

MINUTES



To: Board Members
From: Choi (x446)
Subject: Minutes of the October 31, 2007 Board Meeting on Not-for-Profit Endowments and UPMIFA **Date:** November 15, 2007
cc: FASB: Bielstein, Golden, MacDonald, Leisenring, Bossio, Mechanick, Posta, Gabriele, FASB Intranet, Chookaszian, Posta, Allen; GASB

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement, Interpretation, or FSP.

Topic: Not-for-Profit Endowment Funds and UPMIFA
Basis for Discussion: Memorandum #1 dated October 18, 2007, and Memorandum #1-A dated October 18, 2007
Length of Discussion: 1:00-1:25 p.m.

Attendance:
Board members present: Herz, Crooch, Linsmeier, Seidman, Smith, and Young
Board members absent: Batavick
Staff in charge of topic: Mechanick
Other staff at Board table: Golden, Bossio, Choi
Outside participants: None

Summary of Decisions Reached:

The Board discussed the implications of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) on the net asset classification of donor-restricted endowment funds by not-for-profit organizations, including the (a) short-term spending flexibility it affords, (b) diverse views of constituents about its implications, and (c) need for guidance on the application of the relevant provisions and guidance provided by:

1. FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*
2. FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*
3. EITF Topic No. D-49, "Classifying Net Appreciation on Investments of a Donor-Restricted Endowment Fund."

The Board added a short-term project to its agenda and decided to issue an FSP to provide further guidance. The Board agreed that guidance should:

1. Affirm that, consistent with the principle for classifying endowment appreciation in paragraph 22 of Statement 117, in the absence of explicit donor stipulations, a not-for-profit organization should continue to classify a portion of a donor-restricted endowment fund as permanently restricted net assets, which continues to be based on the amount of the donor restriction that, in the long run, remains in force permanently. As noted in Statement 117, that determination ultimately rests with the organization's governing board and its interpretation of the entity's accountability to its donor for a restriction of permanent duration based on the donor's stipulations and relevant state law (including the state's adopted version of UPMIFA).
2. Affirm that an organization should disclose its interpretation of relevant state law in the notes to the financial statements.
3. Include additional disclosures that may be necessary to provide sufficient transparency to users in the new UPMIFA environment. The Board directed the staff to develop those disclosures for further consideration by the Board.
4. Affirm the continued applicability of the guidance in paragraphs 12 and 13 of Statement 124 to so-called under water situations and observe that the short-term spending flexibility afforded under UPMIFA does not change an organization's long-term accountability for a fund of perpetual duration.
5. Affirm the continued applicability of the guidance in Topic D-49. The Board observed that (a) contractual or other legally imposed restrictions on particular assets do not necessarily constitute donor-imposed restrictions for accounting purposes and (b) a temporary restriction should not be implied from the "donor restricted assets" language in Section 4(a) of UPMIFA.
6. Clarify that, similar to the guidance in Topic D-49, a temporary restriction should not be implied from the rebuttable presumption of imprudence provision under some versions of UPMIFA.

Objective of Meeting:

1. The purpose of this meeting was to discuss whether the Board should add to its agenda a short-term project to issue an FASB Staff Position (FSP) with guidance concerning the effect of UPMIFA on the classification of net assets related to donor-restricted endowment funds for not-for-profit organizations. Specifically, the Board addressed how UPMIFA's elimination of the historic-dollar-value threshold to determine the amount of an endowment fund that is not expendable should affect the organization's net asset classification of its perpetual endowment funds.

Matters Discussed and Decisions Reached:

AGENDA PROPOSAL

2. Mr. Mechanick introduced an agenda proposal by providing background on the issues and diverse views of constituents about whether and how the net asset classification scheme provided in current GAAP may be affected by UPMIFA.
3. **Staff Recommendation:** The staff recommended that the Board add to its agenda a short-term project to issue an FASB Staff Position addressing these issues.
4. **Board Vote:** The Board voted unanimously in favor of adding the short-term project to its agenda.
5. **Board Comments:** Ms. Seidman commented that, at a minimum, the Board would need to update the references in existing GAAP from UPMIFA's predecessor, the Uniform Management of Institutional Funds Act of 1972 (UMIFA), to UPMIFA. She noted, however, that because UPMIFA apparently includes some significant changes from UMIFA, she also supports the Board's taking a look at how the new legislation affects any underlying premises or specific guidance in the existing GAAP.

