

April 15, 2008

Mr. Russell G. Golden
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference Proposed FSP FAS 117-a

Dear Mr. Golden:

The Planning Subcommittee (PSC) of the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants is pleased to offer comments on the FASB's Exposure Draft of a proposed FASB Staff Position, *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*.

The PSC supports the Board's decision to provide guidance on the issues in the proposed FSP. The PSC generally supports the proposed guidance, except that the PSC believes some of the proposed disclosures are excessive and unnecessary.

We have provided more specific comments in the attachments to this letter.

* * * * *

We appreciate the opportunity to comment on the proposed FSP. We are available to discuss our comments with Board members or staff at their convenience.

Sincerely,

Ben Neuhausen
Chairman
PSC

Susan E. Budak
Chair
NPO
Endowment/UPMIFA
proposed FSP
Comment Letter Task
Force

Attachment A

1. Is the guidance for net asset classification of donor-restricted endowment funds for not-for-profit organizations subject to UPMIFA appropriate, and can it be applied consistently? If not, why not?

Response - We agree that an organization could classify some portion of an endowment fund as permanent in an UPMIFA jurisdiction and support FASB in stating that conclusion. Beyond stating that conclusion, however, this FSP is not particularly helpful in determining net asset classifications, because it primarily reaffirms the guidance already included in FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*, and No. 117, *Financial Statements of Not-for-Profit Organizations*. We appreciate, however, that the Board may be reluctant to provide further guidance in determining net asset classifications, because doing so may result in the Board interpreting law. We suggest the Board consider including guidance along the lines of the following:

How the version of enacted 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 precedent currently exists for its interpretation and enforcement. Instead, organizations should consider looking to the discussion that occurred in the legislative committees leading to the laws adopted in a particular state, announcements from the state's attorney general, a consensus by a committee of learned lawyers in the state, or similar information to help the organization understand what the law requires.

2. Are the proposed disclosures about an organization's endowment funds needed, and do they provide sufficient transparency in the new UPMIFA environment? If not, please explain which disclosures are not needed or what additional disclosures are needed.

Response - We believe certain of the required disclosures go beyond what is necessary to provide meaningful information to financial statement users. In summary, our views on the disclosures are as follows:

Paragraph 12(a): Support

Paragraph 12(b): Support, with modification (discussed on **page 9** of this letter)

Paragraph 12(c): Object (discussed on **page 4** of this letter)

Paragraph 12(d): Support, with modification (discussed on **pages 4, 7, and 13** of this letter)

Paragraph 12(e): Support, with modification (discussed on **pages 9 and 13** of this letter)

Paragraph 13: Object (discussed on **pages 4 and 7** of this letter)

Paragraph 12(c): We object to the disclosure of endowment investment policies. If prepared as illustrated in the ED, the information is boilerplate and not particularly useful. (The discussion in paragraph 90 of *Basis for Conclusions* of FASB Statement No. 124, which describes the Board's consideration of similar disclosures in that earlier standard, expresses similar concerns about boilerplate disclosures.)

Paragraph 12(d): We believe organizations should not be required to disclose (1) cumulative amounts added to PRNA based on the organization's interpretation of the law separately from (2) cumulative amounts added to PRNA based on explicit donor stipulations. We believe *permanent* should be *permanent*, and how it came to be classified as permanent is irrelevant. By requiring such separate disclosure, some may infer that amounts added based on the organization's interpretation of the law are tainted, or less permanent than amounts added based on explicit donor stipulations. For example, some may infer that the governing board may at some future time withdraw (or otherwise make other than permanent) some of the amounts added based on the organization's interpretation of the law.

Paragraph 13: The disclosure of the planned appropriation for a future year is troublesome to auditors because it is forward-looking, and therefore difficult to audit. That type of information, if reported by an organization, should appear only outside its financial statements. We believe the disclosures required by paragraph 12(b) give the reader a method of estimating planned appropriations, barring a major change in applying the policy or large planned appropriations, and that is adequate.

