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Non-Profit Endowments and ASC 958-205 (FAS 117-1): Compliance Challenges

Making Tough Decisions on Asset Classification and Disclosures

WEDNESDAY, JULY 13, 2011

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Non-Profit Endowments and ASC 958-205 (FAS 117-1): Compliance Challenges Seminar

July 13, 2011

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Today's Program

Rhona Kwiram, Clark Nuber

LATEST UPMIFA DEVELOPMENTS

History Of UPMIFA

- Uniform Prudent Management of Institutional Funds Act (UPMIFA)
  - Replaced UMIFA (1972)
  - Model act, approved by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in 2006
  - Adopted by all states except Mississippi and Pennsylvania

What Does UPMIFA Do?

- Updates and clarifies standard of care applicable when managing, investing and spending from institutional funds
- Gives greater flexibility for spending in a down market
- Allows modification of restrictions on old and small funds
- Modernizes the law
  - More similar to UPIA (1994) which applies to trusts

Recent State Actions

- New York
  - Adopted Sept. 17, 2010
  - Applies to:
    - Not-for-profit corporations
    - Wholly charitable trusts in which the trustee is a NFP corporation
    - Not limited to charitable corporations
      - Includes 501(c)(4) social welfare, 501(c)(6) business leagues and trade associations, and 501(c)(7) social clubs
  - Applies to New York corporations, wherever they are located

Recent State Actions (Cont.)

- New York differences
  - "Opt in, opt out" notice given to "available donors" regarding appropriations from existing funds
    - 90 days before first appropriation
  - "Imprudence" if greater than 7%
  - Contemporaneous record for decisions to appropriate
    - Consider alternatives to expenditure
  - Notify donors of the power of appropriation
  - Requirement for a policy in accordance with the standard, regardless of whether investments are held
  - Assess independence of investment managers
  - Review decisions not to diversify

Resource For New York

- "A Practical Guide to the New York Prudent Management of Institutional Funds Act," by attorney General Eric T. Schneiderman
  - www.charitiesnys.com

Recent State Actions (Cont.)

- Florida
  - House Bill 599
  - Applies to all charitable institutions (UMIFA applied only to educational funds)
  - Approved by governor June 17, 2011
  - Effective date: July 1, 2012

- Mississippi
  - Introduced legislation – Senate Bill 2454
  - Died in committee March 1, 2011

Other State Actions

- Pennsylvania
  - Not expected to adopt
- Puerto Rico
  - Expected
- District of Columbia, U.S. Virgin Islands
  - Already adopted

Neely Duncan, Lane Gorman Trubitt PLLC

REVIEW OF MATERIAL TERMS OF ASC 958-205 (FAS 117-1)

FSP FAS 117-1, As Codified In ASC 958-205

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

July 13, 2011

Presented by:
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ASC 958-205 (FAS 117-1) Overview

- FAS 117-1 (as codified in ASC 958-205) is effective for fiscal years ending after Dec. 15, 2008.

- Requires enhanced disclosures

- Provides guidance on the net asset classification of *donor-restricted endowment funds* (definition per standard coming soon)

- For the accounting treatment, remember that this need not be applied to immaterial items (straight out of the standard).

ASC 958-205 (FAS 117-1) Overview (Cont.)

* TUPMIFA does not change standard accounting for funds.

- Can spend the principal i.e. elimination of the HDV (discussed later)

- Can have underwater funds (more to come)

- The standard is also meant to improve disclosures about an organization's *endowment funds* (both donor-restricted endowment funds and *board-designated endowment funds*), whether or not the organization is subject to UPMIFA.

ASC 958-205 (FAS 117-1) Overview (Cont.)

- An endowment fund is defined by the standard as “an established fund of cash, securities, or other assets to provide income for the maintenance of a not-for-profit organization.”

- 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.

- 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 for a long but unspecified period.

ASC 958-205 (FAS 117-1) Overview (Cont.)

- A board-designated fund is only considered a quasi-endowment if the board has specifically designated the return for long-term purposes.

- Terms such as “endowment,” “only the interest is available for use in current operations,” and “provide interest income to support operations over the long-term” would be indicative that the board intended an arrangement that is a quasi-endowment under GAAP.

ASC 958-205 (FAS 117-1) Overview (Cont.)