UPMIFA ISSUES

6. The staff also raised four issues concerning UPMIFA's potential effect on the classification of net assets related to donor-restricted endowment funds. Those issues are:
 - a. Given the elimination of the historic-dollar-threshold, how should a not-for-profit organization classify the net assets associated with a donor-restricted endowment fund under UPMIFA?

- b. Should investment losses continue to be charged to temporarily restricted net assets (if present) and unrestricted net assets, rather than permanently restricted net assets, when a donor-restricted endowment fund is under water?
- c. Should a temporary restriction be implied from UPMIFA's provision in section 4(a) 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 issue affects both perpetual and term endowments.)
- d. Should a temporary restriction be implied from UPMIFA's optional rebuttable presumption of imprudence? (This issue affects both perpetual and term endowments.)

Issue 1: Given the elimination of the historic-dollar-threshold, how should a not-for-profit organization classify the net assets associated with a donor-restricted endowment fund under UPMIFA?

- 7. Mr. Mechanick began discussions by providing background on the issues. He explained that net asset classification for not-for-profit organizations reflects the presence or absence of restrictions that donors place on their gifts and whether the restrictions are temporary—expected to expire or be met by the organization—or permanent—remain in force in perpetuity. In the case of endowments for which the donor does not specify how subsequent earnings (interest, dividend, rents, royalties, and net appreciation) on those gifts are to be used, issues arise about whether some portion of the earnings is also permanently restricted by the donor or relevant law.
- 8. He added that in 46 states, as well as the District of Columbia, the key law for endowments has been a version of the Uniform Management of Institutional Funds Act of 1972 – UMIFA. That law is gradually changing, state by state, as the various states replace UMIFA with UPMIFA. Of particular importance is the change made by UPMIFA to the guidelines on endowment spending in the absence of explicit donor stipulations.
- 9. UPMIFA provides more flexibility to organizations for handling the type of under water situations seen in 2001-2003. It does so by eliminating the notion of historic dollar value (a bright-line below which an organization cannot spend) in favor of

more extensive guidelines on what constitutes prudent spending. That change, however, has also raised questions and generated diverse views about net asset classification of endowment funds.

10. In the staff's discussions regarding this matter with constituents, the staff identified the following four views for consideration by the Board:

View A: None of the fund should be classified as permanently restricted

View B: The entire fund should be classified as permanently restricted

View C: The entire fund should be classified as a new net asset class/subclass

View D: Some, but generally not all, of the fund should be classified as permanently restricted. The amount would be the portion of the fund that must be retained permanently as determined by interpretation of the state's version of UPMIFA (and any other relevant state law). Additional disclosures would be needed.

11. **Issue 1 Staff Recommendation:** The staff agreed with View D. The staff recommended the guidance in the FSP affirm that, consistent with the principle for classifying endowment appreciation in paragraph 22 of FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*, and in the absence of explicit donor stipulations, a not-for-profit organization should continue to classify a portion of a donor-restricted endowment fund as permanently restricted net assets, which continues to be based on the amount of the donor-restriction that, in the long-run, remains in force permanently. As noted in Statement 117, that determination ultimately rests with the organization's governing board and its interpretation of the entity's accountability to its donor for a restriction of permanent duration based on the donor's stipulations and relevant state law (including the state's adopted version of UPMIFA).

12. The staff also recommended that the guidance in the FSP affirm that an organization should disclose its interpretation of relevant state law in the notes to the financial statements. Furthermore, the staff noted the FSP should include additional disclosure requirements that may be necessary to provide sufficient transparency to users in the new UPMIFA environment.

