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WEBINAR

Endowment Accounting for K-12 Schools

February 27, 2023

WEBINAR

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Speaker Biography

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Rick is a partner with **FORVIS** (which is the result of a merger between BKD and DHG) with more than 25 years of experience serving nonprofit organizations. He is the New York Market Industry Leader for Nonprofit and Education and is a member of FORVIS' Higher Education Center of Excellence, which is an internal committee focused on addressing issues important to the higher education industry. Rick focuses on audits and advisory services for nonprofit and higher education organizations.

Prior to this role, he worked at the FASB, where he served as a supervising project manager for almost six years. In that role, he was the project manager on Accounting Standards Update (ASU) 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*; ASU 2018-08, *Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*; and ASU 2019-03, *Updating the Definition of Collections*. He also was coordinator for FASB's NFP Advisory Committee and Private Company Council. Before joining the FASB, Rick was vice president and controller at a large national museum in New York for seven years and a senior manager with a large international accounting firm where he worked for 14 years and specialized in audits of higher education institutions and other not-for-profit organizations.

Rick is a member of the AICPA Not-for-Profit Expert Panel. He is a lecturer at Columbia University's School of Professional Studies in their Nonprofit Management program. He also has been a frequent speaker with NACUBO, the American Institute of CPAs (AICPA), and various state CPA societies.

He is a CPA in New York and New Jersey and is a member of the AICPA and New York State Society of Certified Public Accountants. Rick is a graduate of Montclair State University, New Jersey, with a B.S. degree and an M.B.A. degree.

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Speaker Biography

Amy Rutledge, CPA
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Amy is a member of FORVIS' New York audit and assurance team focused on the nonprofit industry. She has approximately six years of experience providing audit and attestation services to a variety of clients. Amy's audit experience includes managing over ten K-12 private and charter schools, Single Audits, and numerous other nonprofit organizations. Amy serves as the audit manager for many of her engagements, coordinating communication between FORVIS and the client on the timing of the audit, deadlines, staffing, and other relevant items.

She is a member of the American Institute of CPAs and the New York State Society of CPAs.

Amy is a graduate of The University of Texas at San Antonio, with a B.B.A. degree in accounting and an M.P.A. degree.

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Agenda

- Definition & types
- Reporting & accounting
- The definition & requirements of underwater endowments
- Example disclosures
- Other items
- Questions

What Are Endowment Funds?

FASB Codification Subtopic 958-205 outlines the requirements for endowment accounting

It is a fund of cash, securities, & other assets to provide income for the maintenance of a not-for-profit

They are established by a donor or governing board & include accumulated earnings

Can be with or without donor restrictions

- Donor-restricted: a gift with a stipulation that the resources be invested either for a specified period (also known as a term-endowment) or to be invested in perpetuity
- Without donor restrictions: (also known as board-designated endowment, funds functioning as endowment, or quasi-endowment) when a governing board designates a portion of its net assets without donor restrictions to be invested usually in perpetuity, but it doesn't need to be

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Board-Designated Endowments with Donor Restrictions?

Exception: FASB Codification 958-205-45-13A – A board-designated endowment fund can include a portion of net assets with donor restrictions. Ex: if an NFP is unable to spend donor-restricted contributions in the near term, then the board sometimes considers the long-term investment of these funds

- Caution – Remember that donor restricted funds must be used first. This is known as the “first dollar rule”

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Board-Designated Endowments with Donor Restrictions, Cont.

An example of the exception could be a $10 million gift for the music department of the school. School only spends $400,000 annually on the program. The gift is not asked to be directed to the endowment by the donor, but the board decides to invest it in the endowment with a 4% spending rate ($400,000 annually) to support the music program & preserve the original gift in perpetuity. The board may do this to “endow” the music program with the donor gift

The accounting would be as follows

- Investment return is recorded as without donor restriction (unless the donor restricts investment earnings on unspent money)
- Spending the $400,000 annually on the program actually comes from the net asset with donor restrictions fund & is shown as a release from restrictions
- Over time the donor endowment will be depleted & if the board chooses to do so, the earnings from the endowment would create a new board-designated endowment <u>without</u> donor restrictions

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Donor-Restricted Endowment Fund

When classifying net asset classes, consider the donor’s explicit stipulations & the applicable laws that extend donor restrictions

Since there is a requirement to appropriate for expenditure, the funds are time-restricted until that appropriation takes place