We would not object to the FASB encouraging paragraph 12(d)'s disclosures of the cumulative amount of investment return included in PRNA, and the disclosures in paragraph 12(c), though we believe the Board has not sufficiently made the case that users need that information and that it should be required.

3. Do you agree with the Board's decision to require that organizations provide the additional disclosures even if they are not yet subject to a version of UPMIFA? If not, why not?

Response - We believe that to the extent the additional disclosures are required for some organizations, they should be required for all organizations regardless of whether the organization is subject to a version of UPMIFA.

4. Do you agree with the Board's decision to make the provisions of the FSP effective for fiscal years ending after June 15, 2008, with early application permitted as long as the organization has not previously issued annual financial statements for that fiscal year? If not, why not?

Response - We suggest that the FSP be effective for years ending on or after December 31, 2008, because many organizations will need time to obtain the information necessary to implement the FSP, particularly the disclosures.

If the Board chooses not to delay the effective date until years ending on or after December 31, 2008 for all entities, we suggest (as a fallback position) that they delay the effective date for entities with smaller endowments, for the following reasons:

- They may not have been monitoring UPMIFA changes.
- Their auditors may have a limited number of NPO clients, and therefore their auditors may not have been monitoring UPMIFA changes.
- They may not have legal advisor relationships in place.
- They may not have formal investment and spending rate policies.
- Their governing boards may need additional time to consider what is required under the law and, if necessary, to act to decide what portion of the endowment must be maintained permanently.
- They may not have systems in place to provide the necessary information.

We observe that the Board successfully used dual effective dates in FASB Statement Nos. 116 and 117. The delayed effective date for smaller organizations allowed those organizations, their legal advisors, and their

auditors sufficient time to assimilate the requirements of those pronouncements and to learn from the experiences gained by the larger organizations. We believe that a dual effective date (as a fallback position) would have similar benefits for this FSP, particularly for smaller organizations who attempt to interpret their state's UPMIFA-based law.

If the Board takes the fallback position, we propose that large organizations be defined as those with endowments of \$10 million or more, which would represent approximately 2 percent of NPOs, but cover what we believe would be the vast majority of endowment dollars. Our recommendation for the definition of *large organizations* for this purpose is based loosely on statistics available from the Urban Institute (http://nccsdataweb.urban.org/tablewiz/tw_bmf.php).

Some have suggested that the Board consider a later effective date for the disclosure provisions of the FSP while retaining the proposed effective date for the classification guidance. We prefer that the effective date be the same for both disclosure and classification.

Other comments

Paragraph 6 is not setting new GAAP. Rather, it merely reaffirms existing GAAP and declares that it is applicable to organizations in UPMIFA jurisdictions. Accordingly, we suggest revising the second sentence so that it begins "Consistent with the standards in paragraph 14 of FASB Statement No. 116 and paragraph 22 of FASB Statement No. 117, the amount classified as permanently restricted"

Paragraph 7 and paragraph A6 provide that the governing board's interpretation should be consistent from year to year. We believe that sentence should include a conditional, such as, "In the absence of additional legislation or precedent-setting court decisions, the governing board's interpretation should be consistent from year to year."

Circumstance (a) in the final sentence of paragraph 7 is not setting new GAAP. Rather, it merely reaffirms existing GAAP and declares that it is applicable to organizations in UPMIFA jurisdictions. We suggest revising paragraph 7 refer to the source of that existing GAAP, paragraphs 11 and 12 of FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*.

Paragraph 8 should incorporate the relevant discussion from EITF Topic D-49, *Classifying Net Appreciation on Investments of a Donor-Restricted Endowment Fund*, rather than just referring to it. This would clarify that the guidance from D-49 is elevated to category (a) in the GAAP hierarchy, as well as be more reader friendly.

Paragraphs 12d and 12e discuss *investment return*. The Board should clarify whether investment return should be considered net of investment expenses. If so, the Board should consider defining *investment expenses* as including costs of activities conducted by the NPO or directly on its behalf to generate an investment return. Concurrently, we suggest that the Board revise FASB Statement No. 117 to (a) eliminate the requirement in paragraph 24 of Statement No. 117 that the amount of investment expenses be disclosed in circumstances in which investment revenues are reported net of related expenses and (b) require that total return be reported net of investment expenses.

