Notice for Recipients of This Proposed FASB Staff Position

This proposed FASB Staff Position (FSP) would provide guidance on the net asset classification of donor-restricted endowment funds 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), a model act adopted by the National Conference of Commissioners on Uniform State Laws (NCCUSL) that serves as a guideline for states to use in enacting legislation. This proposed FSP also would improve disclosures about an organization's endowment (both donor-restricted and board-designated funds), whether or not the organization is subject to UPMIFA.

The Board invites individuals and organizations to send written comments on all matters in this proposed FSP. Comments are requested from those who agree with the provisions of this proposed FSP as well as from those who do not. Comments are most helpful if they identify the issues and the specific paragraph or group of paragraphs to which they relate and clearly explain the issue or question. Those who disagree with provisions of this proposed FSP are asked to describe their suggested alternatives, supported by specific reasoning.

The Board requests that constituents provide comments on the following:

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?

   See paragraphs 6–10 for the related guidance and paragraphs A1–A8 for the basis for the Board's conclusions.

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.

   See paragraphs 11–13 for the related guidance and paragraphs A9 and A10 for the basis for the Board's conclusions.

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?

See paragraph 11–13 for the related guidance and paragraph A11 for the basis for the Board's conclusions.

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?

   See paragraph 16 for the related guidance and paragraph A12 for the basis for the Board's conclusions.

Responses must be received in writing by April 18, 2008. Interested parties should submit their comments by email to director@fasb.org, File Reference: Proposed FSP FAS 117-a. Those without email may send their comments to "Russell G. Golden, Director of Technical Application and Implementation Activities, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116, File Reference: Proposed FSP FAS 117-a." Responses should not be sent by fax.

All comments received by the FASB are considered public information. Those comments will be posted to the FASB website and included as part of the project record with other project materials.

PROPOSED FASB STAFF POSITION

No. FAS 117-a

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

Comment Deadline: April 18, 2008

Objective

1. This FASB Staff Position (FSP) provides guidance on the net asset classification of donor-restricted endowment funds 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), a model act adopted by the National Conference of Commissioners on Uniform State Laws (NCCUSL) that serves as a guideline for states to use in enacting legislation. It also improves disclosures about an organization's endowment (both donor-restricted funds and board-designated funds),[1] whether or not the organization is subject to UPMIFA.

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[1]Paragraph 168 (the glossary) of FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*, defines an *endowment fund* as follows:

> 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 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, encompassing those established by donor-restricted gifts (herein called *donor-restricted endowment funds*, consistent with the use of the term in FASB Statement No. 124, *Accounting for Certain Investments Held*

Background

2. In July 2006, the NCCUSL 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.[2]

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,[3] 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 expenditure by the institution." This wording is similar to wording contained in the versions of UMIFA in place in Maine and Utah and related to an advisory published by

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by Not-for-Profit Organizations) and those established by board designation (herein called *board-designated endowment funds*). The term *donor-restricted endowment funds* is intended to be synonymous with *endowment funds* as that term is used in UPMIFA (and UMIFA).

[2]An annotated text of UPMIFA, with the NCCUSL'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.)

[3]UMIFA 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."

the Massachusetts Attorney General.[4] Questions have arisen about whether this wording would impose a temporary (time) restriction on the portion of a donor-restricted endowment fund that otherwise would be classified as unrestricted net assets.

5. Subsection 4(d) of UPMIFA includes an optional provision for adding a rebuttable presumption of imprudence for spending over 7 percent of the fair market value of the fund (calculated over the period on which the organization bases its endowment spending formula but not less than three years). Thus far, some of the enacting states have elected to exclude that provision but others have included it, with one of those states varying the percentage based on the size of the organization's endowment. Questions also have arisen about whether this provision would impose a temporary (time) restriction on the portion of a donor-restricted endowment fund that otherwise would be classified as unrestricted net assets.

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

FASB Staff Position

6. **A not-for-profit organization that is subject to an enacted version of UPMIFA shall classify all or a portion of a donor-restricted endowment fund of perpetual duration[5] as permanently restricted net assets. 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 permanently, if any, under the relevant law.**

7. 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

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[4] "Attorney General's Position on FASB Statement of Financial Accounting Standards No. 117, ¶ 22 and Related G.L.c. 180A Issues" (June 1995).

[5] As distinguished from term endowments.

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).[6] However, 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.