If the fund is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA), it extends a donor’s restriction to use of the funds, that includes the corpus & the investment return, until the funds are appropriated for expenditure by the governing board

49 of the 50 states have an enacted version of UPMIFA

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Board-Designated Endowment Fund

Funds without any purpose-type restrictions

The original fund & all investment returns are free of donor restrictions

Reported in net assets without donor restrictions

Are set up by the board

NOT subject to an enacted version of UPMIFA

NOT subject to underwater disclosure requirements

Subject to the disclosure requirements under FASB's ASU 2016-14

- Since both board-designated & donor endowments are typically shown in the notes side by side, no additional disclosures may be necessary
- It is optional to bifurcate this within net asset without donor restrictions on the balance sheet

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How Should an NFP Report the Net Assets of an Endowment Fund?

Ending balances of endowments should be included in the Statement of Financial Position/Balance Sheet within the following two classes

- Net Assets with donor restrictions – donor-restricted endowment
- Net Assets without donor restrictions – board-designated endowment fund

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How Should an NFP Report the Income from Endowments?

Earnings from endowments are included in the statement of activities in the same net asset class as the investments

- Net Assets with donor restrictions – all earnings on donor endowments
- Net Assets without donor restrictions – all earnings on board-designated endowments
- Endowment funds typically are tracked by assigning units which allow the investment income/return to be allocated

Accounting policy election on "simultaneous release." You can report restricted investment income as part of without donor restrictions if the investment income has been appropriated & spent if you have a similar election for contributions. See 958-225-45-6

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Accounting for Donor Endowments with an Enacted Version of UPMIFA

The original gifted amount, additional gifts, & investment returns should initially be classified as net assets with donor restrictions

Donors may provide specific instructions on spending from a donor-restricted endowment fund

When an appropriation is recorded, the amount of Net Assets with donor restrictions are transferred to Net Assets without donor restrictions, utilizing the release from restrictions category. The restriction expires as long as all-time restrictions have lapsed, & all-purpose restrictions have been met

If restrictions have not lapsed, you wait to transfer the Net Assets to without donor restrictions until all the restrictions have been satisfied

The board can plan & budget for future appropriations. However, the appropriations are not recorded as a reduction of the endowment & net assets with donor restrictions until the funds are spent, *i.e.*, in the future when the costs are incurred. Operating appropriations are typically defined in the budget & released in equal amounts throughout the period to which the budget relates

There could also be special appropriations beyond the typical annual approvals for things like capital projects, liquidity needs, etc. as long as you stay within the appropriation percentage amounts permitted by law

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Underwater Endowment Fund

A donor-restricted endowment fund with a fair value at the reporting date that is less than either the original gift amount or the amount required to be maintained by the donor or by law

Accumulated losses should be included in net assets with donor restrictions

Disclosures per 958-205-50-2

- A. The fair value of the fund
- B. The original endowment gift amount or level required to be maintained by donor stipulations or by law that extends donor restrictions
- C. The amount of the deficiencies of the underwater endowment funds (A–B)

During the creation of FASB's ASU 2016-14 the Attorney General/State Charity offices had voiced concern that underwater funds still need to be tracked by the nonprofit, & they expressed concern that enacted versions of UPMIFA gave a false belief that since you could spend if you are underwater that you no longer needed to track underwater amounts. Those who were spoken to seemed relieved at this requirement

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Factors in Appropriating or Accumulating Donor-Restricted Endowment Funds

The following are required as part of SPMIFA & the FASB shows it as part of its example disclosure. See 958-205-50-1B & 958-205-55-38

(1) The duration & preservation of the fund

(2) The purposes of the organization & the donor-restricted endowment fund

(3) General economic conditions

(4) The possible effect of inflation & deflation

(5) The expected total return from income & the appreciation of investments

(6) Other resources of the organization

(7) The investment policies of NFP

Enacted versions of UPMIFA could have other requirements. For example, NYPMIFA also has 1. alternatives to appropriation & 2. cash needs

Consideration of these factors when appropriating, along with the spending rate, should be documented in the board committee minutes

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Disclosures

FASB Codification 958-205-50-1B says an NFP should disclose information about the Endowment Fund’s Net Asset Classification, Net Asset Composition, Changes in net asset composition, Spending policies, & Related investment policies