Paragraph 12(d): It is unclear what is meant by “and by type of endowment fund?” Is it something other than donor-restricted endowment funds separate from board-designated endowment funds intended? If not, why is it necessary to include the words “and by type of endowment fund”? If the intent is to describe something other than donor-restricted endowment funds and board-designated endowment funds, why aren't fund types other than donor-restricted endowment funds and board-designated endowment funds illustrated in the example?

Paragraph 13 - We believe the Board should not require the disclosures in paragraph 13. However, if the Board decides to retain the disclosures, it should clarify whether the disclosure includes only amounts appropriated under a spending policy or, instead, all planned appropriations from the endowment. The latter are more difficult to determine than the former, as the amount of some withdrawals, particularly those from board-designated endowments, typically are known only after the close of a fiscal year. For example, the governing board may have a policy of covering program deficits from a particular endowment fund.

Paragraph C4 - We note that the tables in the illustrative disclosures in paragraph C4 include amounts of \$570 and \$644 as temporarily restricted board designated funds. We believe the tables include amounts of \$570 and \$644 as temporarily restricted board designated funds because in this circumstance the organization took temporarily restricted net assets and characterized them as a board designated endowment, thereby retaining their restricted status until the restriction is met. Though we understand that temporarily restricted board-designated endowment may exist, we believe illustrating such a circumstance in the FSP may cause confusion in practice, because many NPOs have not created board designated endowments in that manner. Accordingly, we believe illustrating the \$570 and \$644 temporarily restricted board-designated funds raises more questions than it answers and detracts from the purpose of the example. We suggest that the amounts be removed.

Following from the discussion in the previous paragraph, we suggest that the Board explain that temporarily restricted board designated endowment funds are possible by revising FASB Statement No. 117's definition of *endowment fund* as follows:

...An organization's governing board may earmark a portion of its unrestricted or temporarily restricted 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. A board-designated endowment, which results from an internal designation, creates no restrictions beyond those, if any, imposed by the donor. For example, a board designated endowment that results from an internal designation on unrestricted net assets is not donor restricted and is remains classified as unrestricted net assets. A board designated endowment that results from an internal designation on temporarily restricted net assets remains classified as temporarily restricted net assets until the restriction is met.

The FSP frequently refers to “spending policy.” Spending policies are one of several ways that organizations remove assets from an endowment fund. Other ways that organizations remove assets from an endowment fund include onetime withdrawals for specific projects; a “tax” that organizations apply to fund the investment department and/or the development department; and term endowments that have matured. We believe the FSP should more clearly state which of these events should be

included in the “amounts appropriated for expenditure” line item. Further, some organizations that use spending policies do not apply them to all endowment funds. For example, some organizations apply spending policies only to donor-restricted endowment funds, and withdrawals from board-designated endowments are made on an as-needed basis. We believe the Board should confine the required disclosure in paragraph 12(b) to the spending policy and describe the endowment funds to which the policy(ies) apply. Then, in the reconciliation required by paragraph 12(e), the amount(s) of the appropriation under the spending policy(ies) should be displayed on a separate line from other appropriations.

Section 6 of UPMIFA discusses the release or modification of previously established restrictions, either by donor consent, modification by a court of law, or certain other similar circumstances. The ED does not describe the appropriate accounting for release or modification of restrictions in accordance with Section 6 of UPMIFA. We suggest that the Board include guidance for display in financial statements of these events.

Examples

We expect that the illustrated interpretation of UPMIFA in the example will not be the most common interpretation of UPMIFA once organizations and their legal counsel have a chance to determine what the law requires. UPMIFA does not include a requirement to maintain purchasing power; the only discussion of purchasing power appears in the Commissioner’s comments. We are aware of no states that have included in their laws a requirement to maintain purchasing power. (On the contrary, we have heard that some attorneys advising NPOs and NPO management plan to advise governing boards to interpret UPMIFA as requiring that an amount defined similarly to UMIFA’s historic dollar value is the amount to be maintained permanently.) By illustrating an interpretation of law that is likely to be uncommon, the Board risks creating an example that is less useful than it might otherwise be. We observe that that circumstance occurred in FASB Statement No. 117, which also illustrated an interpretation of UMIFA that requires the preservation of purchasing power of the permanent endowment.