13. With regard to endowment classification in the absence of historic dollar value, Mr. Mechanick noted that the staff proposed a solution for both Issues 1 and 2 that avoids either jettisoning the current conceptual framework for not-for-profits or straying into definitive legal interpretation. He added that the approach reflects the staff's view that, while the UPMIFA guidelines provide short-term spending flexibility to deal with market declines that result in under water situations, that flexibility does not change the organization's long-term accountability to the donor for a fund of perpetual duration. Moreover, it is the amount corresponding to that accountability, and not the amount that an organization happens to have on hand because of cumulative asset allocation and spending decisions and investment results, that should be reflected in permanently restricted net assets. In essence, that was the Board's reasoning behind its decisions in FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*. Clear disclosure of the amount and how it's been determined, in the statements and/or the notes, will be important to all key users, whether they be donors, regulators, or creditors. Based on the staff's discussions with constituents, the staff believes the classification guidance is especially important to financial ratios used by credit analysts and others in assessing debt capacity and other short-term and long-term measures of an organization's financial health. The staff believes this is also important to regulators who monitor not-for-profit organizations and provide oversight for their use of charitable resources.

14. **Issue 1 Board Vote:** The Board voted unanimously in favor of the staff recommendation on Issue 1.

15. **Issue 1 Board Comments:** One question posed by Mr. Herz during the meeting was whether an organization would have to determine under UPMIFA those endowment fund assets that it must maintain permanently regardless of having to classify net assets for accounting purposes. Mr. Herz wanted to be sure that organizations would not have to make this determination only for accounting purposes, but that UPMIFA requires organizations to go through similar considerations for legal purposes. In the past, organizations could simply use the historic-dollar-value bright line approach to determine what it must maintain permanently for both legal and accounting purposes.

16. Mr. Mechanick indicated that such a determination would not be made solely for accounting purposes, though it would go hand-in-hand with the accounting for an endowment fund. He explained that an organization, above all, needs to determine the long-term accountability to the donor in terms of what needs to be held in perpetuity. Mr. Golden stressed that the amount to be retained permanently, in the long run, and thus classified as permanently restricted net assets, would not simply be an organizational policy decision but the governing board's interpretation of the state's version of UPMIFA and any other relevant state law.
17. Mr. Linsmeier inquired as to whether the differences in interpretations of the law would be a result of different state legislatures' interpretation of UPMIFA or a result of different not-for-profit entities interpreting UPMIFA differently. Mr. Mechanick explained that UPMIFA is a model act and that it is very possible that individual states would change the language surrounding certain elements of the act when adopting it into state law. For example, a particular state adopting UPMIFA might require that organizations maintain purchasing power of the original gifts in their endowment. Such a provision would further limit what the organization could spend out of the endowment fund. Therefore, the responsibility of distinguishing between what an organization can and cannot spend out of its endowment funds rests on the governing board (and its auditors) to interpret their state's version of the law.
18. Mr. Smith pointed out that interpretations might not only vary state by state, but also entity by entity. He noted that the model act offers factors that a governing board should consider when determining what it can spend in accordance with UPMIFA standard of *prudence*. Some governing boards may evaluate those factors differently depending on the specific nature of their fund, organization, or environment. Therefore, different entities in the same state could reach different conclusions regarding amounts it can spend out of its endowment fund. Mr. Mechanick then clarified that those factors provided in UPMIFA primarily relate to what the organization must *consider* when making *spending decisions in the short-term*. (He indicated that one exception to this would be if the language around considering the effects of inflation and deflation were modified by a state to require specifically the maintenance of purchasing power.) A governing board's classification of a portion of

the fund as permanently restricted net assets should accurately reflect the organization's *long-term accountability* to the donor.