Minimum disclosures

- A description of the governing board's interpretation of the law or laws that underlie the NFP's net asset classification of donor-restricted endowment funds, including its interpretation of the ability to spend from underwater endowment funds
- A description of the NFP's policy or policies for the appropriation of endowment assets for expenditure (its endowment spending policy or policies), including its policy, & any actions taken during the period, concerning appropriation from underwater endowment funds
- A description of the NFP's endowment investment policies, including all of the following: Return objectives & risk parameters, how it relates to spending policies, & strategies employed
- The composition of the NFP's endowment by net asset class at the end of the period, in total & by type of endowment fund, showing donor-restricted endowment funds separately from board-designated endowment funds
- Reconciliation of the beginning & ending balance of the endowment fund, including: Net investment return, contributions, amounts appropriated for expense, other changes

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Disclosures

According to FASB Codification 958-205-50-1C For donor-restricted endowment fund if there is a restriction or law that the governing board interprets as maintaining purchasing power, the NFP should periodically adjust the disclosed amount that is required (by donor or by law) to reflect that interpretation to maintain the purchasing power of the endowment fund in perpetuity

Unless a donor provides an amount or an index, the inflation (deflation) index (or indexes) that is most relevant for adjusting that amount should be used

- Ex: the Consumer Price Index or the Higher Education Price Index

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Examples from the FASB Codification

Composition

200Y
Endowment Net Asset Composition by Type of Fund as of June 30, 200Y

	Without Donor Restrictions	With Donor Restrictions	Total
Board-designated endowment funds	$ 7,084	$ -	$ 7,084
Donor-restricted endowment funds:			
Original donor-restricted gift amount and amounts required to be maintained in perpetuity by donor	-	97,759	97,759
Accumulated investment gains	-	35,201	35,201
Term endowment	-	4,388	4,388
Total funds	$ 7,084	$ 137,348	$ 144,432

Rollforward

Changes in Endowment Net Assets for the Fiscal Year Ended June 30, 200Y

	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets, beginning of year	$ 6,947	$ 142,053	$ 149,000
Investment return, net	10	372	382
Contributions	-	2,000	2,000
Appropriation of endowment assets for expenditure	(373)	(7,077)	(7,450)
Other changes:			
Transfers to create board-designated endowment funds	500	-	500
Endowment net assets, end of year	$ 7,084	$ 137,348	$ 144,432

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Endowment Note

Endowment

The [Organization]'s governing body is subject to the State of [_____________] Prudent Management of Institutional Funds Act ([__]PMIFA) *OR* [Uniform Prudent Management of Institutional Funds Act (UPMIFA)]. As a result, the [Organization] classifies amounts in its donor-restricted endowment funds as net assets with donor restrictions because those net assets are time restricted until the governing body appropriates such amounts for expenditures. Most of those net assets also are subject to purpose restrictions that must be met before being reclassified as net assets without donor restrictions.

Additionally, in accordance with [__]PMIFA [UPMIFA], the [Organization] considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. Duration and preservation of the fund
2. Purposes of the Organization and the fund
3. General economic conditions
4. Possible effect of inflation and deflation
5. Expected total return from investment income and appreciation or depreciation of investments
6. Other resources of the Organization
7. Investment policies of the Organization

The [Organization]'s endowment consists of approximately [_____] individual funds established for a variety of purposes. The endowment includes both donor-restricted endowment funds and funds designated by the governing body to function as endowments (board-designated endowment funds). As required by accounting principles generally accepted in the United States of America (GAAP), net assets associated with endowment funds, including board-designated endowment funds, are classified and reported based on the existence or absence of donor-imposed restrictions.

The composition of net assets by type of endowment fund at December 31, 2021 and 2020, was:

	2021		
	Without Donor Restrictions	With Donor Restrictions	Total
Board-designated endowment funds	$ -	$ -	$ -
Donor-restricted endowment funds			
Original donor-restricted gift amount and amounts required to be maintained in perpetuity by donor	-	-	-
Accumulated investment gains	-	-	-
Term endowment	-	-	-
Total endowment funds	$ -	$ -	$ -

	2020		
	Without Donor Restrictions	With Donor Restrictions	Total
Board-designated endowment funds	$ -	$ -	$ -
Donor-restricted endowment funds			
Original donor-restricted gift amount and amounts required to be maintained in perpetuity by donor	-	-	-
Accumulated investment gains	-	-	-
Term endowment	-	-	-
Total endowment funds	$ -	$ -	$ -

Change in endowment net assets for the years ended December 31, 2021, **and 2020** were:

