



Does your Not-for-Profit Organization have income-producing funds that support operations?

Do you understand the new guidance, including the reporting and disclosure rules, about these funds?

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*Not-for-Profit Informational Session
Providence Marriott
March 5, 2009*

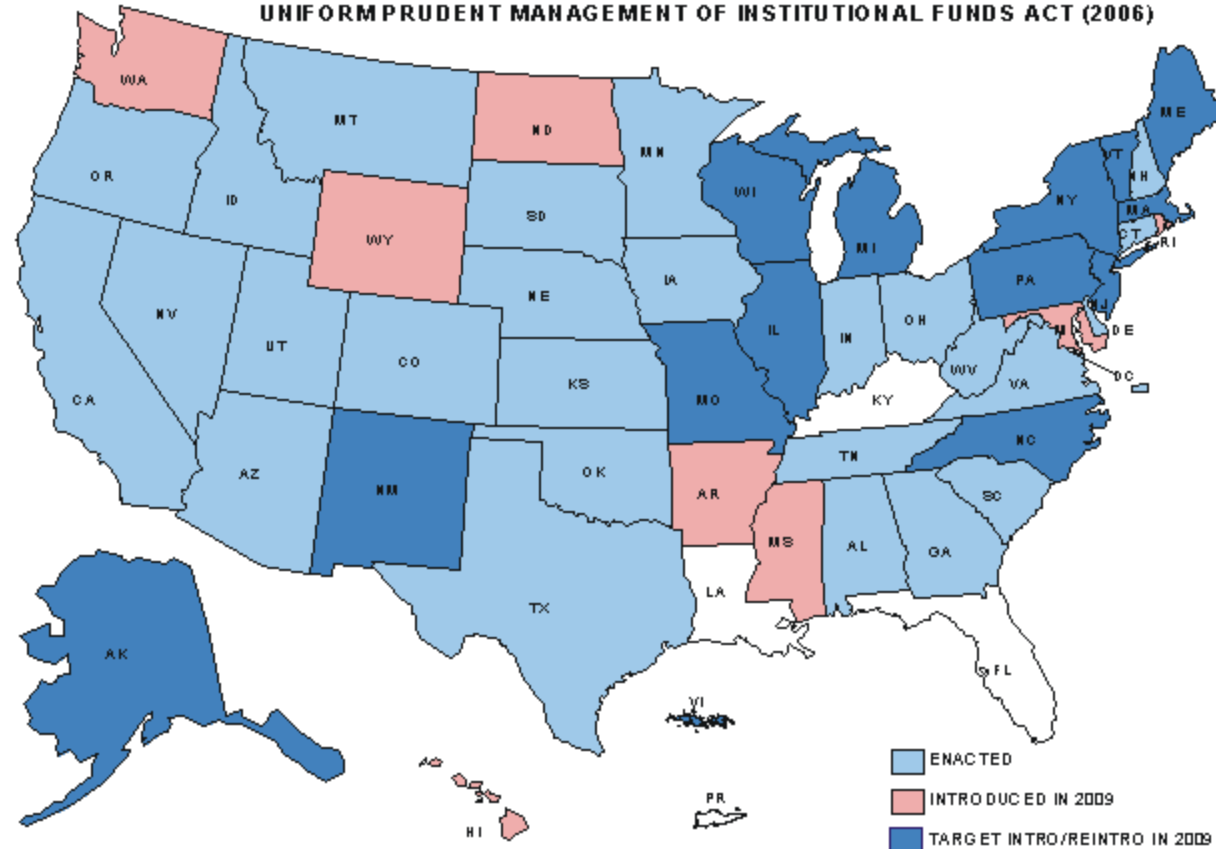
UPMIFA

uniform prudent management of institutional funds act



Uniform Law Commission

UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT (2006)



February 6, 2009

Rhode Island: Introduced as [HB 5244](#) in 2009 - House Corporations



FASB Staff Position FAS 117-1

What is generating this heightened interest in investments and their management?



FASB Staff Position FAS 117-1

Today's Objectives

Discuss the changes in net asset classification of donor restricted endowment funds for a Not-for-Profit that is subject to an enacted version of UPMIFA [Uniform Prudent Management of Institutional Funds Act]

Understand the enhanced disclosures about a Not-for Profit organization's endowment funds.



ENHANCED DISCLOSURES

Enhanced Disclosures for All Endowment Funds -

Disclosures apply to all endowment funds (both donor-restricted endowment funds and board-designated endowment funds) whether or not the organization is subject to UPMIFA.

Note there may be some board-designated funds that are not endowment funds.

ENHANCED DISCLOSURES

En-dow-ment [def.] - *An established fund of cash, securities, or other assets to provide income for the maintenance of a not-for-profit organization. The use of the assets of the fund may be permanently restricted, temporarily restricted, or unrestricted.....The governing board may earmark a portion of the unrestricted net assets as a board-designated endowment.....***The FAS uses the term endowment to mean all endowment funds collectively, both donor-restricted and those established by board designation.**



Statement of Financial Position

Cash only:

ASSETS

Cash	\$ 1,225,000
	<hr/>
	<u>\$ 1,225,000</u>

NET ASSETS

Unrestricted	\$ 1,225,000
	<hr/>
	<u>\$ 1,225,000</u>

No apparent endowment but is this prudent management?



Statement of Financial Position

Cash only:

ASSETS

Cash	\$	1,225,000
		<hr/>
	\$	<u>1,225,000</u>

NET ASSETS

Unrestricted:		
Board-designated	\$	750,000
Other		80,000
Temporarily restricted		275,000
Permanently restricted		120,000
		<hr/>
	\$	<u>1,225,000</u>

Restricted net assets do not need to be in a separate account.



Statement of Financial Position

CD and Investments:

ASSETS

Cash	\$	25,000
Certificates of deposit		200,000
Investments		1,000,000
		<u>\$ 1,225,000</u>

NET ASSETS

Unrestricted:		
Board-designated		750,000
Other		80,000
Temporarily restricted		275,000
Permanently restricted		120,000
		<u>\$ 1,225,000</u>



Statement of Financial Position

Assets limited as to use:

ASSETS

Cash	\$	225,000
Assets limited as to use		1,000,000
		<hr/>
	\$	<u>1,225,000</u>

NET ASSETS

Unrestricted	\$	1,225,000
		<hr/>
	\$	<u>1,225,000</u>

Who has limited the use? External or internal?



ENHANCED DISCLOSURES

A not-for-profit organization, whether or not it is subject to an enacted version of UPMIFA, shall disclose information to enable users of financial statements to understand the Entity's endowments and related policies.



ENHANCED DISCLOSURES

(continued)

Organizations must answer a call to action to consider and prepare the required disclosures.

Remember, **the disclosures apply to endowment funds**, whether or not UPMIFA has been enacted in your state.

This applies to board-designated funds, too, if they meet the endowment definition. These are considered endowments!



ENHANCED DISCLOSURES

(continued)

Organizations should look at how they are investing and managing, and how they have publicly characterized, their various “reserve funds” to determine whether their inclusion is necessary to satisfy the FAS' objective of providing disclosure that gives a picture of the endowments.



ENHANCED DISCLOSURES

(continued)

Advance preparation areas include:

- Understand the definition of endowment and apply it to your net assets and assets.
- Review gift arrangements and donor solicitation language **(Remember a donor restriction always governs the accounting).**
- Review policies for spending and investment of endowment funds.
- Consult with the board of directors/trustees or relevant committee.
- Consider consultation with legal counsel to review law.
- Consider a meeting with your lender to extent there is an impact on debt covenant calculations, if any.

DISCLOSURE

Further, FAS 117 and 124 require more Information:

- The nature and type of permanent and temporary restrictions
- The aggregate amount of deficiencies for all donor-restricted endowment funds for which the fair value of the assets at the reporting date is less than the level required by donor stipulations or law.