8. **In determining whether provisions in enacted legislation that are based on subsection 4(a) ("restricted assets" wording) or 4(d) (rebuttable presumption) 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).**

9. Contractual and legal provisions often impose constraints on an organization's use of particular assets, but those constraints generally do not create a *donor-imposed restriction* or *temporarily restricted net assets* or *permanently restricted net assets*, as defined in FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*. Only legal restrictions that extend a donor-imposed restriction create temporarily or permanently restricted net assets. Laws that refer to actions that are entirely within the purview of an organization's governing board, such as acting to appropriate funds or exercising prudence in doing so, do not, in and of themselves, create or extend donor-imposed restrictions. Similarly, laws that provide additional guidance on what constitutes prudence, rather than establishing absolute ceilings on spending, do not, in and of themselves, extend donor-imposed restrictions.

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

10. In applying the guidance in Topic D-49, organizations should consider the wording of the specific enacted version of UPMIFA (or other relevant law) to which the organization is subject.

11. **A not-for-profit organization shall disclose information to enable financial statement users to understand the net asset classification, net asset composition, changes in net asset composition, spending policy(ies), and related investment policy(ies) about its endowment funds (both donor-restricted and board-designated).**

12. 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 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. In addition, the organization shall indicate 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. In addition, the organization shall indicate how much, if any, of the additions of investment return to permanently restricted net assets are the result of the organization's interpretation of relevant law, beyond that required by explicit donor stipulations.

13 In addition, the organization shall disclose its planned appropriation for expenditure, if known, for the year following the most recent period for which the organization presents financial statements.

14. Appendix C contains an illustrative example of the disclosures in paragraphs 11–13.

Amendment to Statement 124

15. 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 (UMIFA) or states whose relevant law is based on trust law, it ~~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 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-x, *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*.

Effective Date and Transition

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

17. In initially applying the guidance in paragraphs 6–10 to donor-restricted endowment funds in existence at the start of a period in which 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.

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

Appendix A

BASIS FOR CONCLUSIONS

A1. 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, 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.

A2. 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).

A3. 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).

A4. Similar to 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.

A5. 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.[7] 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:

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[7]As indicated in the NCCUSL'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.

> 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.

A6. 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. Although UPMIFA removed the explicit requirement to maintain historic dollar value, it does **not** remove that fiduciary duty. 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 indeed 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 about either the investment of the trust or distributions from the trust are within the purview of a beneficiary organization's governing board.
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 6 of this FSP and the additional disclosure requirement of paragraph 12(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.

The Board expects that a governing board's interpretation of the relevant law will be a one-time interpretation, applied to all donor-restricted endowment funds consistently from year to year. It should **not** be treated as an accounting policy decision that may be changed from time to time.

A7. 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 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 that guidance to expenditures 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.

A8. In considering the question of whether subsection 4(a) ("restricted assets" wording) or 4(d) (rebuttable presumption) of UPMIFA would impose a temporary (time) restriction on the portion of a donor-restricted endowment fund that otherwise would be classified as unrestricted net assets, the Board considered the guidance previously provided by the FASB staff in Topic D-49. Shortly after the issuance of Statement 117, disagreements arose between accountants and attorneys in a few states about whether unappropriated appreciation of a donor-restricted endowment fund could be considered unrestricted net assets. In response to those disagreements, the FASB staff provided guidance by making an announcement at the March 1996 EITF meeting, as reported in Topic D-49. That guidance drew upon paragraph 22 of Statement 117, paragraph 11 of Statement 124, and the Board's basis for conclusions in Statement 117 and also was influenced by input received from the Law & Accounting Committee of the Section on Business Law of the American Bar Association. In a letter to the FASB, a member of that committee made the following point:

> There is no question but that any common law or statutory principle dealing with the appropriation of appreciation is applicable and therefore can be said to constitute a legal "restriction." **However, we believe that the real question for the FASB is whether such a common law or statutory principle constitutes a "restriction," not for legal purposes, but under GAAP.** [Emphasis added.]

Topic D-49 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 concluded that such guidance also is applicable to enacted provisions of legislation based on subsections 4(a) and 4(d) of UPMIFA. The Board 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.

A9. After considering the views of a range of constituents within the not-for-profit community, the Board decided that enhanced disclosures about an organization's endowment are needed by users of an organization's financial statements, especially in the new UPMIFA environment. Thus, the Board decided to use this FSP to require disclosures about an organization's endowment spending policies and the net asset composition of its endowment and the changes therein:

a. Disclosure of an organization's endowment spending policy(ies) (paragraph 12(b)), together with its actual spending (paragraph 12(e)) and its planned spending for the upcoming year (paragraph 13), as well as the disclosure about deficiencies that is required by paragraph 15(d) of Statement 124, would provide valuable information to donors, creditors, and other users about how an organization is approaching its stewardship and management responsibilities, especially in the more flexible UPMIFA environment. Given the diversity of endowment size and organizational sophistication regarding endowments, the Board decided to keep the disclosure requirement about spending policy as general as possible to allow for flexibility of presentation.
b. Disclosure of the net asset composition and changes therein (paragraphs 12(d) and 12(e)) would help users better understand the nature of an organization's endowment resources by providing them with a holistic picture of how the different pieces of the organization's endowment are classified in the organization's statement of financial position and statement of activities. That disclosure also would help users assess an organization's stewardship of endowment resources by placing expenditures of endowment assets within the context of endowment size and overall changes in the endowment during the year. In conjunction with the qualitative disclosure of a governing board's interpretation of law (paragraph 12(a)), disclosure of investment return and cumulative investment return added to permanently restricted net assets, as the result of that interpretation, would help users in comparing organizations (especially in different jurisdictions) and in assessing an organization's year-to-year consistency in adhering to that interpretation.