	2021		
	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets, beginning of year	$ -	$ -	$ -
Investment return, net	-	-	-
Contributions	-	-	-
Appropriation of endowment assets for expenditures	-	-	-
Other changes			
Transfer to create board-designated endowment	-	-	-
Distribution of board designation of endowment funds	-	-	-
Endowment net assets, end of year	$ -	$ -	$ -

	2020		
	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets, beginning of year	$ -	$ -	$ -
Investment return, net	-	-	-
Contributions	-	-	-
Appropriation of endowment assets for expenditures	-	-	-
Other changes			
Transfer to create board-designated endowment	-	-	-
Distribution of board designation of endowment funds	-	-	-
Endowment net assets, end of year	$ -	$ -	$ -

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Investment and Spending Policies

The [Organization] has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs and other items supported by its endowment while seeking to maintain the purchasing power of the endowment. Endowment assets include those assets of donor-restricted endowment funds the Organization must hold in perpetuity or for donor-specified periods, as well as those of board-designated endowment funds. Under the [Organization]'s policies, endowment assets are invested in a manner that is intended to produce results that exceed [*insert description of results benchmark*] while assuming a [*higher OR moderate OR lower*] level of investment risk. The [Organization] expects its endowment funds to provide an average rate of return of approximately [___] percent annually over time. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate of return objectives, the [Organization] relies on a total return strategy in which investment returns are achieved through both current yield (investment income such as dividends and interest) and capital appreciation (both realized and unrealized). The [Organization] targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

The [Organization] has a spending policy of appropriating for expenditure each year [___] percent of its endowment fund's average fair value over the prior [___] quarters through the year end preceding the year in which expenditure is planned. In establishing this policy, the Organization considered the long-term expected return on its endowment. Accordingly, over the long term, the Organization expects the current spending policy to allow its endowment to grow at an average of [___] percent annually. This is consistent with the Organization's objective to maintain the purchasing power of endowment assets held in perpetuity or for a specified term, as well as to provide additional real growth through new gifts and investment return.

Underwater Endowments

The governing body of the [Organization] has interpreted [__]PMIFA [UPMIFA] as not requiring the maintenance of purchasing power of the original gift amount contributed to an endowment fund, unless a donor stipulates the contrary. As a result of this interpretation, when reviewing its donor-restricted endowment funds, the Organization considers a fund to be underwater if the fair value of the fund is less than the sum of

a) the original value of initial and subsequent gift amounts donated to the fund and

b) any accumulations to the fund that are required to be maintained in perpetuity in accordance with the direction of the applicable donor gift instrument.

The Organization has interpreted [__]PMIFA [UPMIFA] to permit [spending/not spending] from underwater funds in accordance with the prudent measures required under the law.

At December 31, 2021 and 2020, funds with original gift values of $[__________] and $[__________]; fair values of $[__________] and $[__________]; and deficiencies of $[__________] and $[__________], respectively, were reported in net assets with donor restrictions. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after investment of new restricted contributions and continued appropriation for certain purposes that was deemed prudent by the governing body.

The [Organization] has a policy that permits spending from underwater endowment funds depending on the degree to which the fund is underwater, unless otherwise precluded by donor stipulations or laws and regulations. The governing board appropriated for expenditure $[__________] from underwater endowment funds during the year, which represents [___] percent of the [___] quarter moving average, not the [___] percent it generally draws from the endowment.

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Note

Note 4: Endowment Funds

The College's endowment consists of funds established for a variety of purposes, including both donor-restricted endowment funds and funds designated by the College to function as endowments (board designated).

Return Objectives and Risk Parameters

The College has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking, at minimum, to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the College must hold in perpetuity or for a donor-specified period, as well as board-designated funds. The primary investment objective of the management of the endowment fund is to maintain and grow the fund's real value by generating average annual real returns that meet or exceed the spending rate, after inflation, management fees, and administrative costs. Consistent with this goal, the Board of Trustees and the Investment Committee intend that the endowment fund be managed with an intention to maximize total returns consistent with prudent levels of risk and reduce portfolio risk through asset allocation and diversification.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the College relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Investment Committee is responsible for recommending for approval by the Board of Trustees an asset allocation policy. The asset allocation policy is designed to attempt to achieve diversity among capital markets and within capital markets by investment discipline and management style. The Investment Committee designs a policy portfolio in light of the endowment's needs for liquidity, preservation of purchasing power, and risk tolerances.

