Does the existence of fiduciary responsibility for assuring proper adherence to donor restrictions change the determination of when to record contributions versus agency liabilities?

An audit risk item would surround material amounts of agency transactions. This may be an indicator of additional regulatory and tax reporting requirements such as receipting, etc. There should be a clear and unambiguous understanding by the NFP organization and its auditor on the nature of agency transactions.

Chapter 6:

There is concern about materially different results that could be recorded based on varying discount and mortality assumptions. The discussion in ¶5.54 about discount rates provides little guidance. Consider restating highlights of ¶12 of APB Opinion #21 in this chapter.

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Chapter 6 (Cont'd):

Concerning sources for mortality information, we suggest the guide give specific directions of how to obtain IRS mortality tables. Also, the guide should discuss when and if a not-for-profit organization should engage an actuary to assist in these calculations.

Additional guidance is requested concerning exactly what portion of a gift in trust should be recorded as contribution income and what portion should be recorded as a liability. Would the contribution portion equal the charitable tax deduction allowed the donor with the difference going to the liability account? The guide may want to mention the availability of computer programs to calculate these figures and if the program's results would be acceptable support for accounting entries.

¶6.06 - consider allowing NFP organizations to record assets placed in revocable noncharitable remainder trust arrangements at cost or even a negligible value. In many cases the NFP organization will not be provided market values or even cost values and may not have the resources to engage an appraiser to value of these types of assets - at inception or during the trust's subsequent life. The type of trust we are describing here would be a grantor type living trust which many religious organizations administer and/or trustee in quantity.

¶6A.46 - Consider accounting for the pooled income fund gift the same as a charitable remainder trust gift. Drop the deferred revenue approach. In essence, the two types of arrangements are similar. In fact, many unitrust arrangements are limited to income also.

¶6A.42 - Recognizing investment income earned by an external trustee could be misleading. Consider recording cash received as a decrease in the asset Beneficial Interest in Perpetual Trust. Annually revalue the beneficial interest through an adjustment to Change in Value of Split-Interest Agreements under the theory that the NFP has only an income interest in the trust.

Chapter 7:

¶7.07 - If purchases and contributions are addressed, then items otherwise acquired (such as archaeological finds) by the NFP entity that increases the collection should be addressed.

Chapter 8:

We suggest the Uniform Management of Institutional Funds Act (UMIFA) be described in the chapter along with the Act's implications. An audit procedure would be to confirm the domicile State's adoption of UMIFA and the Board's interpretation of the Act.

¶8.22 - Commentary such as "tolerance of investment risk" creates an opportunity for ambiguity and confusion. Note E on page 70 of FASB 117 makes no attempt to define "tolerance of investment risk", "policies limiting turnover", "circumstances leading to a change, if any, in those objectives or policies".

¶8.22 - ¶8.25 - Since Note E on page 70 of FASB 117 only addresses part of the disclosure requirements, we suggest the AICPA develop an appendix item showing an exhaustive example of the footnotes and disclosures described.

¶8.26 - One audit procedure should be to test and confirm proper classification of investment return (unrestricted, temporarily restricted or permanently restricted) on permanently restricted net assets.

¶8A27 - ¶8A29 - Why develop different ways for different types of NFP organizations to report "other" investments? Develop a method and apply it to for ALL NFP organizations for consistency's sake. Consider allowing either FMV or lower of cost or FMV accounting for ALL NFP organizations as long as the method selected is clearly explained in the footnotes and applied consistently for all "other" investments.

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Chapter 9:

¶9.04 - Further guidance is sought for property and equipment held by not for profit organizations under federal award programs. What portion should be reflected as unrestricted, temporarily restricted or permanently restricted.

Chapter 10: No comments

Chapter 11: No comments

Chapter 12:

Consider including government contracts as an example of an exchange transaction.

¶12.05 - The determination that "certain types of financial aid" should be netted against revenues is not clear. What types of financial aid would be appropriate to net against tuition revenue?

Chapter 13:

¶13.07 - Address in this guide which expenditures could be considered prepaid (if any) and which expenditures must be expensed. In the case of a special fundraising event, we believe incremental costs incurred related to that special event should be shown as prepaid until the event happens.

¶13.40 - We found the requirement to breakout payments to affiliates by functional classification to be problematic. To plug all unallocated affiliated payments as supporting service could create a misleading measure of operational efficiency (or rather, inefficiency). Cannot payments to affiliates simply be described as functional programs unto themselves? Presumably, a portion of the NFP organization's tax exempt purpose would be to "upstream" revenue to carry on international, national or outside regional activities. We can see the logic threading through the approach but cannot develop a way to overcome the potential problems such as a lack of breakout of expenditures from the affiliates, etc.