DISCLOSURE

(continued)

The entity's stewardship and management of funds will be evidenced in the enhanced disclosures:

1. Governing board or relevant committee's interpretation of relevant law.
2. Spending policies.
3. Investment policy, including return objectives and risk parameters.
4. Composition of endowments.
5. Return maintained in permanently restricted because of the interpretation of relevant law.
6. Reconciliation of beginning and ending amounts.



UPMIFA's Management Focus

Two basic principles:

1. That assets would be invested prudently in diversified investments that sought growth as well as income,
2. That appreciation of assets could prudently be spent for the purposes of any endowment fund held by a charitable entity.



UPMIFA's MANAGEMENT FOCUS

Prudent management – meet their fiduciary care of duty; duty to minimize costs and the duty to investigate with respect to investment decision making.

Additional consideration to general economic conditions, to make decisions on a portfolio basis, allocate risk and return across the portfolio and the needs of the organization both to make distributions and preserve capital.

Eliminates the historic dollar value (HDV) concept for expenditures, which is replaced with the concept of prudent management in conjunction with a prudent spending policy.

UPMIFA MANAGEMENT FOCUS

(continued)

Annual expenditures can be guided by seven criteria or two alternate methods, if adopted by each state.

Seven criteria:

1. Duration and preservation of the endowment fund
2. The purposes of the entity and the endowment fund
3. General economic conditions
4. Effect of inflation and deflation
5. The expected total return from the income and the appreciation/ (depreciation) of the investments.
6. Other resources of the entity
7. The investment policy of the entity



UPMIFA MANAGEMENT FOCUS

(continued)

Two alternate methods:

#1 - A rebuttable presumption of imprudence if the organization expends more than 7% of FMV of the fund, calculated on a three year average, it would be deemed to be imprudent.

Note: the 7% is *not a safe harbor*



UPMIFA MANAGEMENT FOCUS

(continued)

#2 - If an organization has endowment funds valued at <\$2M and plans to authorize spending levels that will take the total value of all endowment funds below HDV, then the organization must notify the Attorney General.

The Attorney General would then have 60 days to respond to it.



UPMIFA MANAGEMENT FOCUS

(continued)

Mechanisms to obtain the release or modification of restrictions are provided in UPMIFA:

1. The Court may release or modify if:

(a) The restriction is impracticable or wasteful or meets an unanticipated circumstance that would further the purposes

OR

(b) The purpose is unlawful, impracticable, impossible to achieve, wasteful.

Both of these require Court action and notification to the Attorney General.

2. Small, old funds (generally <\$25K and held more than 20 years) may be released or modified without court approval. However, advance notice to the Attorney General is still required.



What concerns has UPMIFA raised?

Public perception - UPMIFA raised significant questions about the reporting of donor-restricted endowment funds.

Impact - Not-for-Profits find themselves subject to increased public scrutiny on how they manage and use their endowments

FASB Response - FSP 117-1 was released in 8/08 and is effective for fiscal years ending after 12/15/08.



What concerns has UPMIFA raised?

UPMIFA - Changes the way restricted endowments are managed.

Before UPMIFA - The focus was on prudent spending of the net appreciation.

Under UPMIFA - The entity must consider the original gift and net appreciation on the gift when making investment decisions.



The Primary Impact - Net Asset Classification

A result of UPMIFA and the FAS may be the *reclassification to temporarily restricted net assets* of amounts in donor-restricted endowment funds that were previously considered unrestricted net assets.

Why? FASB has concluded that UPMIFA effectively imposes a time restriction on net assets of a donor-restricted endowment fund until they are **appropriated for expenditure** by the organization.



APPROPRIATION FOR EXPENDITURE

Appropriation is deemed to be approval for expenditure.

This may occur through different means:

1. The specific expenditure is included in the budget.

OR

2. The expenditure arose during the year for unexpected needs or emergency relief.



APPROPRIATION FOR EXPENDITURE

Included in the budget – you do not have to have a balanced budget or a budgeted loss to meet the “appropriation” test. However, the budget should include the identified earnings as a source of revenue.

OR

As an unexpected need or emergency relief – should be evidenced in the minutes as approval by the governing body.

RECLASSIFICATION

Relates to the portion of the donor-restricted endowment funds that are not classified as permanently restricted – the “earnings”.

1. Earnings are:

- (a) As defined by the governing body and*
- (b) As further enhanced by donor stipulation, if any*

2. Earnings may include:

- (a) Income (interest and dividends)*
- (b) Market appreciation / depreciation*
- (c) Preservation of purchasing power, as defined by applicable law*

RECLASSIFICATION

Relates to the portion of the donor-restricted endowment funds that are not classified as permanently restricted.

1. **Pre-UPMIFA:** earnings were released to unrestricted net assets.
2. **Post-UMIFA:** earnings are released to temporarily restricted net assets until they are appropriated for expenditure.

RECLASSIFICATION

Applies to permanently restricted net assets existing on the effective implementation date and decisions made on or after that date.

1. However the entity defines earnings, it should reflect on its use of prior year's permanently restricted endowment earnings.
2. If these earnings have always been part of the operating budget, they are considered appropriated for expenditure and therefore, appropriately released to unrestricted net assets. No reclassification is required.

RECLASSIFICATION

Applies to permanently restricted net assets existing on the effective implementation date and decisions made on or after that date.

3. If these earnings were never budgeted, then the entity must look to any emergency or other unanticipated reasons that the earnings may have been appropriated.
 - (a) *If such reasons existed, in the magnitude of the prior years' earning released, there is no reclassification.*
 - (b) *If no such reasons existed or if their magnitude was less than the earnings released, a reclassification is required.*

Disclosure areas in an UPMIFA state need more analysis:

1. Donor documentation will need to be reviewed along with state law to determine if net asset need to be reclassified.
2. Significant net asset reclassifications may result.

Disclosure areas in an UPMIFA state may need more analysis: *(continued)*

3. The portion of the endowment fund that is not classified as permanently restricted net assets will be classified as temporarily restricted (time restricted) until appropriated for expenditure by the organization.

ANALYSIS

Disclosure areas in a UPMIFA state may need more analysis: *(continued)*

- (a) If there is also a purpose restriction, the funds are not released to unrestricted net assets until the purpose is performed and the expenditure is appropriated.*
- (b) If in an initial application year, donor-restricted funds that were previously considered available to meet a purpose restriction were never appropriated, then the purpose restriction previously considered fulfilled shall be considered reinstated.*
- (c) If "appropriated for expenditure" is for an approved expenditure in a future year, it is not considered appropriated until that future period is reached and the asset remains temporarily restricted.*

Endowments in a Down Market

Reminder:

When an NFP accepts an endowed contribution, it normally is making an agreement to retain it in perpetuity. Often the income from this contribution provides a source of income to the organization.

- (a) Understand the donor's wishes and directions.*
- (b) Define the general policies for the receipt of such contributions and how the release of income is handled.*
- (c) Understand and track donor directions that do not agree with the overall general policies.*



Endowments in a Down Market

Reminder:

Permanently restricted net assets:

- (a) Are not reduced by losses on the investments of the fund, except to the extent required by the donor, including losses related to the specific investments that the donor requires the organization to hold in perpetuity.*
- (b) Are not reduced by an organization's appropriations from the fund.*



Further Reading

Consult our website (www.lgcd.com) for the following materials

FAS 117-1

Uniform Law Commission website



QUESTIONS

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FASB STAFF POSITION

No. FAS 117-1

Title: Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds

Date Issued: August 6, 2008

Objective

1. This FASB Staff Position (FSP) provides guidance on the net asset classification of *donor-restricted endowment funds*¹ for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). UPMIFA is a model act approved by the Uniform Law Commission (ULC; formerly known as the National Conference of Commissioners on Uniform State Laws) that serves as a guideline for states to use in enacting legislation. This FSP also improves disclosures about an organization's *endowment funds* (both donor-restricted endowment funds and *board-designated endowment funds*),² whether or not the organization is subject to UPMIFA.

