



FSP 117-1 and UPMIFA: Separating Myth from Reality

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Presented by

John Mattie

Partner, *PriceWaterhouseCoopers* LLP

&

Jeff Mechanick

Assistant Director, FASB



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Presentation Overview

- UPMIFA & Net Asset Classification Under FSP FAS 117-1 (including some key implementation matters)
- FSP FAS 117-1 Disclosure Requirements (including some key implementation matters)
- Other Implementation Questions



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FSP FAS 117-1 (Endowments & UPMIFA)

- Objectives:
 - Provide guidance on net asset classification of donor-restricted endowment funds for not-for-profit organizations subject to UPMIFA
 - Improve disclosures about an organization's endowment funds (both donor-restricted and board-designated), whether or not the organization is subject to UPMIFA



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FSP FAS 117-1: Effective for Fiscal Years Ending After December 15, 2008

- Net asset classification guidance effective for NFPs with donor endowments in states in which that law has been enacted and is effective
 - If UPMIFA was first effective in a prior year, see slide 30 on transition provisions
- Disclosure requirements effective for all NFPs with endowments (including board-designated endowments)



UPMIFA: What Is It?

- The Uniform Prudent Management of Institutional Funds Act of 2006
- A model act that serves as the basis for state-by-state legislation
- An overhaul/ modernization of the Uniform Management of Institutional Funds Act of 1972, which has/had been the basis for primary endowment laws in 46 states and the District of Columbia



UPMIFA Highlights

- UPMIFA abolishes the historic dollar value limitation on expenditure in UMIFA.
- Seven percent rule. States may adopt a provision that creates a rebuttable presumption of imprudence if an institution expends an amount greater than 7% of the fair market value of a fund, calculated in an averaging formula over three years. (Not addressed in UMIFA)
- Release of restrictions for small institutional funds. These is a new procedure for releasing restrictions on small institutional funds (less than \$25,000) held for a long period of time (20 years), requiring only notice to the Attorney General 60 days in advance of the release. (Not addressed in UMIFA)



UPMIFA Highlights

- Application. UPMIFA applies to funds held in any form, including nonprofit corporate form, except charitable trusts, with a commercial or individual trustee. (UMIFA applies only to endowments held by a charitable institution for its own account)





UPMIFA: Factors to Consider in Prudent Appropriation for Spending

1. The duration and preservation of the endowment fund;
2. The purposes of the institution and the endowment fund;
3. General economic conditions;
4. The possible effect of inflation or deflation;
5. The expected total return from income and the appreciation of investments;
6. Other resources of the institution; and;
7. The investment policy of the institution.



UPMIFA: Other Key Points

- Most of the provisions of UPMIFA, including the key appropriation provisions, only apply to donor endowments, not board designated endowments (or other funds).
- UPMIFA applies retroactively, that is, to all such funds in existence, not just to new funds received after the law is effective.

And, VERY IMPORTANT:

- The specific provisions of UPMIFA only apply in the absence of explicit donor stipulations.



Net Asset Classification with UMIFA

- FAS 117 and 124, EITF Topic D-49
- Net asset classification is done fund-by-fund and then aggregated: a “cross-section” through the institution’s equity.
- Historic dollar value (HDV) portion of fund is classified as permanently restricted net assets
- Portion of each fund in excess of HDV:
 - Additional amounts a governing board determines that the law requires to be retained permanently are also classified as permanently restricted net assets
 - Rhode Island: maintenance of purchasing power
 - Remainder of fund is classified as temporarily restricted or unrestricted net assets



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Net Asset Classification with UMIFA

- Losses that bring the value of the fund below HDV are charged to temporarily restricted or unrestricted net assets, rather than permanently restricted net assets.
- In sum:
 - Unless maintenance of purchasing power is required by either the donor or the state’s UMIFA, the amount classified as permanently restricted net assets for a particular fund **doesn’t** change from year to year.



