MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Choi (x446)
Subject:	Minutes of the June 4, 2008 Board Meeting for Not-for-Profit Endowments and UPMIFA
Date:	June 12, 2008
cc:	FASB: Bielstein, Golden, MacDonald, Leisenring, Bossio, Posta, Cosper. Lott, Glotzer, C. Smith, Chookaszian, Gabriele, Klimek, Allen, FASB Intranet, 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:	Redeliberations
Basis for Discussion:	Memoranda #3, 3A, and 3B dated May 15, 2008
Length of Discussion:	10:45 a.m. – 11:35 a.m.

Attendance:

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

Summary of Decisions Reached:

The Board discussed issues raised by respondents to the proposed FASB Staff Position FAS 117-a, *Endowments of Not-for-Profit Organizations: Net Asset Classification oft Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures*. The Board made the following decisions, which will be incorporated into the FSP:

a. As proposed by FSP FAS 117-a , organizations should continue to classify a portion of a donor-restricted endowment fund as permanently restricted net assets, as determined by the organization's (governing board's) interpretation of relevant law.

b. As proposed by FSP FAS 117-a, organizations should continue to account for underwater funds as a reduction of unrestricted or temporarily restricted net assets (rather than as a reduction of permanently restricted net assets), which is consistent with the guidance in FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*.

c. The portion of an endowment fund that is not classified in permanently restricted net assets should be classified as temporarily restricted net assets, even in the absence of purpose restrictions. This decision is consistent with the view that UPMIFA extends a donor restriction to the unappropriated portion of an endowment fund, specifically by implying a time restriction.

d. The disclosure requirements proposed by FSP FAS 117-a will be retained and incorporated into the final FSP except for the elimination of:

   i. The proposed disclosure of an organization's planned appropriation for expenditure, if known, for the year following the most recent period for which the organization presents financial statements

   ii. The proposed supplemental disclosure to the tabular disclosures of the amount added to permanently restricted net assets because of governing board interpretation of the law.

e. The final FSP will not address respondents' requests for additional guidance that are outside the scope of the project.

f. The effective date of the FSP will be deferred six months to fiscal years ending after December 15, 2008. Early application of the FSP is permitted.

The Board directed the staff to monitor the implementation of UPMIFA and the application of the FSP in practice. The Board also directed the staff to proceed to a draft of a final FSP for vote by written ballot.

Objective of Meeting:

1. The purpose of this meeting was to deliberate the substantive issues raised in respondents' comment letters received on the proposed FSP. That objective was met.

Matters Discussed and Decisions Reached:

2. Mr. Mechanick explained that this has been a fairly difficult FSP project, because it touches upon issues on which there apparently have been some long-standing disagreements and, because it involves a law that's brand new, it may not easily fit within the current net asset classification scheme. If one listens to the range of viewpoints, especially within the legal and regulatory communities, one quickly realizes that it is not at all clear how the law might be interpreted and enforced.

3. He noted that the FSP had a comment period that lasted approximately two months, and that the staff had accepted letters for an additional three weeks, through May 8, 2008. Before, during, and after the comment period, the staff reached out extensively to various constituencies, through webcasts, speeches, electronic newsletters, articles, media interviews, phone discussions, emails, and so forth. While there were only 45 letters, the staff thinks that those letters, combined with the discussions with credit rating agencies, represent a good cross-section of views with a great deal of good information and suggestions.

4. The staff also noted that in the weeks since the Board's Education Session, the staff had done some additional outreach to a representative sample of key constituents, including accountants, attorneys, preparers, regulators, and one of the credit rating agencies. Based on those discussions, there seems to be a pretty good consensus that if the Board were to approve the package of staff recommendations presented at the Education Session and contained in today's handout, the FASB would be coming out where it should be coming out in terms of guidance at this time.

Issue 1: Net Asset Classification of Donor-restricted Endowment Funds Under UPMIFA

5. Mr. Mechanick noted that regarding net asset classification—clearly the most difficult set of issues—some thoughtful arguments have been made for classifying donor-restricted endowment funds in one net asset class, either a new net asset class

or a permanently restricted net asset class revamped in such a way that it would effectively be a new net asset class. However, beyond questions about whether such a significant change to the net asset classification framework, put into place a decade ago after extensive due process, would be in the best interests of users—especially if done through an FSP—it is not at all clear at this time whether this new law will actually be interpreted and enforced in such a way as to treat a donor endowment as a homogeneous fund. And that is the underlying premise of most of the one net asset class arguments.