¹ The term *donor-restricted endowment funds* is used in this FSP to refer to those endowed funds that are established by donor-restricted gifts for that purpose. Like UPMIFA's use of the term *endowment funds*, *donor-restricted endowment funds* does not include board-designated endowment funds.

²The term *endowment fund* is used in this FSP to refer to the broader group of funds as defined as follows in paragraph 168 (the glossary) of FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*:

An established fund of cash, securities, or other assets to provide income for the maintenance of a not-for-profit organization. The use of the assets of the fund may be permanently restricted, temporarily restricted, or unrestricted. Endowment funds generally are established by donor-restricted gifts and bequests to provide a permanent endowment, which is to provide a permanent source of income, or a term endowment, which is to provide income for a specified period. The portion of a permanent endowment that must be maintained permanently—not used up, expended, or otherwise exhausted—is classified as permanently restricted net assets. The portion of a term endowment that must be maintained for a specified term is classified as temporarily restricted net assets. An organization's governing board may earmark a portion of its unrestricted net assets as a board-designated endowment (sometimes called funds functioning as endowment or quasi-endowment funds) to be invested to provide income

Background

2. In July 2006, the ULC approved UPMIFA as a modernized version of the Uniform Management of Institutional Funds Act of 1972 (UMIFA), the model act on which 46 states and the District of Columbia have based their primary laws governing the investment and management of donor-restricted endowment funds by not-for-profit organizations. A number of states already have enacted a version of UPMIFA, and many of the remaining states are expected to do so over the next few years.³

3. Among its changes, UPMIFA prescribes new guidelines for expenditure of a donor-restricted endowment fund (in the absence of overriding, explicit donor stipulations). Its predecessor, UMIFA, focused on the prudent spending of the net appreciation of the fund. UPMIFA instead focuses on the entirety of a donor-restricted endowment fund, that is, both original gift amount(s) and net appreciation. UPMIFA eliminates UMIFA's *historic-dollar-value* threshold,⁴ an amount below which an organization could not spend from the fund, in favor of a more robust set of guidelines about what constitutes prudent spending, explicitly requiring consideration of the duration and preservation of the fund. Questions have arisen about whether UPMIFA's shift in focus affects the net asset classification of a donor-restricted endowment fund.

4. Subsection 4(a) of UPMIFA provides that "unless stated otherwise in the gift instrument, the assets in an endowment fund are donor-restricted assets until appropriated

for a long but unspecified period. A board-designated endowment, which results from an internal designation, is not donor restricted and is classified as unrestricted net assets.

This FSP uses the term *endowment* to mean all of an organization's endowment funds collectively, which thus encompasses both donor-restricted endowment funds and those established by board designation (herein called *board-designated endowment funds*). The latter are sometimes called funds functioning as endowment or quasi-endowment funds.

³An annotated text of UPMIFA, with the ULC's comments, can be found at http://www.law.upenn.edu/bll/archives/ulc/umoifa/2006final_act.pdf. The current status of enactments and introduced legislation can be found at http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-upmifa.asp.)

⁴UMIFA defines *historic dollar value* as "the aggregate fair value in dollars of:

- An endowment fund at the time it became an endowment fund
- Each subsequent donation to the fund at the time it is made, and
- Each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the fund."

for expenditure by the institution.” Questions have arisen about whether this wording, together with the provisions in UPMIFA about prudent spending, would impose a temporary (time) restriction on the portion of a donor-restricted endowment fund that otherwise would be classified as unrestricted net assets.

<p>All paragraphs in this FSP have equal authority. Paragraphs in bold set out the main principles.</p>

FASB Staff Position

Net Asset Classification for Funds Subject to UPMIFA

5. **A not-for-profit organization that is subject to an enacted version of UPMIFA shall classify a portion of a donor-restricted endowment fund of perpetual duration⁵ as permanently restricted net assets. Consistent with paragraph 14 of FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*, and paragraph 22 of FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*, the amount classified as permanently restricted shall be the amount of the fund (a) that must be retained permanently in accordance with explicit donor stipulations, or (b) that in the absence of such stipulations, the organization’s governing board determines must be retained (preserved) permanently consistent with the relevant law.**

6. How an enacted version of UPMIFA will be interpreted and enforced in a particular state will become clearer with the passage of time. Because the legislation is newly enacted, no case law currently exists for its interpretation. In the meantime, organizations could look to other sources, such as the discussion that occurred in the legislative committees leading to the law adopted in a particular state, announcements from the state attorney general, a consensus of learned lawyers in the state, or similar information, to help them understand what the law requires. In the absence of new legislation, clarifying court decisions, additional guidance issued by the state attorney general, or similar

⁵As distinguished from term endowments.

developments, the governing board's interpretation of the relevant law should be consistent from year to year.

7. Consistent with paragraphs 11 and 12 of FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, the portion of a donor-restricted endowment fund that is classified as permanently restricted net assets is not reduced by losses on the investments of the fund, except to the extent required by the donor, including losses related to specific investments that the donor requires the organization to hold in perpetuity. Likewise, the amount of permanently restricted net assets is not reduced by an organization's appropriations from the fund.

8. For each donor-restricted endowment fund for which the restriction described in subsection 4(a) of UPMIFA is applicable, a not-for-profit organization shall classify the portion of the fund that is not classified as permanently restricted net assets as temporarily restricted net assets (time restricted) until appropriated for expenditure by the organization.⁶

9. In the absence of interpretation of *appropriated for expenditure* by legal or regulatory authorities (for example, court decisions or interpretations by state attorneys general), for purposes of this FSP, appropriation for expenditure is deemed to occur upon approval for expenditure,⁷ unless approval is for a future period, in which case appropriation is deemed to occur when that period is reached. Upon appropriation for expenditure, the time restriction expires to the extent of the amount appropriated and, in the absence of any purpose restrictions, results in a reclassification of that amount to unrestricted net assets. If the fund is also subject to a purpose restriction, the reclassification of the appropriated amount to unrestricted net assets would not occur until that purpose restriction also has been met, in accordance with the provisions of paragraph 17 of Statement 116.

⁶ The net asset classification guidance contained in EITF Topic No. D-49, "Classifying Net Appreciation on Investments of a Donor-Restricted Endowment Fund" (see Appendix B), remains effective for donor-restricted endowment funds subject to UMIFA.

⁷ Approval for expenditure may occur through different means within and across organizations. For example, expenditures could be approved as part of a formal, annual budget. Expenditures also could be approved during the year as unexpected needs arise (such as for emergency relief efforts).

Enhanced Disclosures for All Endowment Funds

10. A not-for-profit organization, whether or not it is subject to an enacted version of UPMIFA, shall disclose information to enable users of financial statements to understand the net asset classification, net asset composition, changes in net asset composition, spending policy(ies), and related investment policy(ies) of its endowment funds (both donor-restricted and board-designated).

11. At a minimum, an organization shall disclose the following information for each period for which the organization presents financial statements:

- a. A description of the governing board's interpretation of the law(s) that underlies the organization's net asset classification of donor-restricted endowment funds.
- b. A description of the organization's policy(ies) for the appropriation of endowment assets for expenditure (its endowment spending policy(ies)).
- c. A description of the organization's endowment investment policies. The description shall include the organization's return objectives and risk parameters; how those objectives relate to the organization's endowment spending policy(ies); and the strategies employed for achieving those objectives.
- d. The composition of the organization's endowment by net asset class at the end of the period, in total and by type of endowment fund, showing donor-restricted endowment funds separately from board-designated endowment funds.
- e. A reconciliation of the beginning and ending balance of the organization's endowment, in total and by net asset class, including, at a minimum, the following line items (as applicable): investment return, separated into investment income (for example, interest, dividends, rents) and net appreciation or depreciation of investments; contributions; amounts appropriated for expenditure; reclassifications; and other changes.