- Generally, an operating reserve is available for emergency or capital purposes, i.e. the board could decide to build a building with those funds without reversing a prior decision of the board. When that is the case, the funds are not a quasi-endowment.

ASC 958-205 (FAS 117-1) Overview (Cont.)

- Generally established by donor-restricted gifts and bequests to provide a permanent endowment (a permanent source of income) or a term endowment (income for a specified period)
  - The portion of a **permanent endowment** that must be maintained permanently 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.
  - A governing board may earmark a portion of unrestricted net assets as a **board-designated endowment** to be invested to provide income for a long but unspecified period. A board-designated endowment is not donor-restricted and is classified as unrestricted net assets.

- Applies regardless of the application of UPMIFA

ASC 958-205 (FAS 117-1) Overview (Cont.)

- 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.

ASC 958-205 (FAS 117-1) Overview (Cont.)

- 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), then that portion would be classified as permanently restricted net assets.

ASC 958-205 (FAS 117-1) Overview (Cont.)

- The board also considered the question of whether the language in 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 URNA.
- 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.
- UPMIFA abolishes the historic dollar value limitation on expenditure in UMIFA.

ASC 958-205 (FAS 117-1) Overview (Cont.)

- 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.

- 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.

ASC 958-205 (FAS 117-1) Overview (Cont.)

- Permanently restricted net assets are not reduced by investment losses **or organizational appropriations for spending**.
- Instead, temporarily restricted or unrestricted net assets would be charged.
- The only balances in donor endowments that will be classified as unrestricted are **negative balances in underwater situations**.

ASC 958-205 (FAS 117-1) Overview (Cont.)

- Underwater investments are those for which the current market value is less than the amount required to be maintained as donor-restricted net assets.
- Previous accounting guidance required a disclosure for investments that were significantly underwater, but it did not require a specific disclosure format.
- The tabular presentation required by the standard clearly communicates the existence underwater endowments for financial statement users.
- Debt covenants: Significant reduction of URNA could violate debt covenants.
  - Review covenants and if necessary, discuss changes with lenders. You may need a waiver or amendment.

ASC 958-205 (FAS 117-1) Overview (Cont.)

- 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 standard, appropriation for expenditure is deemed to occur upon approval for expenditure; unless approval is for a future period, in which case appropriation is deemed to occur when that period is reached.

ASC 958-205 (FAS 117-1) Overview (Cont.)

- 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.

ASC 958-205 (FAS 117-1) Overview (Cont.)

- An organization, (regardless of whether 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)
  - Related investment policy(ies) of its endowment funds (both donor-restricted and board-designated)

ASC 958-205 (FAS 117-1) Overview (Cont.)

Prudent Spending

- Eliminates bright-line test (or HDV) in favor of multi-faceted prudence standards
  - No longer can a board spend any amount so long as it doesn't affect HDV
  - Allows spending from an underwater endowment (FMV < amount restricted by the donor) if the board determines it is prudent to do so
  - To what extent expenditures from underwater fund are prudent is not easy to determine.

- Non-profits should have revisited their investment and spending policies after TUPMIFA, and the policies may vary by fund, depending on the terms of the gift instrument(s).

ASC 958-205 (FAS 117-1) Overview (Cont.)

Prudent Spending (Cont.)

Seven criteria/factors to guide board regarding spending

1. Duration and preservation of the endowment fund
2. Purposes of the institution and the endowment fund
3. General economic conditions
4. Effects of inflation or deflation
5. Expected total return from income and the appreciation of investments
6. Other resources of the institution
7. Investment policy of the institution

ASC 958-205 (FAS 117-1) Overview (Cont.)

TUPMIFA Presumption of Imprudence

- **Common misconception that this is a safe harbor**, particularly because UMIFA gave us a bright-line rule
- Applies to expenditures from TUPMIFA endowment funds, but not to institutional funds
- If spending from endowment fund exceeds thresholds:
  - Funds > $1MM: Presumption at 7% FMV
    - University systems > $450MM: 9% FMV
  - Funds < $1MM: Presumption at 5% FMV
- FMV is determined quarterly and averaged over a three-year period (or if in existence less than three years, for the period since inception).

ASC 958-205 (FAS 117-1) Overview (Cont.)