19. Mr. Crooch commented that the “permanently restricted” classification in the current GAAP model could now be misleading because that amount could now be drawn down upon in the short-term under UPMIFA. He also pointed out that since there is no mechanism in place to evaluate the temporary nature of an under water fund, he was reluctant to accept labeling a portion of an endowment fund “permanently restricted.” Mr. Crooch also noted that donors will still assume that their original gift amounts are untouchable by the organization for spending regardless of the new law.
20. Mr. Bossio pointed out that a donor could still explicitly stipulate in the gift instrument that the original gift or a portion thereof could never be used, even for short-term spending, and that UPMIFA only provides a rule of construction for those endowment assets that do not have explicit donor stipulations. Mr. Mechanick noted that, given the experiences of many organizations with newer endowments during the market downturn of 2001-2003, he would expect that, in general, donors would not wish an organization to bear the hardship of not being able to fund its programs and would wish to afford the organization flexibility in the short-term *as long as the organization has established a prudent set of policies and practices to ensure the endowment would be maintained in the long-term.* Mr. Bossio and Mr. Mechanick stressed that while the amount in the fund might fluctuate, the accountability to a donor for a fund of permanent duration would remain unchanged, and thus they did not consider the categorization of that portion of the fund as permanently restricted net assets to be misleading. Finally, Mr. Mechanick noted that the one other alternative that the staff sees to address Mr. Crooch's concern would be to overhaul the entire net asset classification model provided under current GAAP, which would be a major project that the Board would be unlikely to support at this time. Mr. Linsmeier and other Board members concurred.
21. Finally, Mr. Herz mentioned how important disclosures would be for not-for-profit organizations operating in the UPMIFA environment. Mr. Mechanick indicated that the staff would return in December with a recommended set of additional disclosures

to include in the FSP. The staff plans to work with some key constituents between now and then to ensure those disclosures are both feasible and useful.

Issue 2: Should investment losses continue to be charged to temporarily restricted net assets (if present) and unrestricted net assets, rather than permanently restricted net assets, when a donor-restricted endowment fund is under water?

22. The staff noted that the classification of net assets relating to an endowment fund under UPMIFA is particularly important in under water situations. Under current GAAP, investment losses on donor-restricted funds when the fair value of the fund's assets has dropped below the level required by donor stipulations or law (under water) are charged to temporarily restricted or unrestricted net assets, rather than permanently restricted net assets, in accordance with paragraphs 12 and 13 of Statement 124. In light of the additional spending flexibility and the elimination of the historic-dollar-value threshold provided in UPMIFA, the Board considered whether or not the guidance surrounding investment losses is still appropriate.

View A: The approach should be different; investment losses and spending in under water situations should be charged to permanently restricted net assets

View B: The approach should be the same; investment losses and spending in under water situations should be charged to temporarily restricted or unrestricted net assets.

23. **Issue 2 Staff Recommendation:** The staff recommended View B, not to fundamentally change the guidance in Statement 124. The staff conveyed that none of the changes in the spending guidelines under UPMIFA provide a substantive reason for the Board to change its decision in Statement 124 concerning the reporting of endowment losses and spending (if any). The staff views spending in an under water circumstance as a type of intra-organizational borrowing that must ultimately be repaid in order to meet UPMIFA's long-term goal of preserving the endowment fund, rather than as a release from a donor-imposed permanent restriction. The latter would in fact diminish permanently restricted net assets and result in a reclassification of net assets to either temporarily restricted or unrestricted net assets, thus signaling, inappropriately, a diminishment of the organization's long-term accountability to the donor. Instead, the degree by which a fund is under water at the balance sheet date

should be indicated by a diminishment of the assets (as disclosed on the balance sheet and/or the notes) and the under water disclosure already required under Statement 124.

24. **Issue 2 Board Vote:** The Board voted unanimously in favor of the staff recommendation on Issue 2.

25. **Issue 2 Board Comments:** Ms. Seidman pointed out that she is comfortable with the staff recommendation. In response to comparisons made to pension accounting, she noted that with endowments, all of the cash flows, and revenues, gains, and losses, are actually presented on the financial statements, even under the current guidance.

Issue 3: Should a temporary restriction be implied from UPMIFA’s provision in section 4(a) 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”?

26. The Board considered EITF Topic No. D-49, “Classifying Net Appreciation on Investments of a Donor-Restricted Endowment Fund,” which clarifies 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 does not in and of itself extend a donor restriction to that appreciation. (See Appendix II.) The “donor restricted assets” language in section 4(a) UPMIFA has been viewed by some as yet another incursion by legal professionals into the realm of accounting for endowment funds. The Board considered the implications of this language in UPMIFA on the net asset classification of endowment funds.