12. In accordance with the requirements of Statements 117 and 124, an organization also shall provide information about the net assets of its endowment funds, including:

- a. The nature and types of permanent restrictions or temporary restrictions (paragraphs 14 and 15 of Statement 117)
- b. The aggregate amount of the deficiencies for all donor-restricted endowment funds for which the fair value of the assets at the reporting date is less than the level required by donor stipulations or law (paragraph 15(d) of Statement 124).

13. Appendix C contains an illustrative example of the disclosures in paragraphs 10–12.

Amendment to Statement 124

14. FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, is amended as follows: [Added text is underlined and deleted text is ~~struck out~~.]

a. Footnote 4 to paragraph 13:

Donors that create endowment funds can require that their gifts be invested in perpetuity or for a specified term. Some donors may require that a portion of income, gains, or both be added to the gift and invested subject to similar restrictions. In states that have enacted a version of the Uniform Management of Institutional Funds Act of 1972 (UMIFA) or states whose relevant law is based on trust law, it is generally understood that at least the amount of the original gift(s) and any required accumulations is not expendable, although the value of the investments purchased may occasionally fall below that amount. Future appreciation of the investments generally restores the value to the required level. In states that have enacted its provisions, the Uniform Management of Institutional Funds Act-UMIFA describes “historic dollar value” as the amount that is not expendable. In states that have enacted the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA), the level required by law is the amount that must be retained (preserved) permanently under the version of UPMIFA enacted in that jurisdiction, as determined by the organization’s governing board. This is explained further in FASB Staff Position FAS 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds.*

Effective Date and Transition

15. The provisions of this FSP shall be effective for fiscal years ending after December 15, 2008. Earlier application is permitted provided that annual financial statements for that fiscal year have not been previously issued.

16. In initially applying the guidance in paragraphs 5–9 to donor-restricted endowment funds in existence when UPMIFA is first effective, an organization shall report any resulting net asset reclassifications in a separate line item within the organization’s statement of activities for that period, outside a performance indicator or other intermediate measure of operations, if one is presented. If the organization initially

applies the provisions of this FSP subsequent to the period in which UPMIFA is first effective, the reclassification shall be reported in those financial statements in the earliest comparative period presented for which UPMIFA was effective. If the period in which UPMIFA first became effective is not presented, the effects of the reclassification shall be reported retrospectively in the earliest period presented.

17. In the initial application of the guidance in paragraphs 8 and 9, any amounts within a donor-restricted endowment fund that were previously considered available to meet a purpose restriction under the provisions of paragraph 17 of Statement 116,⁸ but that have never been appropriated for expenditure, shall, like other unappropriated amounts in that fund, be considered unavailable⁹ until appropriated, and, therefore, the purpose restriction previously considered fulfilled shall be considered reinstated.

The provisions of this FSP need not be applied to immaterial items.

This FSP was adopted by the unanimous vote of the five members of the Financial Accounting Standards Board:

Robert H. Herz, *Chairman*
George J. Batavick
Thomas J. Linsmeier
Leslie F. Seidman
Lawrence W. Smith

⁸ Paragraph 17 of Statement 116 states:

If an expense is incurred for a purpose for which both unrestricted and temporarily restricted net assets are available, a donor-imposed restriction is fulfilled to the extent of the expense incurred unless the expense is for a purpose that is directly attributable to another specific external source of revenue.

⁹ Footnote 5 to paragraph 17 of Statement 116 states:

Temporarily restricted net assets with time restrictions are not available to support expenses until the time restrictions have expired.

Appendix A

BASIS FOR CONCLUSIONS

Introduction

A1. Proposed FSP FAS 117-a, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures*, was issued for public comment in February 2008. The Board received 46 comment letters and redeliberated the substantive issues raised by those letters at a public meeting in June 2008.

A2. This appendix summarizes the considerations that Board members deemed significant in reaching the conclusions in this FSP. It includes the reasons for accepting certain views and rejecting others. Individual Board members gave greater weight to some factors than to others.

Net Asset Classification for Funds Subject to UPMIFA

A3. In considering the effect of UPMIFA's elimination of the historic-dollar-value threshold on the net asset classification of a donor-restricted endowment fund without explicit donor stipulations, in its initial deliberations the Board considered the following four views expressed by constituents:

View 1: None of the fund should be classified as permanently restricted net assets.

View 2: The entire fund should be classified as permanently restricted net assets.

View 3: The entire fund should be classified as a new net asset class/subclass.

View 4: Some, but generally not all, of the fund should be classified as permanently restricted net assets. The amount classified as permanently restricted net assets should be the portion of the fund that must be retained permanently as determined by a governing board's interpretation of the state's version of

UPMIFA (and any other relevant law). The interpretation would need to be disclosed.

A4. View 1 centered on the belief that in the absence of a historic-dollar-value threshold an organization's ability to spend down an endowment balance below the amount of the original gift, even on a temporary basis, precludes classification of any of a donor-restricted endowment fund as permanently restricted net assets. Proponents of View 1 stressed that, by definition, permanent restrictions result from "donor-imposed stipulations that neither expire by passage of time nor can be fulfilled **or otherwise removed by actions of the organization**" (FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*, paragraph 209; emphasis added).

A5. View 2 emphasized UPMIFA's shift in focus, from prudent spending of net appreciation to prudent spending of an endowment fund as a whole. Proponents of this view asserted that shift should be reflected by reporting the fund in its entirety in one net asset class (thereby also mirroring the fund-as-a-whole reporting that organizations often make to donors). Given the perpetual nature of the fund, View 2 proponents argued that the net asset class should be permanently restricted. They cited the accounting for perpetual trusts (essentially endowment funds held in perpetuity by third parties but recognized on the beneficiary organization's financial statements) as an example of perpetual funds already reported entirely in permanently restricted net assets. An interest in a perpetual trust increases or decreases permanently restricted net assets for investment return and decreases permanently restricted net assets for distributions by the trust to the organization (spending).

A6. Like proponents of View 2, proponents of View 3 emphasized that UPMIFA's shift in focus to the fund as a whole should be reflected by classification in one net asset class. However, they disagreed that all of the fund should be classified as permanently restricted net assets. View 3 proponents instead suggested a fundamental restructuring of the net asset classification model, such as by merging the temporarily and permanently restricted net asset classes into one restricted net asset class with a breakdown into endowment and other-than-endowment, or more nuanced categories, either on the face of the statement of financial position or in the notes to the financial statements.

A7. View 4 stressed that despite the short-term spending flexibility that becomes available under UPMIFA, its explicit requirement for consideration of the preservation of the funds among factors for prudent spending suggests that a donor-restricted endowment fund (other than a term endowment) is still perpetual in nature.¹⁰ Thus, at least a portion of a donor-restricted endowment ultimately is not expendable and should be classified as permanently restricted net assets. Proponents of View 4 asserted that a key principle for determining the amount that is permanently restricted can be found by extrapolating to the overall fund the principle in paragraph 22 of Statement 117 on investment gains:

If the governing board determines that the relevant law requires the organization to retain permanently some portion of gains on investment assets of endowment funds, that amount shall be reported as an increase in permanently restricted net assets.

In other words, if the governing board determines that a portion of a donor-restricted endowment fund **must** be retained permanently in accordance with explicit donor stipulations or the relevant law (as opposed to being simply good organizational policy to retain), that portion would be classified as permanently restricted net assets.

A8. The Board considered each of those views and, for the reasons discussed, concurred with View 4.