We believe the FSP should provide two separate examples with different interpretations of UPMIFA; one in which the governing board determines that the law requires that the organization retain permanently only historic dollar value and the other with a requirement to retain permanently historic

dollar value adjusted for purchasing power changes. [We appreciate that paragraph C6 addresses disclosures for states without a requirement to maintain purchasing power. We believe, however, that fully illustrating both fact sets would be more useful than providing a roadmap of adjustments readers should make, particularly when the fully illustrated fact set is the one that we expect to be the less common interpretation of the law.]

We believe the first example should address the fact set in which the governing board interprets its state's law as requiring the permanent retention only of what UMIFA calls historic dollar value. That is, the state law requires the permanent retention of the fair value in dollars of an endowment fund at the time it first becomes an endowment fund, plus the fair value in dollars of each subsequent contribution to the fund at the time it is made, plus the fair value in dollars of each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the fund. That example will provide guidance for those who interpret UPMIFA in that manner, as well as provide an example for organizations in UMIFA states.

We believe the second example should address the fact set in which the organization's governing board interprets its state law as having a requirement to maintain purchasing power. That is, the second example should be the example currently included in the FSP (unless FASB learns that interpretation of UPMIFA is likely to evolve in another direction). (In order to avoid unnecessary text in the FSP, Year 200X could be deleted from the example, because nothing is illustrated in Year 200X that does not also appear in Year 200Y.)

As a general comment, the fact set should be robust enough so that readers can understand the basis for each number in the disclosures, particularly those in the tables.

Because of rounding errors, the Changes in Endowment Assets schedule for 200Y does not foot.

The \$2,946 investment return added to PRNA in 200Y is exactly 3% of the beginning balance of PRNA, and the inflation rate is given as 3%. Thus, it appears that note * is incorrect, as it states that \$2,500 is the purchasing power adjustment and the remainder is a result of explicit donor stipulations. Perhaps this is merely coincidence, but it is an unnecessarily confusing coincidence. Also, it appears that no purchasing power

adjustment is made to current year gifts. Does that need to be explicitly stated in the policy?

Appropriation is exactly 5% of the beginning balance of the endowment in both 200Y and 200X, which, given the total ending fund balances at June 30, 200Y and 200x, is inconsistent with the 5% of the rolling average FMV that is described in the policy note.

Consider adding a fact set or describing the circumstances that would lead to the following amounts displayed in the example reconciliation:

- a donor-restricted endowment having an unrestricted net asset portion (e.g., the use of the income is unrestricted, thus the net appreciation on the investments is not restricted or the net appreciation was restricted as to purpose but the restrictions have been met even though the governing board did not appropriate the appreciation)
- a release from restriction within the endowment fund (e.g., spending of unrestricted resources for the purpose for which an endowment was created without the governing board appropriating the net assets of that endowment fund, as illustrated in paragraph 96(b) of FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*.)

Because total net assets on the balance sheet will not necessarily articulate with the amount of net assets in the required disclosures, include the word “endowment” before “net assets, beginning of year” and “net assets, end of year.”

Paragraph C4 - In the example disclosure on the Interpretation of Relevant Law, include disclosure of which particular state(s) version of UPMIFA the organization is subject to, and in what year the organization became subject to that law. For example, consider revising the first sentence as follows:

The Board of Trustees of Organization A has interpreted the [200Y State Prudent Management of Institutional Funds Act of the state of \[enter your state name here\]](#) as requiring the preservation of the purchasing power (real value) of the donor-restricted endowment funds absent explicit donor stipulations to the contrary.

In paragraph C6, describe how the final sentence of the *Interpretation of Relevant Law* would be modified if the real value of the endowment were not required to be maintained.