Issue 1A: The amount of endowment fund to be classified as permanently restricted net assets

6. **Issue 1A Staff Recommendation**: After considering the totality of the information that the staff had learned and the views expressed since the proposed FSP was released for comment back in February, the staff recommended that the Board reaffirm its view in the proposed FSP. That view is that an organization would classify some but generally not all of a donor-restricted endowment fund in permanently restricted net assets, based on the organization's good faith interpretation of the law. To go beyond that, especially before learning more about how the law is actually being interpreted and enforced over the next year or two, would be, in the staff's view, a disservice to key users. The staff also recommended the FSP downplay any implication that "plain vanilla" UPMIFA requires maintenance of the purchasing power equivalent of the original gift amount.

7. **Issue 1A Board Vote:** The Board voted unanimously in favor of the staff recommendations.

8. **Issue 1 Board Comments:** Mr. Smith expressed that he would prefer that no guidance be issued at this time. He suggested that the Board should wait to see how the new law is interpreted and enforced before it issues guidance. Mr. Smith acknowledged, however, the need for some type of guidance in the interim and therefore did not object to the staff recommendation.

Issue 1B: Accounting for Underwater Funds

9. **Issue 1B Staff Recommendation:** The staff recommended the Board reaffirm its decision in the proposed FSP regarding underwater funds. That decision, consistent with Statement 124, is that underwater funds should be reflected as a reduction of unrestricted or temporarily restricted net assets (rather than as a reduction of permanently restricted net assets).

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

Issue 1B Board Comments: None.

Issue 1C: Temporary versus Unrestricted Net Asset Classification

11. **Issue 1C Staff Recommendation:** The staff recommended that the portion of a donor-restricted endowment fund that is not classified in permanently restricted net assets should be classified as temporarily restricted net assets, even in the absence of purpose restrictions. This decision is consistent with the view that UPMIFA extends a donor restriction to the unappropriated portion of an endowment fund, specifically by implying a time restriction.

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

13. **Issue 1C Board Comments:** The Board and the staff clarified that upon adoption of the proposed FSP, any portion of a donor-restricted endowment fund under UPMIFA that is currently classified as unrestricted net assets would instead be classified as temporarily restricted net assets until appropriated by the organization. That is, the FSP would not allow any unappropriated portion of donor-restricted endowment funds to be classified as unrestricted net assets. Only when a governing Board has gone through the required appropriation process can the appropriated amount be reclassified from temporarily restricted net assets to unrestricted net assets (unless there is a purpose restriction, which would also need to be met before such reclassification could occur). Furthermore, the FSP's transition guidance would require a one-time reclassification of all donor-restricted endowment assets classified as unrestricted net assets (if not appropriated). Such reclassification would be in the

year in which UPMIFA is effective and would not require restatement of net asset amounts reported in prior year financial statements.

Issue 2: Disclosures

14. Mr. Choi first explained that the FSP had proposed six new disclosures that would apply to all not-for-profit organizations regardless of whether an organization is subject to a state's enacted version of UPMIFA. The feedback received on the disclosures was generally supportive. Most respondents agreed that the disclosures would provide useful information about all endowment funds, especially in the new UPMIFA environment, and that the required information is obtainable by the reporting organization.

15. **Issue 2 Staff Recommendation:** The staff provided a recommendation on each of the proposed disclosures.

Interpretation of Relevant Law & Spending Policy

16. There was little disagreement among respondents concerning the first two disclosures described in the handout. Those are (a) the disclosure of a governing board' s interpretation of law that underlies the organization's net asset classification and (b) disclosure of an organization's spending policy. Those disclosures received overwhelming support and the staff recommended that they be retained in a final FSP.

Investment Policy

17. The investment policy disclosure drew the most mixed response. After weighing the responses, the staff recommended retaining the disclosure because of the important link between the investment and spending policies for endowments.

Tabular Disclosures

18. Respondents generally supported the tabular disclosures in the proposed FSP with the exception of the supplemental disclosure of the amount added to permanently restricted net assets because of governing board interpretation of the law. The argument that came from many respondents is that permanently restricted is permanently restricted, and the organization should not have to distinguish between

UPMIFA (or law-based) permanent restrictions and other types of permanent restrictions. The staff suggested that disclosing such details puts an unnecessary cloud on the reported amount and recommended that that level of detailed information not be required.

Planned Appropriation

19. Very few respondents supported the disclosure of next year's planned appropriation of endowment funds, to the extent that those appropriations are known. Objections were primarily based on concerns about requiring prospective information. The staff suggested that those concerns get into issues that go well beyond the basic objectives of this FSP. Thus, the staff recommended dropping the disclosure requirement in paragraph 13 of the FSP.