- a. The Board concluded that View 1 would overstate the flexibility allowed by UPMIFA by disregarding the organization's fiduciary duty to maintain a fund of perpetual duration. UPMIFA does **not** remove that fiduciary duty, even though it removed the explicit requirement to maintain historic dollar value. Classifying all of the funds as, for example, temporarily restricted has the potential to mischaracterize a donor-restricted endowment fund as "just another expendable fund."
- b. The Board concluded that View 2 would understate the flexibility allowed by UPMIFA by implying the unavailability of resources that a governing board could prudently spend now or in the future. The Board also noted that the analogy to perpetual trusts is an imperfect one because, in contrast to most donor-restricted endowment funds, none of the ongoing decisions

¹⁰As indicated in the ULC's commentary to Section 4:

UPMIFA requires the persons making spending decisions for an endowment fund to focus on the purposes of the endowment fund as opposed to the purposes of the institution more generally, as was the case under UMIFA. When the institution considers the purposes and duration of the fund, the institution will give priority to the donor's general intent that the fund be maintained permanently.

about either the investment of the trust or distributions from the trust are within the purview of a beneficiary organization's governing board. Instead, perpetual trusts are more like the donor requirement to hold a specific investment security in perpetuity that is discussed in paragraph 11 of Statement 124.

- c. The Board concluded that View 3 would require a fundamental reconsideration of the donor-restricted net asset classification framework for reporting by not-for-profit organizations. The Board was not convinced that the enactment of UPMIFA or other changes in the environment since the adoption of that reporting framework necessitate a reconsideration. The Board also noted that such an undertaking, if warranted to meet the needs of donors, creditors, and other users of financial statements, would be a major undertaking. If needed, it would be best done after completion of the not-for-profit phase of the Board's conceptual framework project, which is a long-term joint project with the International Accounting Standards Board.
- d. The Board concluded that View 4 best reflects the underlying nature of the fund under UPMIFA within the current framework for reporting donor-restricted net assets of not-for-profit organizations. Consistent with the principle in paragraph 5 of this FSP and the additional disclosure requirement of paragraph 11(a), View 4 provides the most faithful representation of the organization's fiduciary duty for its donor-restricted endowment funds. The Board also noted that this guidance is both workable and appropriate because it:
 - (1) Retains the current net asset classification scheme, which creditors and other users have found useful
 - (2) Neither overstates nor understates the flexibility afforded by UPMIFA
 - (3) Avoids inappropriately providing a definitive legal interpretation
 - (4) Provides important information about how an organization interprets its fiduciary duties under an enacted version of UPMIFA.

A9. A number of the respondents to the proposed FSP, especially from the legal community and some preparers, reiterated that the "fund as a whole" approach taken by UPMIFA necessitated the classification of donor-restricted endowment funds entirely in one net asset class. Some respondents argued for a new net asset class, while others argued for a significant overhaul of the permanently restricted net asset class that would, in effect, make that a new net asset class. Both groups of respondents argued that a single-net-asset-class approach would be more in sync with the way in which the UPMIFA statute is written.

A10. The Board noted that such an approach may be worth exploring as a longer-term alternative; however, in the absence of interpretation and enforcement history for this new statute, and based on letters and other information received from constituents, particularly regulators, it is not clear at this time that treating the fund homogeneously in net asset classification would provide users of financial statements with more useful information. Rather, the Board decided that useful information is provided by financial reporting that continues to distinguish the portion of a donor-restricted endowment fund that is permanently restricted from the portion that is not permanently restricted. Thus, the Board reaffirmed its view (View 4) and retained the proposed guidance that a portion of a donor-restricted endowment fund of perpetual duration be classified as permanently restricted net assets. The Board also directed the staff to continue to monitor any developments about UPMIFA in the legal and regulatory environment, as well as how the FSP is actually applied in practice.

A11. In its initial deliberations, the Board also considered whether UPMIFA's elimination of the historic-dollar-value threshold affects the guidance for reporting losses on investments of a donor-restricted endowment fund. Paragraph 12 of Statement 124 provides that:

In the absence of donor stipulations or law to the contrary, losses on the investments of a donor-restricted endowment fund shall reduce temporarily restricted net assets to the extent that donor-imposed temporary restrictions on net appreciation of the fund have not been met before the loss occurs. Any remaining loss shall reduce unrestricted net assets.

The Board noted in the proposed FSP that it believes the short-term spending flexibility provided by UPMIFA's elimination of the historic-dollar-value threshold does not change the organization's long-term fiduciary duty to the donor (and others) for a fund of perpetual duration. Therefore, consistent with its decision in Statement 124, the Board concluded that the amount to be reported as permanently restricted net assets should be the amount corresponding to that duty, which is not necessarily the amount of the fund that an organization happens to have on hand at the reporting date because of cumulative investing and spending decisions. The Board therefore decided to retain the guidance in Statement 124 rather than to require that investment losses on donor-restricted

endowment funds be charged to permanently restricted net assets, even if the losses reduce the fair value of the fund below the level required by donor stipulations or law. Likewise, the Board decided to extend the guidance in Statement 124 to appropriations from the fund because short-term flexibility on the use of endowment assets in so-called underwater situations does not remove the organization's long-term fiduciary duty for the preservation of those resources.

A12. Several respondents, primarily from the legal community and some preparers, disagreed with the retention of the guidance from Statement 124. Some of those respondents indicated that reducing temporarily restricted or unrestricted net assets, rather than permanently restricted net assets, in underwater situations is misleading because there is no affirmative obligation to restore the endowment fund to its original value. A few respondents suggested that the accounting treatment in Statement 124 would undermine UPMIFA by arbitrarily deterring current spending in economically difficult situations in which UPMIFA indeed intended to allow for such current spending.

A13. The Board noted that in issuing Statement 124 it had rejected a similar argument that there is no affirmative obligation to restore (see paragraph 68 of Statement 124). The Board noted that UPMIFA seemingly does not require an affirmative obligation to restore the endowment fund to its original gift value, even if the organization were facing liquidation. Nonetheless, under the assumption that the organization is a going concern, the fiduciary duty remains in perpetuity absent judicial relief (*cy pres* action). That is, for financial reporting purposes, no release from restriction has occurred. The Board also rejected the argument that the classification requirements of Statement 124 undermine UPMIFA, noting that it is important to distinguish between net asset classification for the purpose of external financial reporting and internal budgetary and cash management decisions for which the options may have been expanded by UPMIFA, depending on how that act is interpreted and enforced. The Board thus reaffirmed the guidance on this issue in the proposed FSP.

A14. The Board also considered the question of whether the language in subsection 4(a) of UPMIFA ("endowment assets are donor-restricted until appropriated"), together with UPMIFA's prudent spending guidelines, would impose a temporary (time)

restriction on the portion of a donor-restricted endowment fund that otherwise would be classified as unrestricted net assets. In its initial deliberations, the Board considered and placed weight on the guidance previously provided by the FASB staff in EITF Topic No. D-49, “Classifying Net Appreciation on Investments of a Donor-Restricted Endowment Fund.” (This Topic is contained in Appendix B.) That guidance, which drew upon paragraph 22 of Statement 117, paragraph 11 of Statement 124, and the Board’s basis for conclusions in Statement 117, clarified that a legal requirement that a governing board act to appropriate net appreciation for expenditure under a statutorily prescribed standard of ordinary business care and prudence did not, in and of itself, extend a donor restriction to that appreciation and, therefore, did not result in temporarily or permanently restricted net assets. The Board initially concluded that such guidance also was applicable to enacted provisions of legislation based on subsection 4(a) of UPMIFA, as well as subsection 4(d), which contains an optional rebuttable presumption of imprudence for annual spending of more than 7 percent of the fair value of the assets of a donor-restricted endowment fund. The Board also noted that, in applying the guidance in Topic D-49, an organization would need to consider the wording of the specific enacted version of UPMIFA (or other relevant law) to which the organization is subject.