Editorial

Paragraph 7 – Revise as follows:

A governing board’s interpretation of the relevant law should be applied to all donor-restricted endowment funds and should be consistent from year to year. If the governing board determines that the relevant law requires the organization to maintain the purchasing power of a donor-restricted endowment fund, the amount of permanently restricted net assets should be increased as purchasing power of a dollar decreases (or decreased if purchasing power of a dollar increases).¹ ~~However, c~~Consistent with the organization’s fiduciary duty for a fund of permanent duration, the amount of permanently restricted net assets should **not** be reduced by (a) losses on the investments of the fund, except to the extent that losses are related to specific investments that the donor requires the organization to hold in perpetuity, or (b) an organization’s expenditures from the fund.

Paragraph 8 should be revised as follows:

In determining whether provisions in enacted legislation that are based on subsection 4(a) (“restricted assets” until appropriated wording) or 4(d) (rebuttable presumption of imprudence based on spending rate) of UPMIFA impose a temporary (time) restriction on the portion of a donor-restricted endowment fund that otherwise would be classified as unrestricted net assets, an organization shall apply the guidance in EITF Topic No. D-49, “Classifying Net Appreciation on Investments of a Donor-Restricted Endowment Fund” (see Appendix B).

¹This would normally be done by adjusting the permanently restricted net assets by an appropriate measure of the rate of inflation (or deflation).

Paragraph 9 provides that "only legal restrictions that *extend* a donor-imposed restriction create temporarily or permanently restricted net assets." [Emphasis added] Other sections of the ED, such as paragraph 6 ("... governing board determines must be retained permanently, if any, under the relevant law.") and paragraph 7 ("... if the governing board determines that the relevant law requires the organization to maintain the purchasing power of a donor-restricted endowment fund...") refer to legal restrictions without mentioning whether those restrictions *extend* a donor-imposed restriction. To avoid confusion, the FSP should use consistent wording throughout in the discussing this issue.

Paragraph 12a - Based on paragraphs 6, 7, and C6a, some may infer that disclosures describing the governing board's interpretation of the law that underlies the organization's net asset classification of donor restricted endowment funds would be required only in circumstances in which the governing board interprets the law as requiring that amounts in addition to those required by explicit donor stipulations be retained permanently. (We believe paragraph 12a implies that such disclosures should be made in all circumstances.) We suggest that paragraphs 6, 7, and C6a be revised to remove the potential ambiguity.

Paragraph 12(d): If this disclosure is retained, the final sentence of the required disclosure should be modified to recognize that increases in purchasing power could also cause reductions in the amount of permanently restricted net assets. We suggest revising it as follows:

In addition, the organization shall ~~disclose~~indicate the cumulative effect on permanently restricted net assets resulting from amount of investment return, if any, added to (or deducted from) contained in the permanently restricted net assets ~~class~~ because of the organization's interpretation of relevant law, beyond that required by explicit donor stipulations.

Paragraph 12(e): The final sentence of the required disclosure should be modified to recognize that increases in purchasing power could also cause reductions in the amount of permanently restricted net assets. We suggest revising it as follows:

In addition, the organization shall ~~disclose~~ indicate how much, if any, of the ~~additions of~~ investment return added to (deducted from) ~~to~~ permanently restricted net assets ~~are the results from of~~ the organization's interpretation of relevant law, beyond that required by explicit donor stipulations.

The penultimate sentence of paragraph 15 (a) should be revised as follows:

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 the organization's governing board determines must be retained permanently under the version of UPMIFA enacted in that jurisdiction, ~~as determined by the organization's governing board.~~

The final sentence of paragraph A7 should be revised as follows:

Likewise, the Board decided to extend that guidance to expenditures from the fund because short-term flexibility on the use of endowment assets when the fair value of the fund is below the level required by donor stipulations or law ~~in so-called underwater situations~~ does not remove the organization's long-term fiduciary duty for the preservation of those resources.

The first sentence of paragraph C6(b) should be revised as follows:

The footnotes to the tabular disclosures discussing investment return classified as permanently restricted net assets by the Organization would ~~could~~ be revised.