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New Accounting Rules Create Greater Accountability for Nonprofits

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The winter 2009 Nonprofit Minute outlined major changes The Uniform Prudent Management of Institutional Funds Act (UPMIFA) will have on nonprofit organizations in states where the Act has been implemented. This issue focuses on the Financial Accounting Standards Board (FASB) Staff Position (FSP) 117-1, "Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subjected to an Enacted Version of UPMIFA and Enhanced Disclosures for All Endowment Funds," which provides guidance on classification and disclosure for donor-restricted endowments subject to UPMIFA as well as guidance on disclosures for all endowment funds.

As a refresher, UPMIFA was drafted in 2006 by the National Conference of Commissioners on Uniform State Laws and has been adopted by 42 states and the District of Columbia. UPMIFA contains new guidelines regarding expenditure from donor-restricted assets in that it focuses on the entire fund (original gift, income, appreciation) and how to best preserve these funds. UMIFA (UPMIFA's predecessor) focused only on the spending of the growth (income and appreciation) of the fund. In doing away with "historic dollar value," UPMIFA allows for prudent spending of the income earned and, potentially, original principal of permanently restricted endowments as determined, according to several UPMIFA-defined factors, by the nonprofit board.

FSP 117-1 was issued Aug. 8, 2008,

to improve the overall financial reporting of nonprofit endowment funds. It looks to 1) provide guidance on the net asset classification of donor-restricted endowment funds for nonprofits that have adopted UPMIFA, and 2) improve disclosure about an organization's endowment funds (both donor-restricted and board-designated funds) whether UPMIFA has been adopted or not.

Net Asset Classification for Funds Subject to UPMIFA

Under UPMIFA, nonprofits will continue to classify a portion of donor-restricted assets as permanently restricted net assets; the challenge now is determining how much is classified as permanently restricted. UPMIFA introduced the concept of endowment fund "preservation," which effectively eliminates the historic dollar value concept that was part of UMIFA. The amount now classified as permanently restricted will be determined by the gift instrument or, absent explicit donor consent, based on the board's interpretation of its state's version of UPMIFA.

If a donor specifically or implicitly intends that the restricted portion of their gift maintain its "purchasing power" over time, assuming inflation, an increase in permanently restricted net assets would be required. For instance, some donors specify that the amount of increase to permanently restricted assets each year must be equal to the Consumer Price Index (CPI). If this "maintenance of purchasing power" is stated or implied, the organization will have to develop a method to determine the amount that should be added to permanently restricted net assets.

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If the donor is silent regarding purchasing power, the organization must determine if the state-enacted version of UPMIFA requires preservation of the fund or maintenance of purchasing power, and calculate how much must be added, per the FSP requirement, to the permanently restricted classification class each year. Absent rulings pertaining to applicable law, since this is a relatively new ruling, the board interpretation of the law would have to be consistent year to year.

For states still following UMIFA (not UPMIFA), there is no change in classification of the net assets under the FSP. The historic dollar value is generally regarded as the original gift and any donor-restricted accumulations to that fund. This is the amount understood to be permanently restricted and not available for appropriation in order to maintain the fund in perpetuity.

Besides elimination of historic dollar value, a second key UPMIFA change addressed in the FSP is the classification of earnings. Previously any earnings on donor-restricted assets were considered unrestricted unless the earnings were explicitly restricted by the donor or relevant law. With UPMIFA there is now a greater emphasis on the endowment fund's purposes as opposed to the organization's purposes. UPMIFA states that "unless stated otherwise in the gift instrument, the assets in an endowment fund are donor-restricted assets until appropriated for expenditure by the organization." This ruling implies a greater duty of the organization to follow donor intent by extending a donor restriction not only to the original gift but to the earnings generated by the gift. Hence, assets that were once considered unrestricted will now be classified as temporarily or time restricted until appropriated for expenditure, as will related earnings. The temporary restriction is lifted when the amount is appropriated (spent) which results in a reclassification of the amount to unrestricted net assets.

With the adoption of FSP 117-1, many organizations may now see a reclassification of assets from unrestricted to temporarily-restricted on their statements of financial position.

A third issue addressed by the FSP is in regard to underwater endowments that can result from investment losses or board appropriations below the original gift amount. The FSP clearly addresses this issue and states that the new law does not change the accounting aspect as to how to attribute losses or appropriations of amounts that would effectively spend a portion of the original gift. As such, any losses by the endowment or appropriations are not allocated to permanently restricted assets, but would reduce accumulated earnings that are classified as temporarily restricted until exhausted. If the amount of losses or appropriations exceeds the amount reflected in temporarily restricted net assets, a charge against unrestricted net assets would occur. Permanently restricted net assets, however, are reduced only if provided for by the gift instrument.

Enhanced Disclosures for All Endowment Funds
With today's scrutiny of financial documents related to publicly-traded companies as evidenced by Sarbanes-Oxley, FSP 117-1 will effectively improve nonprofits' overall accountability to the community. Organizations will now have to include additional disclosures, which will provide users of financial statements a better understanding of the overall financial and fiduciary health of the organization. These additional disclosures are included for all donor and board designated endowments, whether they are subject to UPMIFA or UMIFA. They include:

- A description of the organization's interpretation of the law governing net asset classification of donor-restricted endowment funds
- Endowment investment and spending policies
- Composition of the endowment by net asset class (donor-restricted and board-designated)
- Reconciliation of beginning and ending balances of the endowment, in total and by net asset class.

Some examples of disclosures an organization can use regarding the interpretation of relevant law are:

An organization's board interprets the state version of UPMIFA as requiring the preservation of the fair value of the original gift. As a result, it classifies as permanently restricted net assets (1) the original gift (2) the value of any subsequent gifts (3) accumulation of earnings in accordance with the direction of the donor gift instrument. The remaining portion of the fund is classified as temporarily restricted until appropriated for expenditure.

An organization's board interprets the state version of UPMIFA as requiring the maintenance of purchasing power of the fair value of the original gift. It therefore classifies as permanent net assets (1) the original gift, (2) the value of any subsequent gifts, (3) accumulation of earnings in accordance with the direction of the donor gift instrument, (4) an additional amount added each year equal to the value of the donor restricted endowment fund multiplied by the consumer price index for that respective year. The remaining portion of the fund is classified as temporarily restricted until appropriated for expenditure.

FSP 117-1 is meant to help an organization properly account and categorize their assets vis-à-vis UPMIFA. This position will also assist those organizations where UPMIFA has not been adopted to create a greater sense of organizational transparency for their most important constituents, their donors. With this higher level of disclosure, more donors should feel comfortable that their wishes will be carried out.

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