A10. Because of the interrelationship of endowment spending policy and endowment investment policy, the Board also decided to require the disclosure in paragraph 12(c). As with the spending policy disclosure requirement, the Board decided to keep the investment policy disclosure requirement as general as possible to allow for flexibility of presentation.

A11. The initial objective of this FSP was to provide guidance on net asset classification of donor-restricted endowment funds in an UPMIFA environment.

However, when asked if additional information was needed as the result of UPMIFA, constituents indicated that additional disclosures are needed even in jurisdictions that have not yet enacted or contemplated the enactment of UPMIFA. The Board agreed that such additional information is needed. The Board believes that disclosures about endowment size, growth and spending, and underlying net asset composition provide important information, especially in an era of increased public scrutiny of endowment management. And, disclosure of a governing board's interpretation of relevant law would inform readers about which law was currently in place for that organization (UPMIFA, UMIFA, or other) and, even prior to the enactment of UPMIFA in a jurisdiction, would provide important contextual information about an organization's classification of appreciation on endowment investments. Thus, the Board decided to require the disclosures in paragraphs 11–13 and make them effective for all organizations rather than only for those in states (or other jurisdictions) that have adopted a version of UPMIFA.

A12. UPMIFA already is effective in a number of states, and the information contained in the disclosures is 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 therefore concluded it would be both desirable and practicable to make the provisions of this FSP effective for fiscal years ending after June 15, 2008.

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 11–13 of this FSP. The example does not illustrate all disclosures required under generally accepted accounting principles (GAAP), including all of those that pertain to investments held by not-for-profit organizations. However, the example includes a disclosure of the aggregate amount of deficiencies for 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 (which is required to be disclosed under paragraph 15(d) of Statement 124).

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. The Board encourages organizations to use a format that displays the information in the most understandable manner and to provide any additional information they deem necessary to achieve the objective stated in paragraph 11 for their specific circumstances.

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. **FOOTNOTE X: ENDOWMENT**

Organization A's endowment consists of approximately 100 individual funds established for a variety of purposes. Its endowment includes permanent endowments, term endowments, 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 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 A classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) subsequent gifts to the endowment, (3) accumulations made pursuant to 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 fund to maintain its purchasing power. For purposes of determining that portion, each year Organization A adjusts permanently restricted net assets by the change in the Consumer Price Index (CPI) for that year. The increase in the CPI was 3 percent in 200Y and 2.7 percent in 200X. 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 if the use is restricted by the donor or as unrestricted net assets if it is not.

200Y

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ 32,644	$ 10,834	$ 103,146*	$ 146,624
Board-designated funds	$ 8,786	$ 570	$ –	$ 9,356
Total funds	$ 41,430	$ 11,404	$ 103,146	$ 155,980

*Permanently restricted net assets include $13,000 of cumulative investment return on donor-restricted endowment funds that the Organization has determined must be retained permanently to maintain the purchasing power of those funds, in accordance with the State Prudent Management of Institutional Funds Act, beyond the amount required by any explicit donor stipulations.

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Net assets, beginning of year	$ 37,921	$ 12,879	$ 98,200	$ 149,000
Investment return:				
Investment income	$ 4,023	$ 447	$ –	$ 4,470
Net appreciation (realized and unrealized)	$ 4,054	$ 450	$ 2,946*	$ 7,450
Total investment return	$ 8,077	$ 897	$ 2,946	$ 11,920
New gifts	$ –	$ –	$ 2,000	$ 2,000
Appropriation of endowment assets for expenditure	$ (7,077)	$ (372)	$ –	$ (7,450)
Other changes:				
Transfers to create board-designated funds	$ 500	$ –	$ –	$ 500
Other	$ 10	$ –	$ –	$ 10
Total other changes	$ 510	$ –	$ –	$ 510
Released from restriction	$ 2,000	$ (2,000)	$ –	$ –
Net assets, end of year	$ 41,430	$ 11,404	$ 103,146	$ 155,980

*Investment returns classified as permanently restricted net assets include $2,500 that Organization A has determined must be retained permanently to maintain the purchasing power of those funds, in accordance with the State Prudent Management of Institutional Funds Act, beyond the amount required by any explicit donor stipulations. The remainder of the investment returns added to permanently restricted net assets represents amounts required to be retained permanently as a result of explicit donor stipulations.