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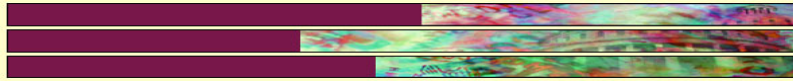
UPMIFA: Provisions with Issues for Net Asset Classification

- Elimination of the concept of historic dollar value, in favor of more robust guidance on what constitutes “prudent” endowment spending (including explicit consideration of preservation of the fund).
 - *Question: How does this affect the amount classified as permanently restricted net assets?*
- Statement that “Unless stated otherwise in the gift instrument, the assets in an endowment fund are donor-restricted assets until appropriated for expenditure by the institution.”
 - *Question: How does this affect classification of the remainder of the fund?*



Net Asset Classification with UPMIFA: Response to Elimination of HDV

- FASB decided not to overhaul the basic net asset classification model (broader than donor endowments) at this time
- Focused on an organization’s (governing board’s) fiduciary duty for a fund of permanent duration
- Felt it important to retain key data point in the face of a new law without interpretation or enforcement history
 - UPMIFA/ legislative powers versus Common Law/ judicial powers
 - Our current “trial by fire”: widespread underwater funds
- Relationship to and importance of disclosures



Net Asset Classification with UPMIFA: Response to Legal Restriction of Assets Until Appropriation

- FASB decided to give accounting significance (for the first time) to the act of Board appropriation
 - UPMIFA's wording here, together with the added rigor around prudence and the appropriation process, tips the more appropriate/ useful net asset classification to temporarily restricted (time restriction)
- Such classification will simplify reporting, minimize confusion, and foster better communication with non-accountants
- Relationship to and importance of disclosures



Net Asset Classification with UPMIFA: What Hasn't Changed (Much)?

- In the absence of explicit donor stipulations, an institution must determine what portion of a donor-restricted fund the state's UPMIFA (and other relevant law) requires the organization to retain permanently.
 - Reflects the organization's fiduciary duty for a fund of permanent duration
 - Depending on whether or not the state's UPMIFA is interpreted to require maintenance of purchasing power, the portion will likely be either the equivalent of HDV or purchasing-power-maintained HDV (see next slide)
- Only that portion is classified as permanently restricted net assets.



Net Asset Classification with UPMIFA: Key Implementation Question

- Does “plain vanilla” UPMIFA require the maintenance of purchasing power?
- Answer: No. While the drafting committee’s commentary to the Model Act certainly encourages it through prudent spending and investment policies, the final Act, unlike an earlier version, contains no such legal requirement.
- An institution must thus look for any modifications made during enactment by the particular state or any guidance put out by the state’s attorney general. To date, we are not aware of any such modifications* or AG guidance.
 - * However, we should note Rhode Island may modify its UPMIFA here, just as it did its UMIFA. Also, a couple of years ago, Florida enacted a law for its educational institutions based on the earlier draft of UPMIFA.



Net Asset Classification with UPMIFA: What Hasn’t Changed (Much)?

- Permanently restricted net assets are not diminished by investment losses **or organizational appropriations for spending.**
 - Rationale: The organization’s permanent fiduciary duty for a fund of permanent duration is unchanged
 - (Short-term) funding/ cash management flexibility for legal purposes versus net asset classification for financial reporting purposes
- Instead, temporarily restricted or unrestricted net assets would be charged.
 - *Hugely important:* that charge is **within the endowment**, not within operating funds. (see slide 34)



Net Asset Classification with UPMIFA: What Has Changed?

- UPMIFA implies a **time restriction** until funds are appropriated.
- The act of appropriation no longer merely involves ordinary business prudence (the basis for the answer in Topic D-49). Amounts in excess of the portion classified as permanently restricted will be classified **entirely as temporarily restricted**, not as mix of temporarily restricted and unrestricted net assets.
 - The only balances in donor endowments that will be classified as unrestricted are **negative balances in underwater situations**. (see slide 34)



Net Asset Classification with UPMIFA: The Time Restriction

- The time restriction lapses **upon appropriation**.
- Appropriation is considered to occur with **approval** for expenditure, **unless** the approval is for a future period.
- For funds without purpose restrictions, reclassification to unrestricted occurs at that time.
- For funds with purpose restrictions, reclassification can only happen when funds are spent or deemed spent for that purpose.
- Purpose restrictions cannot be released until amounts are appropriated: the “deemed spent” rule will **no longer apply** to unappropriated amounts.