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

21. **Issue 2 Board Comments:** Mr. Smith urged the staff to clarify its proposal to eliminate the proposed supplemental disclosure to the tabular disclosure. Under that requirement, an organization would disclose amounts added to permanently restricted net assets solely based on a governing board's interpretation of law. The staff explained that additions to the permanently restricted net asset class could arise from (1) new endowment gifts to be held permanently, (2) explicit donor stipulations requiring that a specified portion of the net appreciation or income from an original gift also be held permanently, and (3) classification of the amount a governing board determines must be maintained permanently based on its interpretation of relevant law absent explicit donor stipulations. The staff pointed out that the first element—new gifts—would be disclosed separately in the table of changes in endowment net assets. The other two elements would be aggregated as investment return added to permanently restricted net assets in the table. Mr. Mechanick explained that the staff believes that that information, coupled with a governing board's interpretation of relevant law, would be sufficient to satisfy the needs of users. Mr. Bossio added that breaking out the piece of permanently restricted net assets allocated by the Board

potentially suggests that that piece is substantively different from the rest of the amount classified as permanently restricted net assets.

Issue 3: Requests for Additional Guidance

22. **Issue 3 Staff Recommendation:** The staff recommended that the Board specifically reject two requests made by respondents as being outside of the scope of this FSP. Mr. Mechanick noted that AcSEC's request to drop the disclosure requirement for investment expenses in paragraph 24 of Statement 117 would be more appropriately considered as part of a comprehensive set of changes to authoritative GAAP (the Codification) that the Board may be asked to clear in the next 1-2 years in connection with the ongoing major revision of the AICPA Audit and Accounting Guide, *Not-for-Profit Organizations*. Similarly, any net asset classification issues concerning community foundations noted by the Council on Foundations (CL #19) that are not directly connected with UPMIFA, if addressed, should be dealt with outside of this FSP project. The issue, which largely goes beyond the scope of this document, has to do with long-standing concern about what they see as a misinterpretation of the role of variance power in net asset classification. Variance power is the unilateral ability to redirect funds in certain circumstances. While a fundamental relook at Statements 117 and 136 on this issue is beyond the scope of this FSP, the staff noted that the implication of a time restriction may at least assuage some of their concern here.

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

24. **Issue 3 Board Comments:** Ms. Seidman suggested that although the second issue is outside the scope of this FSP, perhaps it was something that, along with the first issue, AcSEC could present to the Board as a formal request for guidance.

Issue 4: Effective Date

25. **Issue 4 Staff Recommendatio**n: Based on significant concerns raised by virtually all respondents, the staff recommended that the effective date for the FSP be deferred to fiscal years ending after December 15, 2008. The staff notes that a six-month deferral would roughly coincide with the effective date of the new IRS Form 990, which will

also require organizations to distinguish board-designated endowment funds from other funds. The staff also recommends that the final FSP, like the proposed FSP, permit early application. Organizations in states for which UPMIFA is already effective would need to be able to apply the guidance in the FSP, many of them for their June 30, 2008 financial statements.

26. **Issue 4 Board Vote:** The Board voted unanimously in favor of the staff recommendation.
27. **Issue 4 Board Comments:** None.

Issue 5: Post Implementation Review

28. **Issue 5 Staff Recommendation:** The staff recommended that the Board commit to doing a post-implementation review in 1-2 years. A number of respondents recommended either the creation of a new net asset class or an overhaul of the permanently restricted net asset class. The staff explained that much research would be needed, especially with users, to determine whether the current net asset classification framework as it applies to donor-restricted endowment funds could benefit from such a longer-term project. The staff thought that it would be instructive to see how UPMIFA is actually interpreted and enforced, and the FSP's guidance is applied, over the next year or two. (In addition, some valuable information about financial statement display could be learned from the financial statement presentation project and any additional thinking that may be done in that regard by the staff and others with respect to not-for-profit organizations.)
29. **Issue 5 Board Vote:** The Board rejected the authorization, at this time, of a post-implementation review, but unanimously agreed that the staff should closely monitor the response to the new law and the FSP over the next 1-2 years to see if there is a need for new guidance related to the reporting for donor-restricted endowment funds.
30. **Issue 5 Board Comments:** Mr. Linsmeier explained that he did not believe there was a need to specifically commit to a post-implementation review. He encouraged the Board to wait to see if such a review was necessary. If it becomes clear over time that new guidance is needed related to endowment funds, the Board would pursue the project regardless of whether there was a commitment upfront to conduct a post-implementation review.

31. The Board directed the staff to proceed to the balloting process for a final FSP.

Other Matters Discussed

None.