Modification and Release

- Small/old funds: If a restriction is unlawful, impracticable, impossible to achieve or wasteful, an institution may release or modify a restriction <u>without</u> donor consent or court approval if <u>all of these conditions are met</u>:
  - Institutional fund < $25,000
  - Institutional fund is more than 20 years old
  - Will be used consistent with charitable purposes
  - Requires attorney general's notice

- Example: $15,000 fund set up in 1973 for the cure of polio. With AG notice, you can release restriction and use for a purpose consistent with original purpose (e.g., cure of other children's diseases).

ASC 958-205 (FAS 117-1) Overview (Cont.)

Examples

- Board-designated endowment fund (i.e., assets set aside by the board (no donor instruction) of a university to accumulate for 20 years and then fund a new library)
- A fund held by a charity, where the donor has directed that only income be spent for scholarships
- A fund held by a charity, with a donor restriction that it only be spent for a new school laboratory

ASC 958-205 (FAS 117-1) Overview (Cont.)

Examples (Cont.)

- “This money should be kept intact and the income from it used for the University of Miami.”
- “This money should be kept intact, and the income from it should be used for the purchase of books for the University of Miami library.”
- “This money should be kept intact for a period of 20 years, during which the income from it should be used only for the purchase of books at the University of Miami library, and thereafter the money may be used for the general use of the university.

Second-Year Implementation, Example #1

- Just for Fun Charities has a $100,000, permanently restricted endowment to support miniature golf tournaments for pre-schoolers. The endowment was underwater as of June 30, 2009, as a result of depreciation of investments. The fair market value was $90,000.

- How would Just for Fun Charities record these balances for June 30, 2009?

- Now, as of June 30, 2010, the investments are worth $105,000. No funds have been spent for the designated purpose.

- How would Just for Fun Charities record the endowment income and balances for June 30, 2010?

Answer No.1

- At June 30, 2009, Just for Fun Charities has a deficit of $10,000 in URNA due to the underwater fund.

- For 2010, the first $10,000 of endowment income “restores” this deficit. The remaining income, if any, is TR under 117-1.

	UR	TR – Mini Golf	PR
Balance 6/30/2009	($10,000)	$ 0	$ 100,000
Endowment Income	10,000	5,000	0
Balance 6/30/2010	$ 0	$ 5,000	$ 100,000

Second-Year Implementation Example #2

- In the previous example, Just for Fun Charities did not spend any of the income generated in the second year.
- How would the income and balances be recorded if Just for Fun Charities hosted a mini golf tournament for pre-schoolers in April 2010 and incurred $3,000 of expenses that qualify for the purpose restriction of the endowment?

Answer No. 2

- If expenses are incurred that qualify for the purpose restriction of the endowment (mini golf for pre-schoolers), then there is no change to the recording of the endowment income or balances unless the funds are appropriated from the endowment.

- If there was also an appropriation from the endowment during the year, then there would be a release from TR of $3,000.

	UR	TR – Mini Golf	PR
Balance 6/30/2009	($10,000)	$ 0	$ 100,000
Endowment Income	10,000	5,000	0
Balance 6/30/2010	$ 0	$ 5,000	$ 100,000

Practical Example #3

- A donor gives you a $100,000 endowment that states it should remain intact. But, the gift is silent on what to do with any income earned, and the Just for Fun Charities assumption is that the governing board determined and interpreted with their attorney that the relevant law requires the organization to retain permanently some portion (in this case, let's say 1%) of the gains on investment assets of endowment funds in instances when the donor is silent on how to spend the income.

- How would this be recorded?

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CURRENT DISCLOSURE ISSUES WITH FINANCIAL STATEMENTS

Introduction To The Note

- Example

The School's endowments consist of approximately 155 funds established for a variety of purposes. Its endowments include both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments (quasi-endowments). As required by GAAP, net assets associated with endowment funds, including quasi-endowments, are classified and reported based on the existence or absence of donor-imposed restrictions. The School manages its endowments on a pooled basis, under the direction of the Assets Management Committee, and earnings on the pooled investments are allocated on a pro rata basis to each of the funds.

Description Of Law

- Disclosure requirement
  - A description of the governing board's interpretation of the law or laws that underlie the NFP's net asset classification of donor-restricted endowment funds

- Comments
  - Use the correct law
    - Where was the NFP incorporated?
  - Make sure the board has adopted policies that match the law

Description Of Law (Cont.)