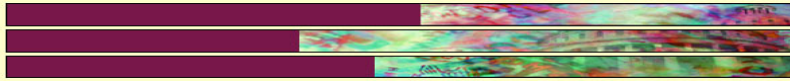
Net Asset Classification with UPMIFA: Putting It All Together

- **Step I: New gift comes in for endowment, without explicit donor language affecting initial net asset classification**
 - Managed as one fund, likely unitized as part of an investment pool
 - All (or some) classified as PRNA for financial reporting purposes
 - Remainder (if any) is classified as TRNA.



Net Asset Classification with UPMIFA: Putting It All Together

- **Step II: Investment activity**
 - Allocated to fund based on unitization
 - PRNA normally does not increase or decrease
 - *Exception: requirements by donor or law such as to maintain purchasing power*
 - Increase or decrease is to TRNA
 - *Exception: In underwater situations, TRNA cannot be negative so URNA would be decreased.*
 - *Very Important: that URNA "deficit" is within the endowment. (see slide 34)*



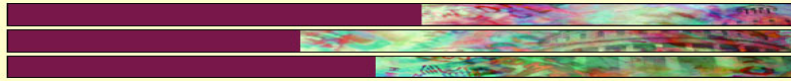
Net Asset Classification with UPMIFA: Putting It All Together

- Step III: Moneys are spent elsewhere for the same purpose
 - No effect on either the fund balance **or** on net asset classification
 - A time restriction is still in place until appropriation and thus the funds are unavailable for spending for that purpose
 - In other words, unlike with net asset classification for UMIFA endowments, the “deemed spent” rule does not apply here and there is no reclassification to URNA for financial reporting purposes.



Net Asset Classification with UPMIFA: Putting It All Together

- Step IV: Board approves funding from the endowment for next year’s budget
 - No effect on either the fund balance or net asset classification until next year is reached



Net Asset Classification with UPMIFA: Putting It All Together

- Step V: Next year is reached and the amounts approved are now available for spending
 - Fund balance is reduced by that amount, even if the cash is not yet transferred: in effect the cash is due to the corresponding non-endowment fund where it will be spent (operating fund, plant fund, etc.)
 - Alternative treatment: in a corresponding board-designated endowment fund until the cash is moved
 - The UPMIFA time restriction for accounting purpose expires because appropriation for accounting purposes is now deemed to be complete.



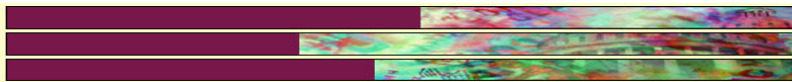
Net Asset Classification with UPMIFA: Putting It All Together

- Step V, cont'd:
 - If the fund has no purpose restriction (beyond being an endowment), there is a reclassification of those amounts from TRNA to URNA
 - *Very important: Such net assets are no longer associated with the donor endowment. Remember, the only URNA amounts associated with donor endowments are negative URNA ("deficits") when the fund is underwater.*
 - If the fund has a purpose restriction, the reclassification would not occur until the amounts are spent or deemed spent for that purpose.
 - *Without the time restriction, such amounts are now available for spending and the deemed spent rule would apply.*



FSP FAS 117-1 Transition on Net Asset Classification

- Net asset reclassifications from initial application of the FSP are a cumulative change adjustment in the year in which the law is effective.
 - Reported in a separate line item in the statement of activities, outside of any operating measures.
- For many institutions, this may involve a significant reclassification of net assets, from unrestricted to temporarily restricted, in the year in which UPMIFA is effective in that institution's state.
 - Possible debt covenant issues.