A15. Several respondents provided important clarifying information about the appropriateness of applying the guidance in Topic D-49 to the portion of a donor-restricted endowment fund that is not classified as permanently restricted. Respondents argued that UPMIFA does not merely require the exercise of ordinary business prudence by a governing board in making decisions about how much to appropriate for expenditure in a given year. They stressed that UPMIFA requires a more specific burden of prudence—to appropriate an amount for expenditure only after carefully weighing the seven factors enumerated in UPMIFA’s spending guidelines. Unlike UMIFA, these factors explicitly include the duration and preservation of the fund. They also pointed to UPMIFA’s creation of a rule of construction that places an organization’s governing board in the shoes of a donor. Thus, they argued that in the absence of a purpose restriction on the use of the appreciation of an endowment fund, the language in subsection 4(a) of UPMIFA considers the donor restriction on the appreciation to lapse only when and to the degree that a governing board, effectively in the shoes of a donor,

appropriates an amount for expenditure after carefully weighing the required seven factors.

A16. Based on the information from respondents to the proposed FSP and other due process procedures, the Board concluded that unlike UMIFA, in the absence of donor stipulations to the contrary, UPMIFA does indeed extend a donor restriction to the portion of a donor-restricted endowment fund that is not classified in permanently restricted net assets. The Board also concluded that because that particular restriction expires upon appropriation for expenditure, it is a time restriction that under Statement 117 should be classified as temporarily restricted net assets. The Board concluded that, based on the constraints put on the governing board by UPMIFA in its appropriation decision, classification as temporarily restricted net assets seems to be, on balance, the most faithful representation of the underlying circumstances.

A17. The Board observed that the guidance contained in Topic D-49 is still applicable to donor-restricted endowments funds subject to UMIFA.

Enhanced Disclosures for All Endowment Funds

A18. Based on its consideration of the views of a range of constituents within the not-for-profit community, the Board concluded that enhanced disclosures about an organization's endowment are needed by users of an organization's financial statements, especially in the new, more flexible UPMIFA environment and an era of increased public scrutiny of endowment management. Thus, the Board decided to use this FSP as an opportunity to improve the disclosures about an organization's endowment for all organizations with endowments, including those in states (or other jurisdictions) that have not yet adopted a version of UPMIFA. The Board decided to include the following disclosures in the proposed FSP:

- a. A description of the governing board's interpretation of the law that underlies the organization's net asset classification of donor-restricted endowment funds.
- b. A description of the organization's policy(ies) for the appropriation of endowment assets for expenditure (its endowment spending policy(ies)).
- c. A description of the organization's endowment investment policies, including:
(1) the organization's return objectives and risk parameters, (2) how those

- objectives relate to the organization's endowment spending policy(ies), and (3) the strategies employed for achieving those objectives.
- d. The composition of the organization's endowment by net asset class at the end of the period, in total and by type of endowment fund, showing donor-restricted endowment funds separately from board-designated endowment funds. That disclosure also highlighted the cumulative amount of investment return, if any, contained in the permanently restricted net asset class because of the organization's interpretation of relevant law, beyond that required by explicit donor stipulations.
 - e. A reconciliation of the beginning and ending balance of the organization's endowment, in total and by net asset class, including, at a minimum, the following line items (as applicable): investment return, separated into investment income (for example, interest, dividends, rents) and net appreciation or depreciation of investments; contributions; amounts appropriated for expenditure; reclassifications; and other changes. That disclosure also highlighted the additions of investment return, if any, to permanently restricted net assets resulting from the organization's interpretation of relevant law, beyond that required by explicit donor stipulations.
 - f. Disclosure of an organization's planned appropriation for expenditure, if known, for the year following the most recent period for which the organization presents financial statements.

The Board believed that together these disclosures would enhance user understanding of an organization's endowment by providing a holistic picture of the endowment and its component pieces as well as insight into how an organization is approaching its stewardship and management responsibilities, especially in the more flexible UPMIFA environment.

A19. Although most respondents generally favored the proposed disclosures, there was mixed response about the investment policy disclosure. Some respondents expressed concern about the disclosure devolving into meaningless boilerplate at one extreme or overwhelming volumes of proprietary information at the other extreme. Because disclosure of investment policy provides important contextual information for evaluating an organization's spending policy, the Board decided to retain this disclosure requirement in the final FSP and let practice develop.

A20. Many respondents disagreed with the proposed separate disclosure of the annual and cumulative amounts that are added to permanently restricted net assets as a result of an organization's interpretation of law. Some argued that such separate disclosure is not useful. Others noted that it puts an unnecessary cloud on those amounts compared with

amounts added to permanently restricted net assets because of explicit donor stipulations. The Board agreed and decided not to include that requirement in the final FSP.

A21. Most respondents disagreed with the requirement to disclose the next year's planned appropriation, arguing that this FSP should not be used to require such prospective information in financial statements prepared in accordance with generally accepted accounting principles (GAAP). The Board agreed that requirements for prospective information raise other issues beyond the scope of this FSP and, thus, decided not to include that requirement in the final FSP.

A22. Virtually all of the respondents agreed that the final disclosure requirements should be applicable in all states, not just those that have enacted a version of UPMIFA.

Effective Date

A23. Because UPMIFA already was effective in a number of states, and the information contained in the disclosures was a prerequisite for the preparation of an organization's statement of financial position and statement of activities and for administration of endowment funds, the Board initially concluded it would be both desirable and practicable to make the provisions of the FSP effective as early as possible. Thus, the proposed FSP would have required that its provisions be effective for fiscal years ending after June 15, 2008.

A24. Many respondents, including those that appreciated the need for timely guidance, argued that the proposed effective date was too close to the planned issuance date of the final FSP. They suggested that the Board delay the effective date by six months or more. They expressed concern that smaller organizations and organizations in states that had not yet adopted UPMIFA would not be sufficiently aware of the proposed guidance to enable them to implement it so soon. Respondents argued that the effective date was too soon even for many larger institutions because that date would not allow sufficient time for the necessary communication with and involvement of audit committees and governing boards. Finally, respondents indicated that for many organizations, especially those outside the higher education sector, distinguishing board-designated endowment

funds from other funds could require additional time to research and resolve before the additional tabular disclosures could be implemented.

A25. The Board decided to delay the effective date to years ending after December 15, 2008. The Board noted that that effective date would allow for the additional time suggested by respondents and would roughly coincide with the effective date of the new IRS Form 990, which requires organizations to distinguish board-designated endowment funds from other funds.

Appendix B

EITF ABSTRACTS, TOPIC No. D-49

Topic: Classifying Net Appreciation on Investments of a Donor-Restricted Endowment Fund

Date Discussed: March 21, 1996

An FASB staff representative announced that the FASB staff has received the following technical inquiry about the application of the provisions in paragraph 22 of FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*, and paragraph 11 of FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, in classifying net appreciation on investments of a donor-restricted endowment fund. Paragraph 22 of Statement 117 states:

A statement of activities shall report gains and losses recognized on investments and other assets (or liabilities) as increases or decreases in unrestricted net assets unless their use is temporarily or permanently restricted by explicit donor stipulations or by law. For example, net gains on investment assets, to the extent recognized in financial statements, are reported as increases in unrestricted net assets unless their use is restricted to a specified purpose or future period. If the governing board determines that the relevant law requires the organization to retain permanently some portion of gains on investment assets of endowment funds, that amount shall be reported as an increase in permanently restricted net assets.

Paragraph 11 of Statement 124 states:

A donor's stipulation that requires a gift to be invested in perpetuity or for a specified term creates a donor-restricted endowment fund. Unless gains and losses are temporarily or permanently restricted by a donor's explicit stipulation or by a law that extends a donor's restriction to them, gains and losses on investments of a donor-restricted endowment fund are changes in unrestricted net assets.

Q—Do legal limitations that require that the governing board act to appropriate net appreciation for expenditure under a statutorily prescribed standard of ordinary business care and prudence extend a donor restriction to the net appreciation on investments of a donor-restricted endowment fund?