- Example

Interpretation of Relevant Law - The Board of Trustees of the School has interpreted the Washington State Uniform Prudent Management of Institutional Funds Act (UPMIFA) 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, the School classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, and (b) the original value of subsequent gifts to the permanent endowment.

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 School in a manner consistent with the standard of prudence prescribed by UPMIFA.

In accordance with UPMIFA, the School considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the fund;
- The purposes of the School and the donor-restricted endowment fund;
- General economic conditions;
- The possible effect of inflation and deflation;
- The expected total return from income and the appreciation of investments;
- Other resources of the School; and
- The investment policies of the School.

Investment Policies

- Requirement
  - A description of the NFP’s endowment investment policies, including all of the following:
    - Return objectives and risk parameters
    - How return objectives relate to the NFP’s endowment spending policy (often included in the spending policy)
    - The strategies employed for achieving return objectives

Investment Policies (Cont.)

- Comments
  - Don’t just copy the example; personalize it for your situation
  - Make sure there is correlation between the spending and investing policies
  - What about donor-required investment policies that differ?

Investment Policy Example

Return Objectives and Risk Parameters - The School has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowments while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the school must hold in perpetuity or for donor-specified periods 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 so that the endowment investments are in the top quartile of any distribution of competitors' performance over rolling five-year or ten-year periods. The School expects its endowment funds, over time, to increase faster than the rate of inflation. Actual returns in any given year may vary.

Strategies Employed for Achieving Objectives - To satisfy its long-term rate-of-return objectives, the School relies on a total return strategy in which investment returns are achieved through both capital appreciation, realized and unrealized, and current yield, such as interest and dividends. The School targets a diversified asset allocation that has a long-term target of 60% equities, 20% inflation protection, and 20% fixed income to achieve its long-term return objectives within prudent risk constraints.

Investment Policy Example (Cont.)

Return Objectives and Risk Parameters - The Foundation 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. Under this policy, as approved by the Foundation's Board of Directors, the endowment assets are invested in a manner that is intended to achieve a cumulative real rate of return (nominal return less the Consumer Price Index) of between 1% and 2.5% compounded annually for a moving five-year period. 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, the Foundation relies on a total return strategy in which investment returns are achieved through both capital appreciation, realized and unrealized, and current yield such as interest and dividends. The Foundation 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 Policies

- Requirement
  - A description of the NFP's policy or policies for the appropriation of endowment assets for expenditure.
- Comments
  - Ranges
  - Room for discretion
  - What about donor-imposed spending amounts that differ from the norm?
  - What if the board suspends spending due to underwater situations?

Spending Policy Examples

The School has a policy of appropriating for distribution each year four to five percent of its endowment assets' average fair value over the prior 12 quarters through the fiscal year-end preceding the fiscal year in which the distribution is planned. This is consistent with the School'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.

Spending Policy Examples (Cont.)

The Alliance has a policy of appropriating for distribution each year an amount appropriate to the various endowments. The distribution rate, expressed as a percentage of market value of the endowment investments, is determined on a year-to-year basis by the Executive Committee upon recommendation of the Finance and Audit Committee of the Board. In light of current market conditions, the Alliance does not expect to make distributions from the earnings of permanently restricted endowment funds in the next fiscal year.

Spending Policy Examples (Cont.)

The XXX has a spending policy to distribute from the Endowment Fund annually no more than four percent (4%) of the average of the fair market value of the Endowment Fund on June 30 of the current year and the immediate two prior years. In the event of exceptional growth in the Endowment Fund, the Finance Committee and Endowment Committee may consider additional distributions, subject to approval of the Board of Trustees

Spending Policy Examples (Cont.)

The XXX Garden Endowment is a permanently restricted endowment fund with a donor-imposed spending policy that overrides the general spending policy of the Foundation. The donor has specified an annual spending rate of 4% which is to be followed even if it should result in some use of principal.

Composition Of Net Assets

- Requirement
  - The composition of the NFP'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

Composition Of Net Assets (Cont.)

