



Uniform Law Commission
NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS

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LETTER OF COMMENT NO. 30

April 18, 2008

Financial Accounting Standards Board
Director of Technical Application and
Implementation Activities
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116
File Reference: Proposed FSP FAS 117-a

Re: Uniform Prudent Management of Institutional Funds Act (UPMIFA)
and proposed FASB Staff Position on Statement 117 (FSP FAS 117-a)

Ladies and Gentlemen:

As Chair of the Uniform Law Commission's Drafting Committee for the Uniform Prudent Management of Institutional Funds Act (UPMIFA) (2006), and on behalf of the Uniform Law Commission, I wish to provide comments on the proposed FSP FAS 117-a. I appreciate the opportunity to offer comments on this significant matter.

Background

The Uniform Law Commission (a.k.a. the National Conference of Commissioners on Uniform State Laws), now in its 116th year, provides uniform laws to the states¹ where uniformity is both desirable and practical. Our members, appointed by the Governors and Legislatures of each state under state statute, are lawyers serving without compensation to help draft and enact well-reasoned laws for the states. Known most notably for the Uniform Commercial Code, our commissioners have drafted dozens of laws for the states in many other areas such as family law, real property, trust and estates, and business law.

¹ In addition to the fifty states, the Uniform Law Commission provides such laws for the District of Columbia, Puerto Rico and the United States Virgin Islands, making a total of 53 jurisdictions. For convenience, the jurisdictions will simply be referred to in this letter as "states".

One of those acts was the very successful Uniform Management of Institutional Funds Act ("UMIFA") (1972), adopted in forty-eight states. It is not an exaggeration to state that UMIFA provided the legal structure and guidance which ushered in the era of modern "total return" portfolio investing and dramatically changed the world of endowment management, investment and spending. It has been nearly universally acknowledged that those changes have been for the betterment of all endowed funds and their charitable works. Institutions which looked to UMIFA for legal guidance (and now to UPMIFA in many states) collectively account for more than five percent of the gross domestic product of the United States and are one of the three top sources of employment in nearly every state. These institutions collectively represent a hugely significant portion of the U.S. economy by any standard of measurement.

The decision to revise UMIFA stemmed from the realization that, after more than 30 years, the revolutionary concepts in UMIFA were no longer sufficiently aiding charitable organizations in their important work, primarily because prudence standards had shifted over time. These prudence standards evolved in part due to our groundbreaking work with the Uniform Prudent Investor Act (1994), which helped to allow the trust world to adopt the use of *modern portfolio methods of total return investing* rather than being bound by formulaic restrictions.

The process of developing UPMIFA involved a one year study committee and a four year drafting project with three day all day meetings twice a year and a full line by line reading and debate at several Annual Meetings. There was also a great deal of participation from the American Bar Association, the American College of Trust and Estate Counsel and the National Association of State Charity Officials as well as observers from the investment advisory community, non-profit institutions and academics. The project was extended for two additional years beyond the average length of a drafting project in order to better deal with numerous complex issues. Ultimately the end product is one that is strongly endorsed by the charitable world and accepted by most state regulators and professional advisors to the donors of such charities. As you know, it is now enacted in 20 states and is pending in 9 others. We anticipate many additional introductions and enactments this year and in 2009.

Proposed Rule

Because UPMIFA has significant support and is already being widely enacted, the Uniform Law Commission was initially delighted that FASB decided to move forward so quickly with promulgating accounting standards to address and supplement the new law. We applaud most of the new disclosure requirements that would help to assure that the *new, more flexible, prudence standards are followed, and the financial statements of non-profit institutions will be more understandable to their readers.* In particular we applaud the addition of Paragraph 12(b) and Paragraph 13. If the concerns hereinafter expressed about the inadequacy of the present and proposed net asset classifications, were sufficiently addressed, Paragraph 12(a), (d) and (e) could also be very useful and helpful

additions.² While obviously connected to prudence standards under UPMIFA, we believe the content of 12(c) is outside the scope of our deliberations and the text of the Act (as long as such investment is done prudently) and we make no comment on 12(c), other than to observe that we believe many institutions will consider such detail on investment strategy to be privileged and confidential and the specific disclosure requirements may be problematic to that extent.

Subject to the concerns raised above, we think that questions No. 2 and No. 3 in FSP FAS 117-a, on which you specifically requested comment, can generally be answered in the affirmative.³ We particularly agree with the proposed decision reflected in question No. 3 since it imposes a new disclosure burden equally on a non-profit entity without respect to whether it is located in a jurisdiction that has or has not adopted UPMIFA. If new disclosures are to be required at all, we think that the burden should be neutral with respect to enactment of UPMIFA, to avoid having a possible, even if unintended, impact on the decision about whether or not a particular state should enact UPMIFA.

Unfortunately, as will be discussed in further detail below, your questions No. 1 and 4 *must be answered in the negative, since we have concluded that the net asset classifications do not follow the law as written, are not appropriate for compliance by the institutions that are governed by UPMIFA, are confusing and are virtually impossible to apply consistently.*⁴ We believe that the proposed new guidelines for net asset classification under UPMIFA, as drafted, will cause tremendous confusion and undue burden on institutions in states which have adopted UPMIFA, and they may lead some states to delay or even reject enactment of UPMIFA until clearer guidance is promulgated. Most importantly, we are greatly concerned that as a result of the decision by the FASB to leave the ultimate classification determination to be made by each institution's board, with very sparse and possibly misleading guidance as to how to make

² While 12(e) is in large part potentially helpful, we do not understand the utility of asking non-profits to separate out net appreciation of assets and investment income since it is not a distinction with any continuing legal or accounting utility and has not been since the adoption of UMIFA. The enactment of UPMIFA makes this distinction even more irrelevant and potentially confusing.

