

Memorandum



March 6, 2008

LETTER OF COMMENT NO. *2*

From: Peter S. Kennedy, CPA
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Wilmington, Delaware

To: Mr. Russell G. Golden
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
Norwalk, CT

Subject: Proposed FSP FAS 117-a

Thank you for providing the opportunity to comment on the proposed FSP prior to its implementation. As you are probably aware, Delaware is an UPMIFA state having enacted the boilerplate legislation omitting only the 7% presumption of imprudence language in section 4d.

Please see below for specific points:

“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?”

There are two scenarios which are prevalent at most of the nonprofit organizations I am familiar with that are fortunate enough to have endowments.

In the first scenario, the nonprofits were founded 50+ years ago with substantial initial endowments which have been added to over the years. Long before the enactment of UPMIFA or even UMIFA, the directors understood the wisdom of maintaining an endowment in perpetuity. The funds were invested wisely and used only sparingly and the growth far outstripped the combined forces of the “appropriation for expenditure” (hereinafter referred to as the “draw”) and inflation. In this scenario, there will be a considerable effort required to retroactively identify each of the hundreds of contributions received over the course of time in order to impute a CPI-related growth rate to arrive at a new permanently restricted net assets balance and temporarily restricted net assets balance. I would argue that these new balances, while larger, are no more meaningful to a financial statement user than the historical dollar value which they would replace and that the cost to compile the information to generate these adjustments would far outweigh the benefit derived.

A second scenario is a younger nonprofit which received many of its significant gifts during 2000 and 2001 in time for them to be invested and reduced by the stock market declines which immediately followed. Following the donors’ intent, the organization

took a draw from these funds at a reasonable rate. Within the past year, some but not all have recovered from their “underwater” status. In this scenario, the CPI adjustment would increase the permanently restricted balance and force the endowments back underwater. The recent stock market turbulence would add to these woes. Even though the organization has acted responsibly and within the donor’s intent, their financial statements will show a severely distressed organization drawing down principle to survive. I am concerned that this may present a misleading picture of such an organization.

A larger overall question: Does the FASB interpret the boilerplate UPMIFA language as requiring a nonprofit to increase the permanently restricted net assets balance to preserve the purchasing power and to record as temporarily restricted the remainder? UPMIFA itself seems to leave some room for interpretation:

From UPMIFA Section 4(a) “Subject to the intent of the donor expressed in the gift instrument, an institution may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines is prudent for the uses, benefits, purposes, and duration for which the endowment fund is established.” UPMIFA Section 4(b) “To limit the authority to appropriate for expenditure or accumulate under subsection (a), a gift instrument must specifically state the limitation.”

The previous guidance was fairly straightforward. If there was a specific donor-imposed restriction, the funds were restricted. If not, they were unrestricted. If, absent specific donor restrictions, an organization is free to spend appreciation on endowment funds as it sees fit within the confines of its charitable purpose, does that not meet the definition of unrestricted funds? It appears that the FSP answer to that is no, but there is no definitive statement here. I understand that an organization’s governing board bears the ultimate responsibility for the financial statements but if the FASB has a position on this or if there exists a legal interpretation we shouldn’t leave nonprofit boards to their own devices on this issue.

“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.”

As a general comment, the goal of transparency is not always served by requiring additional boilerplate disclosures. The illustration in Appendix C of the FSP is roughly four pages long. While much of the information is already required and is being merely reformatted, it is likely that the length of the footnotes will grow by 2 or 3 pages for an average nonprofit with donor restricted endowment funds.

As an aside, on the tabular footnote disclosure example, there are amounts included on the “Donor-restricted endowment funds” line as being unrestricted. Conversely, there are amounts included on the “Board-designated funds” line as being temporarily restricted.

These seem to contradict both UPMIFA and the proposed FSP. I'm having difficulty envisioning how these balances would have come to be.

“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?”

It would seem to me that, whatever the final requirements are, they should be uniform for all financial statements rather than have a “UMIFA GAAP” vs. “UPMIFA GAAP” situation.

“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....? If not, why not?”

All nonprofits I am familiar with have been operating with the intended purpose of UPMIFA at heart since the organization’s inception. Endowment draws are strictly limited to the minimum necessary to continue to fulfill their purpose, the endowment funds have been diversified and invested prudently using professional advisors. The “restrictions” being imposed by UPMIFA and the FSP have been recognized formally or informally by the governing board since the nonprofit was founded. The implementation of the FSP does not represent a sea-change in the manner of operation for these organizations, it represents another administrative hurdle to receiving a clean audit.

In keeping with the goal of prudence, most nonprofits (including large and well-known nonprofits) operate their financial offices with a bare minimum of staff and do not possess the excess capacity in man-hours to effectuate the FSP within the limited window of time the FASB has allotted. It is not wise for such organizations to begin working on compliance with the FSP now prior to the final version being approved and released. Comments will be accepted until April 18. Even assuming a quick turn-around, it would be unreasonable to expect that these organizations would receive final authoritative guidance in early May and be able to generate June 30, 2008 FSP-compliant financial statements in time for an audit in late-July.

I would ask that the Board consider the burden that this FSP represents in its deliberations and delay the implementation for a reasonable period of time to allow nonprofits an opportunity to comply.

Very respectfully,

A handwritten signature in black ink, appearing to read "Peter S. Kennedy". The signature is fluid and cursive, with a large initial "P" and "K".

Peter S. Kennedy, CPA