- Comments
  - Consider more lines to clarify between types of endowments
  - Do perpetual trusts belong?
  - Consider reconciliation between endowment disclosure and total net assets

Composition Example

- Standard disclosure

Endowment net assets for the years ended June 30, consisted of the following:

	Unrestricted	*Temporarily Restricted*	*Permanently Restricted*	*2010 Total*
Donor restricted endowment funds	$ (332,402)	$ 531,949	$ 9,567,320	$ 9,766,867
Quasi-endowment funds	4,579,259			4,579,259
Endowment Net Assets, June 30	**$ 4,246,857**	**$ 531,949**	**$ 9,567,320**	**$14,346,126**

- Alternative reconciliation to total net assets

Reconciliation of Endowment Net Assets to Permanently Restricted Net Assets:

	2010	*2009*
Permanently restricted endowment net assets	$ 9,567,320	$ 9,509,195
Permanently restricted endowment pledges receivable	2,919,200	2,834,300
Total Permanently Restricted Net Assets	**$ 12,486,520**	**$ 12,343,495**

Roll-Forward

- Requirement
  - A reconciliation of the beginning and ending balance of the NFP's endowment, in total and by net asset class, including at a minimum all of the following line items that apply:
    - Investment return, separated into both of the following: Investment income (for example, interest, dividends, rents) and net appreciation or depreciation of investments.
    - Contributions
    - Amounts appropriated for expenditure
    - Reclassifications
    - Other changes.

Roll-Forward Example

Changes to endowment net assets for the years ended June 30, were as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	2010 Total
Endowment net assets beginning balance	$ 3,782,933	$ -	$ 9,509,195	$13,292,128
Endowment investment return				
Interest and dividends	27,048	160,695		187,743
Realized and unrealized gains (losses)	288,911	978,865		1,267,776
Endowment investment return	315,959	1,139,560		1,455,519
Contributions and pledge payments	112,854		58,125	170,979
Appropriation of endowment	(202,100)	(370,400)		(572,500)
Recovery of funds with deficiencies	237,211	(237,211)		
Endowment Net Assets, Ending Balance	**$ 4,246,857**	**$ 531,949**	**$ 9,567,320**	**$14,346,126**

Roll-Forward Issues

- Comments
  - Investment income break-out: How to allocate
  - Showing recoup of losses (alternative presentation)

Endowment investment return				
Interest and dividends, net of fees		740,134		740,134
Realized and unrealized gains and losses		12,038,241		12,038,241
Recovery of prior year underwater amounts	1,773,916	(1,773,916)		
Total endowment investment return	1,773,916	11,004,486		12,778,375

Roll-Forward Issues (Cont.)

- Changes in donor intent

During the year ended December 31, 2009, the Board-established endowment committees of the XXX Scholarship and the YYY Foundation amended their respective fund agreements to clarify that the historic value of the original contributions to those endowments need not be preserved in perpetuity. However, they continued to request that the funds be invested and treated as endowments. The amendments formally change the classification of these endowments from permanently restricted to temporarily restricted. As a result, $267,325 of permanently restricted net assets were reclassified as temporarily restricted net assets during the year ended December 31, 2009.

In addition, during the year ended December 31, 2009, donors of certain other endowment funds changed their intent and redirected their prior contributions to outside charitable organizations. This resulted in a decrease of permanently restricted net assets of $588,084, and a decrease of temporarily restricted net assets of $10,235.

Roll-Forward Issues (Cont.)

- Changes in donor intent (Cont.)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Net Assets, December 31, 2008	**$ (123,914)**	**$ 5,019,117**	**$ 994,607**	**$ 5,889,810**
Endowment investment return:				
Endowment fees		(117,044)		(117,044)
Interest and dividends		184,670		184,670
Realized and unrealized losses		1,120,724		1,120,724
Total endowment investment return		1,188,350		1,188,350
Contributions		2,000	18,129	20,129
Transfers to cover deficiencies	123,914	(123,914)		
Transfers outside the endowments (Note 10)		(10,235)	(588,084)	(598,319)
Transfers within endowments (Note 10)		267,325	(267,325)	
Transfers to other funds		(125,000)		(125,000)
Appropriation of endowment for expenditure		(68,105)		(68,105)
Endowment Net Assets, December 31, 2009		**6,149,538**	**157,327**	**6,306,865**

Roll-Forward Issues (Cont.)