A—No. The FASB staff believes that Section 2 of the Uniform Management of Institutional Funds Act and its reference to the standard of ordinary business care and prudence established by Section 6 does not extend a *donor-imposed restriction* as that term is defined in Statement 117. Paragraphs 120–132 of Statement 117 explain the

FASB's consideration of this matter. In jurisdictions in which the Uniform Act is in force, the governing board must exercise ordinary business care and prudence under the facts and circumstances prevailing at the time of the action or decision in administering its powers to appropriate appreciation. In the absence of other relevant law, if the Uniform Act has been adopted without modifications that preclude the governing board from exercising its discretion to appropriate some or all of an organization's net appreciation on investments, realized or unrealized, the net appreciation is not donor-restricted unless the donor has explicitly restricted the use of either income or net appreciation. Paragraph 128 of Statement 117 notes that the state of Rhode Island has modified the Uniform Act to preclude a governing board from exercising its discretion over a portion of the net appreciation. Paragraph 128 also notes that in Rhode Island the amount of the net appreciation that must be maintained to cover required purchasing power adjustments would be classified as permanently restricted.

Paragraph 168 of Statement 117 defines a *donor-imposed restriction* as “a donor stipulation that specifies a use for a contributed asset that is more specific than broad limits resulting from the nature of the organization, the environment in which it operates, and the purposes specified in its articles of incorporation or bylaws or comparable documents for an unincorporated association.” The FASB staff believes that a requirement to exercise ordinary business care and prudence is not a limitation that is more specific than the broad limits of the environment in which charitable and other not-for-profit organizations operate. Furthermore, paragraph 127 of Statement 117 says, “Others, including Board members, believe that the responsibility to exercise ordinary business care and prudence in determining whether to spend net appreciation is similar to the fiduciary responsibilities that exist for all charitable resources under an organization’s control.” Thus, a legal limitation that requires that a governing board exercise ordinary business care and prudence when appropriating net appreciation is not the equivalent of a law that extends a donor-imposed restriction and, therefore, does not result in classification of net appreciation as donor-restricted, either permanently or temporarily.

Appendix C

ILLUSTRATIVE EXAMPLE OF ENDOWMENT DISCLOSURES

C1. This appendix provides an example that illustrates one way in which an organization might provide the disclosures required by paragraphs 10–12 of this FSP. The example does not illustrate all disclosures required under GAAP, including all of those that pertain to investments held by not-for-profit organizations.

C2. Because this FSP does not specify that the required information be disclosed in a specific format, the formats used in this example are illustrative of just one way in which the information might be provided. To achieve the objective stated in paragraph 10, the Board encourages organizations to use a format that displays information in the most understandable manner for their specific circumstances and provide any additional disaggregation or other information they deem necessary.

C3. The organization in this example is assumed to be subject to an enacted version of UPMIFA. However, all of the disclosures are required for all not-for-profit organizations with endowments, whether or not they are subject to an enacted version of UPMIFA.

C4. **Assumptions**

Organization A is a not-for-profit organization that is issuing a full set of financial statements for both the current fiscal year (200Y) and the previous fiscal year (200X). Organization A has a sizable endowment. At the beginning of 200X, an enacted version of UPMIFA became effective for the State to whose law Organization A is subject. The Board of Trustees has interpreted the new law as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. None of the funds have donor stipulations that override the restriction described in subsection 4(a) of UPMIFA, which the enacted version in the State included verbatim: “unless stated otherwise in the gift instrument, the assets in an endowment fund are donor-restricted assets until appropriated for expenditure by the institution.” The organization had previously been operating under an enacted version of UMIFA. Consistent with this FSP, the change in law prompted a change

in the net asset classification of Organization A’s endowment. Those changes are depicted below:

The following provides a description of restrictions placed on the net assets represented in the organization's endowment as of the beginning of the year 200X.

ITEM A: The portion of donor-restricted perpetual endowment funds that is deemed to be permanently restricted either by explicit donor stipulation or by law

ITEM B: The portion of donor-restricted term endowment funds that is deemed to be restricted over the donor-specified period of the endowment either by explicit donor stipulation or by law

The remaining portion of the donor-restricted endowment funds, which have not yet been appropriated for expenditure and are subject to UPMIFA’s time restriction:

ITEM C: With donor-imposed purpose restrictions that have not yet been met

ITEM D: With donor-imposed purpose restrictions previously deemed to have been met under paragraph 17 of Statement 116

ITEM E: Without donor-imposed purpose restrictions

ITEM F: Board-designated endowment funds without donor-imposed purpose or time restrictions.

Net Assets in the Endowment as of the Beginning of the Year 200X

Net Asset Classification	Pre-Adoption of FSP FAS 117-1		Post-Adoption of FSP FAS 117-1		
	Description	Balance	Description	Balance	Reclassification Adjustment
Donor-restricted endowment funds					
Permanently restricted	Item A	\$ 93,398	Item A	\$ 93,398	\$ -
Temporarily restricted	Items B & C	14,369	Items B, C, D & E	43,107	28,738
Unrestricted	Items D & E	<u>28,738</u>	None	<u>-</u>	\$ (28,738)
Total donor-restricted funds		136,505		136,505	
Board-designated endowment funds					
Unrestricted	Item F	<u>7,184</u>	Item F	<u>7,184</u>	\$ -
Total board-designated funds		7,184		7,184	
Total endowment		<u>\$ 143,689</u>		<u>\$ 143,689</u>	

In the year 200X, the organization had the following endowment-related activities:

	Donor-Restricted Endowment Funds	Board- Designated Endowment Funds	Total
Investment return			
Investment income	\$ 2,587	\$ 287	\$ 2,874
Net appreciation	<u>7,786</u>	<u>835</u>	<u>8,621</u>
Total investment return ^(a)	10,373	1,122	11,495
 Contributions to perpetual endowment	 2,000	 –	 2,000
 Amounts appropriated for expenditure	 (6,825)	 (359)	 (7,184)
 Transfer to remove assets from board- designated endowment funds	 <u>–</u>	 <u>(1,000)</u>	 <u>(1,000)</u>
 Total change in endowment funds	 <u>\$ 5,548</u>	 <u>\$ (237)</u>	 <u>\$ 5,311</u>

- (a) Of the 200X investment return from donor-restricted endowment funds, \$275 must be retained permanently in accordance with explicit donor stipulations to maintain the purchasing power of those funds.

In the year 200Y, the organization had the following endowment-related activities:

	Donor-Restricted Endowment Funds	Board- Designated Endowment Funds	Total
Investment return			
Investment income	\$ 2,682	\$298	\$ 2,980
Net depreciation ^(a)	<u>(2,310)</u>	<u>(288)</u>	<u>(2,598)</u>
Total investment return ^(b)	372	10	382
 Contributions to perpetual endowment	 2,000	 –	 2,000
 Amounts appropriated for expenditure ^(a)	 (7,077)	 (373)	 (7,450)
 Transfer to create board- designated endowment funds	 <u>–</u>	 <u>500</u>	 <u>500</u>
 Total change in endowment funds	 <u>\$ (4,705)</u>	 <u>\$137</u>	 <u>\$ (4,568)</u>

(a) \$125 of 200Y net depreciation occurred in new donor-restricted endowment funds that caused the fair value of those funds to be less than the original gift. In addition, so as not to suspend certain programs, the Board deemed it prudent to continue to appropriate \$75 to those programs.

(b) Of the 200Y investment return from donor-restricted endowment funds, \$286 must be retained permanently in accordance with explicit donor stipulations to maintain the purchasing power of those funds.

C5. The following is an example of disclosures that reflect the assumptions described in paragraph C4.

FOOTNOTE X: ENDOWMENT

Organization A's endowment consists of approximately 100 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. As required by GAAP, net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law

The Board of Trustees of Organization A has interpreted the State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, Organization A classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by SPMIFA. In accordance with SPMIFA, the organization considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund
- (2) The purposes of the organization and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of the organization
- (7) The investment policies of the organization.