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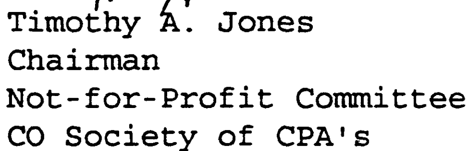
Chapter 14: No comments

Chapter 15: No comments

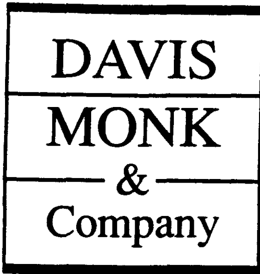
Chapter 16: No comments

In closing, we congratulate the AICPA Not-for-Profit Organizations Committee on its exhaustive undertaking. There has obviously been a great deal of time, energy and thought put into this proposed audit and accounting guide. We hope you find our comments helpful. Please let us know if you have any questions or need anything else. We look forward to receiving the guide in its final form.

Sincerely,



Timothy A. Jones
Chairman
Not-for-Profit Committee
CO Society of CPA's



Certified Public Accountants

A Partnership Consisting of Professional Associations

Mailing address:

P.O. Box 13494
Gainesville, Florida 32604

Location:

4010 N.W. 25th Place
Gainesville, Florida 32606

Phone:

(904) 372-6300
(800) 344-5034

Fax:

(904) 375-1583

Members:

Accounting Firms Associated, inc.

Florida Institute of Certified Public Accountants

American Institute of Certified Public Accountants

Alliott Peirson International

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R - 9-11-95

September 5, 1995

Mr. Joel Tanenbaum
Technical Manager
File 3605.AG
Accounting Standards Division
American Institute of CPAs
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Tanenbaum:

I would offer the following comments relative to the exposure draft for the proposed Audit and Accounting Guide for Not-for-Profit Organizations.

Overall, I support the issuance of the document and feel that it will be an improvement over the numerous standards that are in effect at the present time. However, there are a couple of areas that cause concern.

In Paragraph 5.62, the Guide makes reference to SAS No. 67, the confirmation process, and indicates that based on the definition contained therein, that "contributions receivable are not accounts receivable to which that presumption would apply." This paragraph deals with the necessity to confirm accounts receivable and whether contributions receivable or unconditional promises to give would be treated in the same manner. While SAS No. 67 does not specifically address these types of receivables, I can assure you that the task force that wrote SAS No. 67 probably would have included such items had SAS 67 been written after the new guide. I believe that clearly such receivables should fall under the definition and be subject to the same confirmation requirements as any other receivables.

If you will refer to SAS 67, you will note that the definition was intentionally made broad, even to include loans of financial institutions. That reference was specifically made not to exclude other types of receivables, but because we knew that there were problems related to loans not being confirmed. Certainly to exclude specifically these types of receivables would fly in the face of the intent of SAS No. 67.

Mr. Joel Tanenbaum
Technical Manager
File 3605.AG
Accounting Standards Division
American Institute of CPAs
September 5, 1995

Further, I am concerned that the new guide only makes reference to SOP 92-7, relative to reporting language for not-for-profit organizations receiving government financial assistance. SOP No. 92-7 is out-of-date since it has not been updated for the 1994 Yellow Book. Accordingly, unless 92-7 is superseded by an updated document, the new audit guide will be making references to outdated and inappropriate reports.

Thank you for your consideration of these matters.

Sincerely,

DAVIS, MONK & COMPANY

Harold L. Monk, Jr., C.P.A., P.A.
Managing Partner

HLM:wfb

xc: Auditing Standards Division

ERNST & YOUNG LLP

787 Seventh Avenue
New York, New York 10019

Phone: 212 773 3000

155
R- 9/13/95

September 13, 1995

Mr. Joel Tanenbaum
Technical Manager
Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Proposed Audit and Accounting Guide,
"Not-for-Profit Organizations"
(File 3605.AG)

Dear Mr. Tanenbaum:

We are pleased to provide comments on the above-referenced proposal. We support the issuance of the proposed Audit and Accounting Guide (the Guide). The Guide will provide useful implementation guidance relating to FASB Statements No. 116, *Accounting for Contributions Received and Contributions Made*, and No. 117, *Financial Statements of Not-for-Profit Organizations*, and therefore should be issued as soon as practicable. Our responses to the two specific issues raised in the Exposure Draft (ED) follow.

Issue 1

Does variance power provide not-for-profit organizations with sufficient discretion to recognize resources received as contributions? Does the not-for-profit organization's history of exercising its variance power affect the answer to this question?

Variance power permits an organization, such as a community foundation, to withhold or modify distributions to another organization if, in the sole judgment of the organization, those distributions have become unnecessary, incapable of fulfillment, or inconsistent with the needs of the community. Because of the ability to exercise this discretion over the distribution of funds, we believe that the existence of variance power is sufficient to allow organizations to recognize resources received as contributions, regardless of whether the organization has a history of exercising its variance power. The sole purpose of many organizations is to raise funds to support other charitable organizations. Community foundations generally have variance power over the distribution of funds received. If treatment as a contribution were to be prohibited, the success of such organizations in raising funds would not be accurately reflected in the financial statements.