- What to do with investment fees
  - Separate line

Endowment investment return:				
Endowment fees		(117,044)		(117,044)
Interest and dividends		184,670		184,670
Realized and unrealized losses		1,120,724		1,120,724
Total endowment investment return		1,188,350		1,188,350

  - Netted against interest and dividends

Endowment investment return				
Interest and dividends, net of fees	2,615	14,157		16,772
Realized and unrealized gains and losses	21,543	116,657		138,200
Total endowment investment return	24,158	130,814		154,972

Deficiencies

- Requirement
  - For each period for which a statement of financial position is presented, an NFP shall disclose 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.

Deficiencies Example

- **Funds with Deficiencies -** 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 UPMIFA requires the School to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were $3,199,944 as of June 30, 2010. These deficiencies resulted from unfavorable market fluctuations that occurred during the year. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in unrestricted net assets. The gains during the year ended June 30, 2010, were $1,773,916. There were deficiencies of $4,973,860 at June 30, 2009.

Deficiencies Example (Cont.)

- **Funds with deficiencies -** From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the total amount of the gifts made to the endowment by the donor. Deficiencies of this nature that are reported in unrestricted net assets were $858,399 and $2,599,771 as of December 31, 2010 and 2009, respectively. These deficiencies resulted from unfavorable market fluctuations.
- **Funds with deficiencies -** From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor contributed. There were no deficiencies at December 31, 2010 or 2009.

Typical Errors Or Issues Of Confusion

- Understanding when the standard applies for GAAP vs. the legal concepts
- What is the difference in operating reserves and board-designated endowments?
- Misunderstanding of the difference between the investment account balance and the endowment fund balance

Typical Errors Or Issues Of Confusion (Cont.)

- What about the organization facing a going concern situation?
- Year-of-implementation issues
- Accounting for underwater funds when the deficit has been restored
- The footnote not agreeing with the face of the financial statements
- Not properly applying or analyzing the spending policy

Typical Errors Or Issues Of Confusion (Cont.)

- If money is appropriated but not spent, should it be removed from the endowment disclosure?
- Board appropriations for the following fiscal year
- Should I include pledges receivable associated with donor endowments in the tabular disclosures?
- Should I include split-interest investments that are pooled with endowment funds in the tabular disclosures?

Brian Zygmunt, Crowe Horwath

POST-ASC 958-205: FOUNDATION POLICY REVISIONS

ASC 958-205: Policy Considerations

- Investment policy
  - Return Objectives
  - Risk parameters
  - Relationship between return objectives and risk parameters
- Endowment spending policy
- Valuation policy
- Generic donor gift instrument
  - An example that allows for payouts to invade corpus
- Draft board resolution to clarify definitions upon implementation

ASC 958-205: Policy Revisions

- Description of the organization's endowment investment and spending policies
  - Prior to UPMIFA and 958-205, investment policies were often limited to the responsibility for oversight of managers, target asset allocation, and sometimes return objectives.
  - With the advent of UPMIFA and 958-205, an organization's investment policies should have much more robust content to comply with updated requirements.
  - So, what is required to be disclosed in financial statements of NFPs under ASC 958-205?
    - Policies for appropriation of endowment assets for expenditure
    - Return objectives
    - Risk parameters
    - Strategies employed for achieving those objectives
    - Relationship between return objectives and risk parameters
  - These factors all need to be considered in concert with each other, as decisions made in each area directly affect each other.

ASC 958-205: Policy Revisions (Cont.)

- Example of investment policy
  - Sect. 3 investment objectives
    - Balancing the support for current operations with the long-term goal of developing and maintaining a strategic advantage
  - Sections 4 and 5 performance goals and asset allocation
    - To what are we going to benchmark?
    - Develop asset allocation
    - Organizations need to work with investment committee and advisors to develop these components of the policy.
  - Spending policy
  - Execution
    - Investment management guidelines
    - Selection of new managers
    - Delegation of responsibilities
    - Conflict of interest policy
    - Evaluation and review process

ASC 958-205: Policy Revisions (Cont.)

- Stakeholders in process
  - Trustee
    - Finance committee
    - Audit committee
    - Investment committee
  - Senior management team
    - Finance
    - Development
  - Investment managers/consultants
  - Legal counsel
  - Audit firm