FSP FAS 117-1 Transition on Net Asset Classification

- If the FSP is first applied in a year subsequent to the year in which UPMIFA is first effective for the institution, prior year amounts need to be restated to show the accounting change in that year.
- At initial application of the FSP, purpose restrictions are considered reinstated for all **unappropriated** amounts classified as unrestricted net assets because the “deemed spent” rule was previously applied.
 - Simplifies the accounting and reporting going forward.



FSP FAS 117-1: Disclosure Requirements

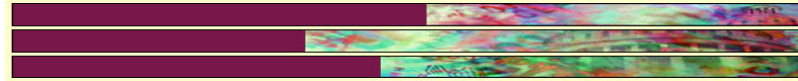
- A not-for-profit organization shall disclose information to enable users to understand the net asset classification, net asset composition, changes in net asset composition, spending policy(ies), and related investment policy(ies) concerning its endowment funds (both board-designated and donor-restricted).
- Applies to **all organizations with endowments**, not just those subject to UPMIFA.
- Rationale: Important information, especially in this era of increased scrutiny on size and use of endowments. Together, the disclosures help “connect the dots” for financial statement users.
 - Many institutions are already presenting much of this information.



FSP FAS 117-1: Disclosures

- Description of governing board's interpretation of relevant law underlying net asset classification
- Description of endowment spending (distribution) policy(ies)
- Description of endowment investment policy(ies)
 - Return objectives and risk parameters
 - How the objectives relate to spending policy(ies)
 - Strategies for achieving objectives
- Composition of endowment by net asset class
- Endowment roll-forward by net asset class





Sample Endowment Composition Disclosure (No Underwater Funds)

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>\$6,947</u>	<u>\$ 46,380</u>	<u>\$ 95,673</u>	<u>\$ 149,000</u>



Sample Endowment Composition Disclosure (Underwater Funds)

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>7,084</u>
Total funds	<u>\$ 6,884</u>	<u>\$ 39,589</u>	<u>\$ 97,959</u>	<u>\$ 144,432</u>



Sample Endowment Roll-Forward Disclosure (Year of Adoption)

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	<u>(1,000)</u>	—	—	<u>(1,000)</u>
Endowment net assets, end of year	<u>\$ 6,947</u>	<u>\$ 46,380</u>	<u>\$ 95,673</u>	<u>\$ 149,000</u>



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Sample Endowment Roll-Forward Disclosure (Ongoing Year)

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>(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>



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FSP FAS 117-1 Disclosures: Key Implementation Question

- What should one consider a **Board designated endowment fund**, as opposed to just a long-term reserve?
- Look to how the fund:
 - Is invested and spent
 - Has been publicly characterized by the institution.



FSP FAS 117-1: Other Common Implementation Questions

- Does the FSP apply to me if I am in a state in which UPMIFA is not yet effective?
- Does the FSP apply to private foundations?
- With the elimination of HDV in UPMIFA, why can my organization still classify the original gift amount as PRNA?
- How do I know if my state, in which UPMIFA is effective, requires maintenance of purchasing power of donor endowments?



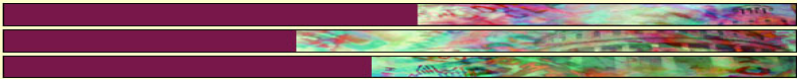
FSP FAS 117-1:
Other Common Implementation Questions

- Are amounts in donor endowments under UMIFA also now time restricted until appropriated?
- Does the FSP change the net asset classification of endowments held by community foundations with variance power?
- If there is no legal obligation to restore underwater amounts to endowment funds (especially now with their being no concept of HDV), isn't it misleading to charge URNA in such situations?



FSP FAS 117-1:
Other Common Implementation Questions

- Do I have to present two years' worth of disclosures in the year I first implement the FSP?
- 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?



Questions ?????