Do donor-advised provisions, in combination with variance power, provide not-for-profit organizations with sufficient discretion to recognize resources received as contributions?

Does the not-for-profit organization's history of deviating from the resource provider's advice affect the answer to this question?

Because "donor-advised" provisions, as opposed to the more rigid "donor-imposed" restrictions, also allow an organization to exercise discretion over the use of funds received, we believe that recognition as a contribution is appropriate, regardless of whether the organization has a history of deviating from the resource provider's advice.

Can the accounting for the income from resources that must be retained in perpetuity differ from the accounting for the resources held in perpetuity? For example, can the receipt of resources that must be retained in perpetuity be accounted for as a contribution if the income from the resources is accounted for as an agency transaction?

We believe that resources that must be retained in perpetuity and income from those resources are inseparable and that the accounting should therefore be consistent.

Issue 2

Should the Guide provide guidance on accounting for financial aid provided by colleges and universities?

The Guide does not address the accounting treatment of financial aid provided by a college or university. We believe that this is appropriate because financial aid is a very narrow issue and discussion in the Guide is not necessary. However, if AcSEC decides to include accounting guidance for financial aid, we believe that in some circumstances, financial aid should be treated as an expense. For example, in the case of benefits being provided in exchange for services, the fair value of the services provided, if material, should be treated as an expense, because the college or university would have had to pay someone else wages for the services provided.

As proposed, the effective date of the Guide would be for periods beginning after June 15, 1995 (December 15, 1995 for organizations with less than $5 million in total assets and less than $1 million in annual expenses). In light of current expectations regarding when the final Guide will be issued, we believe the effective date of the Guide should be delayed until years beginning after June 15, 1996. This will give all organizations sufficient time to analyze the provisions of the Guide and evaluate its effects on their financial statements.

Attachment A to this letter includes our comments on other specific issues.

We appreciate the opportunity to present our views on the ED and would be pleased to discuss our letter with AcSEC or the AICPA staff at your convenience.

Very truly yours,

Ernst + Young LLP

Attachment A

"Not-for-Profit Organizations"

Other Comments on Specific Issues

Reference	Discussion
Paragraph 4.03	Consistent with Statement 117, this paragraph indicates that cash that is subject to donor-imposed restrictions should not be classified on a statement of financial position with assets that are available for current use. We believe cash that the Board or management has designated for future use (e.g., for future capital expansion or retirement of long-term debt) also should be reported separately as a non-current asset and the nature of the internal limitation should be separately disclosed. Our view is consistent with Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*, that states, "(t)his concept of the nature of current assets contemplates the exclusion from that classification of such resources as: (a) cash and claims to cash which are restricted as to withdrawal or use for other than current operations, are designated for expenditure in the acquisition or construction of noncurrent assets, or are segregated for the liquidation of long-term debts ... ."
Chapter 5	Statement 117 states in paragraph 22 that gains and losses on investments and other assets should be recognized "as increases or decreases in unrestricted net assets unless their use is temporarily or permanently restricted by explicit donor restrictions *or by law*." Chapter 5 of the Guide provides guidance on donor-imposed restrictions, but provides no guidance on restrictions imposed by state law (e.g., the Uniform Management of Institutional Funds Act (the Act), which has been adopted by a number of states). In paragraph 129 of Statement 117, the FASB concluded that a definitive interpretation of the Act was not "necessary or critical." Paragraph 131 further states, "the Board has no reason to believe that governing boards will interpret similar facts and circumstances, including state statutes, in significantly differing ways." However, recent experience has indicated that state laws are, in fact, being interpreted differently by governing boards, attorneys, etc. for similar situations. Because of these inconsistencies, we believe that consideration should be given to providing auditing guidance for audits of entities subject to restrictions imposed by state law (e.g., are interpretive letters from attorneys necessary and in what circumstances?).

Chapter 6

This chapter addresses the accounting for split-interest agreements. There are many variables to consider in measuring the contributions to be received under a split-interest agreement (e.g., valuation of assets contributed to a trust that is shared with other beneficiaries, the number of other beneficiaries, and the number of years the agreement covers). In addition, practical problems exist when investments are managed by a third party, such as a trustee. For example, an organization may have difficulty receiving timely information necessary for presentation in its financial statements and may encounter problems in determining the valuation of assets to be received. We recommend that AcSEC provide additional guidance for dealing with these implementation issues.

Chapter 9

Reference should be made in this chapter to FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, as it relates to not-for-profit organizations. Likewise, the exhibit illustrating auditing objectives, selected control procedures, and auditing procedures for financial statement assertions about fixed assets should include a discussion of the factors that the auditor should consider to determine whether and to what extent impairment of fixed assets exists.