200X

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ 30,337	$ 12,235	$ 98,200*	$ 140,772
Board-designated funds	$ 7,584	$ 644	$ –	$ 8,228
Total funds	$ 37,921	$ 12,879	$ 98,200	$ 149,000

*Permanently restricted net assets include $10,500 of cumulative investment return on donor-restricted endowment funds that Organization A has determined must be retained permanently to maintain the purchasing power of those funds, in accordance with the State Prudent Management of Institutional Funds Act of 2006, beyond the amount required by any explicit donor stipulations.

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Net assets, beginning of year	$ 35,922	$ 14,369	$ 93,398	$ 143,689
Investment return:				
Investment income	$ 3,880	$ 431	$ –	$ 4,311
Net appreciation (realized and unrealized)	$ 3,944	$ 438	$ 2,802*	$ 7,184
Total investment return	$ 7,824	$ 869	$ 2,802	$ 11,495
New gifts	$ –	$ –	$ 2,000	$ 2,000
Appropriation of endowment assets for expenditure	$ (6,825)	$ (359)	$ –	$ (7,184)
Other changes:				
Transfers to remove board-designated funds	$ (1,000)	$ –	$ –	$ (1,000)
Total other changes	$ (1,000)	$ –	$ –-	$ (1,000)
Released from restriction	$ 2,000	$ (2,000)	$ –	$ –-
Net assets, end of year	$ 37,921	$ 12,879	$ 98,200	$ 149,000

*Investment returns classified as permanently restricted net assets include $2,400 that Organization A has determined must be retained permanently to maintain the purchasing power of those funds, in accordance with the State Prudent Management of Institutional Funds Act, beyond the amount required by any explicit donor stipulations. The remainder of the investment returns added to permanently restricted net assets represents amounts required to be retained permanently as a result of explicit donor stipulations.

Funds with Deficits (Disclosure Required by Paragraph 15(d) of Statement 124)

From time to time, the fair value of assets associated with individual endowment funds may fall below the level that the donor or the State Prudent Management of Institutional Funds Act requires the Organization to maintain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were $200 and $300 as of June 30, 200Y, and 200X, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions.

Return Objectives and Risk Parameters

Organization A has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowment while ensuring that the purchasing power of the endowment assets do not decline over time (as required by State Prudent Management of Institutional Funds Act). 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 to provide an average rate of return of approximately 9 percent annually.

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. The Organization expects permanent funds to provide an average rate of return of approximately 9 percent annually. Accordingly, over the long term, the Organization expects the current spending policy to grow its endowment at an average of 4 percent annually. This is consistent with objectives to maintain the purchasing power of the endowment assets as well as to provide additional real growth through new gifts and investment return.

Appropriation of Endowment Assets for Next Fiscal Year

For the 200Z fiscal year, the Organization has budgeted to appropriate $8,000 of its endowment assets to be distributed for spending. Consistent with Organization A's spending policy described above, this amount represents approximately 5 percent of the endowment fund's average fair value over the prior 12 quarters.

C5. For the purpose of illustration, the organization in this example has interpreted the State's Prudent Management of Institutional Funds Act to require the maintenance of purchasing power for donor-restricted endowment funds absent explicit donor stipulations to the contrary. In the example, the index used to adjust the permanently restricted net assets of the funds for inflation is the CPI. However, an organization may use the measure of inflation it deems most relevant. For example, the Higher Education Price Index (HEPI) may be more relevant for colleges and universities. In the example, the organization adjusts permanently restricted net assets by adding a portion of the annual investment return. If the return had been less than the CPI, the organization would have had to reclassify a portion of its temporarily restricted net assets, if available, or its unrestricted net assets to make up the difference.

C6. If the organization had interpreted the law as not requiring the organization to maintain the purchasing power of its donor-restricted endowment funds, the example could be modified in the following ways:

a. *Interpretation of Relevant Law*

   The description of the fourth component of the endowment fund to be classified as permanently restricted would be removed from the footnote as well as the discussion of inflationary measures used to approximate the "real" value of the endowment assets.

b. *Tabular Disclosures of Endowment Net Asset Composition by Type of Fund and Changes in Endowment Net Assets*

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

   > Investment return classified as permanently restricted net assets represents only those amounts required to be retained permanently as a result of explicit donor stipulations. In accordance with its interpretation of the State Prudent Management of Institutional Funds Act, the Organization is not required to maintain purchasing power of the donor-restricted endowment funds.