200Y

Endowment Net Asset Composition by Type of Fund as of June 30, 200Y

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (200) ¹¹	\$ 39,589	\$ 97,959	\$ 137,348
Board-designated endowment funds	<u>7,084</u>	<u>—</u>	<u>—</u>	<u>7,084</u>
Total funds	<u>\$ 6,884</u>	<u>\$ 39,589</u>	<u>\$ 97,959</u>	<u>\$ 144,432</u>

Note to Reader: The \$200 deficit in unrestricted net assets represents the amounts by which the fair value of certain donor-restricted endowment funds were below the amount required to be retained permanently.

¹¹ \$(200) = (125) + (75)

**Changes in Endowment Net Assets
for the Fiscal Year Ended June 30, 200Y**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 6,947	\$ 46,380	\$ 95,673	\$ 149,000
Investment return:				
Investment income	298	2,396	286	2,980
Net depreciation (realized and unrealized)	<u>(413)¹²</u>	<u>(2,185)¹³</u>	<u>—</u>	<u>(2,598)</u>
Total investment return	(115)	211	286	382
Contributions	—	—	2,000	2,000
Appropriation of endowment assets for expenditure	(448) ¹⁴	(7,002) ¹⁵	—	(7,450)
Other changes:				
Transfers to create board- designated endowment funds	500	—	—	500
Endowment net assets, end of year	<u>\$ 6,884</u>	<u>\$ 39,589</u>	<u>\$ 97,959</u>	<u>\$ 144,432</u>

Note to Reader: In this example, the changes in unrestricted net assets included \$125 of depreciation on investments and \$75 of appropriations for expenditure for donor-restricted endowment funds in which there was a deficiency as of June 30, 200Y, with respect to the amount required to be retained in perpetuity.

Investment returns classified as changes in permanently restricted net assets represent only those amounts required to be retained permanently as a result of explicit donor stipulations. To the extent that actual investment income attributable to funds with such stipulations was less than \$286, the organization would reclassify to permanently restricted net assets a portion of the temporarily restricted net assets associated with those funds and, to the extent there are insufficient temporarily restricted net assets, then unrestricted net assets. That reclassification would be displayed separately from investment return in the above table.

If unrestricted net assets are reclassified, this would result in a presentation in the endowment net asset composition table that is similar to that associated with the situation described in the preceding paragraph.

¹² \$(413) = (288) + (125)

¹³ \$(2,185) = (2,310) + 125

¹⁴ \$(448) = (373) + (75)

¹⁵ \$(7,002) = (7,077) + 75

200X**Endowment Net Asset Composition by Type of Fund
as of June 30, 200X**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ -	\$ 46,380	\$ 95,673	\$ 142,053
Board-designated endowment funds	<u>6,947</u>	—	—	<u>6,947</u>
Total funds	<u>\$ 947</u>	<u>\$ 46,380</u>	<u>\$ 95,673</u>	<u>\$ 149,000</u>

**Changes in Endowment Net Assets
for the Fiscal Year Ended June 30, 200X**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 35,922	\$ 14,369	\$ 93,398	\$ 143,689
Net asset reclassification based on change in law	<u>(28,738)</u>	<u>28,738</u>	—	—
Endowment net assets after reclassification	7,184	43,107	93,398	143,689
Investment return:				
Investment income	287	2,587	—	2,874
Net appreciation (realized and unrealized)	<u>835</u>	<u>7,511</u>	<u>275</u>	<u>8,621</u>
Total investment return	1,122	10,098	275	11,495
Contributions	—	—	2,000	2,000
Appropriation of endowment assets for expenditure	(359)	(6,825)	—	(7,184)
Other changes:				
Transfers to remove board-designated endowment funds	(1,000)	—	—	(1,000)
Endowment net assets, end of year	<u>\$ 6,947</u>	<u>\$ 46,380</u>	<u>\$ 95,673</u>	<u>\$ 149,000</u>

Note to Reader: In this example, investment returns classified as changes in permanently restricted net assets represent only those amounts required to be retained permanently as a result of explicit donor stipulations.

Description of Amounts Classified as Permanently Restricted Net Assets and Temporarily Restricted Net Assets (Endowment Only)

(Disclosure required by paragraphs 14 and 15 of Statement 117)

	<u>200Y</u>	<u>200X</u>
Permanently Restricted Net Assets		
(1) The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or by SPMIFA	\$ <u>97,959</u>	\$ <u>95,673</u>
Total endowment funds classified as permanently restricted net assets	\$ <u>97,959</u>	\$ <u>95,673</u>
Temporarily Restricted Net Assets		
(1) Term endowment funds	\$ 4,388	\$ 5,058
(2) The portion of perpetual endowment funds subject to a time restriction under SPMIFA:		
Without purpose restrictions	20,102	22,965
With purpose restrictions	<u>15,099</u>	<u>18,357</u>
Total endowment funds classified as temporarily restricted net assets	\$ <u>39,589</u>	\$ <u>46,380</u>

Note to Reader: This illustrative disclosure includes only the permanently and temporarily restricted net assets within the organization's endowment. A typical disclosure would be presented outside an endowment note disclosure and include all of the net assets classified in the permanently and temporarily restricted net asset classes. The amounts contained in the specific lines within the temporarily restricted section of that disclosure are purely for illustrative purposes; additional information beyond that provided in paragraph C4 would be needed to determine those amounts. In addition, in a typical disclosure prepared in accordance with paragraphs 14 and 15 of Statement 117, the organization would provide a further breakdown of the types of purpose restrictions (for example, for scholarships, research, community service). The balances related to Item D of paragraph C4 would be not only time restricted but also purpose restricted.

Funds with Deficiencies

(Disclosure required by paragraph 15(d) of Statement 124)

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or SPMIFA requires the Organization to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were \$200 as of June 30, 200Y. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the Board of Trustees. There were no such deficiencies as of June 30, 200X.

Return Objectives and Risk Parameters

Organization A has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for a donor-specified period(s) as well as board-designated funds. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of the S&P 500 index while assuming a moderate level of investment risk. Organization A expects its endowment funds, over time, to provide an average rate of return of approximately 9 percent annually. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, Organization A relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Organization targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy

Organization A has a policy of appropriating for distribution each year 5 percent of its endowment fund's average fair value over the prior 12 quarters through the calendar year-end preceding the fiscal year in which the distribution is planned. In establishing this policy, the Organization considered the long-term expected return on its endowment. Accordingly, over the long term, the Organization expects the current spending policy to allow its endowment to grow at an average of 4 percent annually. This is consistent with the organization's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

C6. For the purpose of illustration, the organization in the example in paragraphs C4 and C5 is subject to a state law that its governing board has interpreted as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. If, on the other hand, an organization were subject to a state law that its governing board interpreted as requiring the maintenance of purchasing power for donor-restricted endowment funds, then the organization would periodically adjust the amount in permanently restricted net assets to reflect that interpretation. Under those circumstances, the organization would use the inflation (deflation) index (or indexes) that it deems most relevant for adjusting the permanently restricted net assets of the funds (for example, the Consumer Price Index (CPI) or the Higher Education Price Index (HEPI)).

C7. If the organization in this example were subject to an enacted version of UPMIFA that its governing board interpreted as requiring the organization to maintain the purchasing power of its donor-restricted endowment funds, the example disclosure could be modified to read as follows:

Interpretation of Relevant Law

The Board of Trustees of Organization B has interpreted the State Prudent Management of Institutional Funds Act (the Act) as requiring the preservation of the purchasing power (real value) of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, Organization B classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment, (3) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund, and (4) the portion of investment return added to the permanent endowment to maintain its purchasing power. For purposes of determining that portion, each year Organization B adjusts permanently restricted net assets by the change in the Consumer Price Index (CPI) for that year. If the endowment assets earn investment returns beyond the amount necessary to maintain the endowment assets' real value, that excess is available for appropriation and, therefore, classified as temporarily restricted net assets until appropriated by the Board for expenditure. In accordance with the Act, Organization B considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund

- (2) The purposes of the organization and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of the organization
- (7) The investment policies of the organization.