27. **Issue 3 Staff Recommendation:** The staff recommended that the Board issue guidance in the FSP to clarify that a temporary restriction should not be implied from the “donor restricted assets” language in Section 4(a) of the model UPMIFA. Such guidance would be in a similar vein as Topic D-49 in that it would remind readers that not all legal restrictions constitute donor restrictions for accounting purposes, and would state that because the “donor restricted assets” language in the model UPMIFA revolves around an action that is solely within the purview of a governing board, the language by itself does not create or extend a donor restriction. The FSP’s guidance would, however, include the caveat that an organization will need to make a

definitive determination based on the specific language in their state's version of UPMIFA and any other relevant legal guidance.

28. **Issue 3 Board Vote:** The Board voted unanimously in favor of the staff recommendation on Issue 3.

29. **Issue 3 Board Comments:** The Board had nothing to add to the staff recommendation.

Issue 4: Should a temporary restriction be implied from UPMIFA's optional rebuttable presumption of imprudence?

30. For states that wish to include additional guidance regarding prudent spending of donor-restricted endowment funds, the model UPMIFA includes an option for adding a rebuttable presumption of imprudence for spending over 7 percent of the market value of the fund (calculated over the period in which the organization bases its spending formula). Thus far, about half of the enacting states have chosen to include such a provision. (Texas also varies the specific percentage based on the size of the organization; see Appendix I.) The Board considered the implications of a state's inclusion of this provision on the net asset classification of endowment funds.

31. **Issue 4 Staff Recommendation:** Since the staff views the model UPMIFA's optional rebuttable presumption of imprudence as additional "rule of thumb" guidance concerning prudent spending, rather than an absolute ceiling for spending, the staff recommends the Board issue guidance in the FSP to clarify that a temporary restriction should not be implied from that rebuttable presumption. As with the guidance on the "donor restricted assets" language, the guidance will draw upon that in Topic D-49 and include the caveat that an organization will need to make a definitive determination based on the specific language in their state's version of UPMIFA and any other relevant guidance.

32. **Issue 4 Board Vote:** The Board voted unanimously in favor of the staff recommendation on Issue 4.

33. **Issue 4 Board Comments:** The Board had nothing to add to the staff recommendation.

Other matters discussed

34. Ms. Seidman's only other note during the meeting was that the staff draft the FSP to be Codification-ready.

**APPENDIX I: CURRENT STATUS OF STATE-BY-STATE ADOPTION OF
UPMIFA (AS OF OCTOBER 1, 2007)**

State	Status	Effective Date	7% Imprudence Provision?
Connecticut	Enacted	10/1/2007	No
Idaho	Enacted	7/1/2007	No
Indiana	Enacted	7/1/2007	No
Montana	Enacted	10/1/2007	Yes
Nebraska	Enacted	9/1/2007	No
Nevada	Enacted	10/1/2007	Yes
Oklahoma	Enacted	7/1/2007	No
Oregon	Enacted	1/1/2008	Yes
South Dakota	Enacted	7/1/2007	No
Tennessee	Enacted	7/1/2007	Yes
Texas	Enacted	9/1/2007	Yes*
Utah	Enacted	4/30/2007	Yes
Delaware	Enacted	7/31/2007	No
Alabama	Pending		
District of Columbia	Pending		
Kentucky	Pending		
Michigan	Pending		
Minnesota	Pending		
Missouri	Pending		
U.S. Virgin Islands	Pending		
Vermont	Pending		
Georgia	2008 Session		
Kansas	2008 Session		
New Hampshire	2008 Session		
North Carolina	2008 Session		
Pennsylvania	2008 Session		

Note: As of 10/1/2007, no other states had yet announced planned legislation.

* While Texas has adopted UPMIFA, it has included two additional stipulations regarding appropriations of endowment funds. Consistent with the model act, appropriations of expenditures greater than seven percent of the market value of the endowment creates a rebuttable presumption of imprudence for endowments greater than \$1 million. The State's two modifications are as follows:

1. For endowments of less the \$1 million, the presumption of imprudence spending threshold is lowered to 5 percent of the market value of the endowment.
2. The adopted act also provides an exception for university endowment funds greater than \$450 million. For these endowments, spending in excess of 9 percent of the endowment's market value creates a rebuttable presumption of imprudence.

APPENDIX II: EITF ABSTRACTS, TOPIC D-49

Topic No. D-49: “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.