³ 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 to what additional disclosures are needed.

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?

⁴ 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?

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?

that determination, the result is likely to be a messy patchwork of non-uniformity throughout the country, the very antithesis of the uniformity and predictability of result which is the goal and hallmark of uniform state laws.

Although a restriction for legal purposes may well be different from a restriction for accounting purposes, accounting rules that ignore at least some very real and binding legal restrictions create problems for charities and for others that need to use financial statements to understand the financial situation at hand. Many charities may unintentionally spend funds that are classified for accounting purposes as “unrestricted” but that are certainly restricted from a legal point of view. If the accounting statement classification of funds reflects the actual and very real legal restrictions that are imposed on a charity’s use of funds, it will be much more understandable and helpful. There should be different categories for the different types of funds to spell out what is available to spend and what is not.

As correctly noted in the last sentence of FSP FAS 117-a, Page 4, Paragraph 3, the key issue covered in this proposal is whether UPMIFA’s deletion of the Historic Dollar Value (“HDV”) concept, which was a principal feature of UMIFA, should affect the net asset classification of a donor restricted fund.

UPMIFA explicitly states in Subsection 4A that “assets in an endowment fund are donor restricted assets until appropriated for expenditure by the institution.”⁵ That formulation has the force of law and is the operable legal standard in a state which has enacted UPMIFA. This formulation, which has precedent in the Maine and Utah versions of UMIFA and in the opinion of the Massachusetts Attorney General on the proper classification of UMIFA assets, has the effect of creating a time restriction on those assets. UPMIFA does not state that, absent this temporal restriction, those assets would be unrestricted. To the contrary, as is made very clear in the comment to Section 4 under the Subheading “Distinguishing Legal and Accounting Standards”, “[D]eleting historic value does not transform any portion of an endowment fund into unrestricted assets from a legal standpoint.”

FSP FAS 117a, Paragraphs 6, 7, 8, 9 and 10 are all reflective of this fundamental and critical problem, under which there would be a real but unnecessary and potentially harmful distinction between the legal and accounting meanings of “restricted.” In a word, the ULC believes that FSP-FAS 117a has this distinction wrong and that it is fatal to the utility of Paragraphs 6-10. Worse, the effect of Paragraphs 6-8, encourage and practically mandate the boards of a non-profit organization to ignore the removal of HDV from the applicable law in UPMIFA states and to maintain, for accounting

⁵ Of course, this rule, like all of UPMIFA, is a default rule that may be trumped at any time by express donor provisions that take assets outside the scope of UPMIFA. If such specific donor instructions provide that the original gift amount, or even a portion of the increase in the value of such original gift amount be permanently maintained, (or never spent), such instructions would trump UPMIFA and such assets would be properly classified as permanently restricted (both in a legal sense and in accounting purposes or financial statements). The discussion in this section of the letter is only applicable to assets which are subject to UPMIFA.

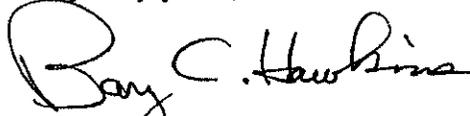
purposes, a continuing obligation to maintain records of and to take action with respect to a category of HDV that is eliminated by law in UPMIFA states. We submit that such a directive to such a non-profit organization will be confusing, disruptive and will certainly promote and result in disunity.

The problems with FSP FAS 117-a are further exacerbated by Appendix C, Illustrative Example of Endowment Disclosures, which adds into the mix not only an extension of the classification problems described above, but also an entirely new element of a mandatory, formulaic obligation to preserve purchasing power on a year-by-year basis. This obligation did not even exist under UMIFA except by specific state law only in Rhode Island. The UPMIFA Drafting Committee specifically considered and rejected this concept. It is neither required by UPMIFA nor is it a very good idea, either in the abstract or in the details. As stated in the commentary to UPMIFA, the preservation of the viability of any fund (and of course a fund will not long remain viable if eroded in purchasing power) is a prime imperative for a board making prudent spending policy decisions. However UPMIFA requires a multi-faceted, non-formulaic approach to meeting this challenge and specifically declined to mandate the use of a formula driven approach as is impliedly required by your example in Appendix C.

The drafting process of UPMIFA was long and arduous, but we think it is a great improvement in the law. The pace at which the Act is being adopted into law by so many states in a short period of time appears to indicate that the vast majority of legislators who have considered UPMIFA agree with that assessment. I urge you to take the necessary time to craft accounting rules that are clear and that conform to the new law. Please extend the comment period to allow for the receipt and consideration of additional comments and to provide sufficient time for FASB to draft accounting rules that will better aid charitable institutions in complying with the law.

Thank you very much for the opportunity to comment.

Very truly yours,



Barry C. Hawkins
Chair, UPMIFA Drafting Committee
Uniform Law Commission

BCH:cg

cc: John Sebert, Executive Director, Uniform Law Commission
Michelle Clayton, Senior Counsel, Uniform Law Commission
Prof. Susan N. Gary, Reporter, UPMIFA Drafting Committee