The College targets a diversified asset allocation that places emphasis on investments in domestic and international equities, fixed income, private equity, real assets, and hedge fund strategies to achieve its long-term return objectives within prudent risk constraints. The Investment Committee reviews the policy portfolio asset allocation, exposures, and risk profile on an ongoing basis.

Spending Policy

The College employs a total return spending policy, based on the "Yale Rule", which recognizes for spending purposes 70% of the previous year's spending, increased by the trailing August to August CPI-U, plus 1%, plus 30% of the pooled endowment fund's four-quarter average multiplied by 4.50%, the long-term real spending rate. The actual spending rate was 3.94% and 5.11% for the years ended May 31, 2022, and 2021, respectively. The Investment Committee may recommend to the Board of Trustees additional amounts beyond those calculated under the spending rule in exceptional circumstances.

In establishing these policies, the College considered the expected return on its endowment and its programming needs. Accordingly, the College expects the current spending policy to allow its endowment to maintain its purchasing power and to provide a predictable and stable source of revenue to the annual operating budget. Additional real growth will be provided through new gifts, any excess total return, or additions designated by the Board of Trustees.

The College follows the New York Uniform Prudent Management of Institutional Funds Act (NYPMIFA) in the management of its endowment. The College has interpreted NYPMIFA as allowing the College to spend or accumulate the amount of an endowment fund that the College determines is prudent for the uses, benefits, purposes, and duration for which the endowment fund is established, subject to the intent of the donor as expressed in the gift instrument. The College has not changed the way net assets with perpetual donor restrictions are classified as a result of this interpretation and classifies net assets with perpetual donor restrictions as (a) the original values of gifts donated to perpetual endowments, (b) the original values of subsequent gifts to perpetual endowments, and (c) accumulations to perpetual endowments made in accordance with the directions of the applicable donors' gift instruments at the times the accumulations are added to the funds. U.S. generally accepted accounting principles requires the portion of a donor-restricted endowment fund that is not classified in net assets with perpetual donor restrictions to be classified as net assets with time or purpose restrictions until those amounts are appropriated for spending by the College's Board of Trustees in a manner consistent with the standard of prudence prescribed by NYPMIFA.

In accordance with NYPMIFA, the Investment Committee considers the following factors in making a determination to appropriate or accumulate endowment funds:

- The duration and preservation of the fund
- The purposes of the College and the endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the College
- Where appropriate and where circumstances would otherwise warrant, alternatives to expenditure of the endowment fund, giving due consideration to the effect that such alternatives may have on the College
- The investment policies of the College

Endowment funds are considered to be underwater when their fair value is less than their historical gift amounts. In accordance with the Prudent Management standards contained in NYPMIFA, the College has the ability to spend from individual endowments that are underwater, if it considers such action to be prudent for that particular endowment. In addition, in accordance with the implementation of NYPMIFA in 2011, the College was required to ask certain existing donors if they wished to prevent spending from their endowment if underwater. If the donor had requested spending not occur if their endowment is underwater, the College is required to comply with this request. As of May 31, 2022, thirteen (13) funds were underwater by $146,804 and at May 31, 2021, no funds were underwater.

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Some Interesting Accounting Policies & Observations

Some NFPs have all bequests without donor restrictions go into the board-designated endowment because they are not budgeted for (& some have a threshold for bequests over a certain dollar go into the board-designated endowment)

Some NFPs regularly manage any operating surplus by moving a portion of it into their board-designated endowment

& some NFPs use the operating measure to reflect some of these activities

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Use of an Operating Measure

An operating measure is optional by an NFP, & it is self-defined, subject to a few restrictions (for example gains/loss on the sale of fixed assets must be inside the operating measure). See 958-225-45-9 through 45-12

Most NFPs that use an operating measure will include the endowment spending rate inside the operating measure & investment return in excess of the spending rate outside of the operating measure

With this presentation style, even thought it looks awkward, the spending rate would be included within the operating measure when you have an overall investment loss. It just makes the nonoperating loss larger by the amount of the spending rate

Spending rates & formulas vary by entity & laws vary by state. For example, NYPMIFA requires a 5-year analysis where more than 7% of the fair value is “not presumptively prudent”

If you use an operating measure, you are required to disclose what is included or excluded unless it is obvious

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Some Other Reporting Reminders

Remember that 958- 225-14-14 requires NFPs to report investment return, net. That is all realized & unrealized gains & dividends, & interest are netted on the statement of activity in one line & includes all external & direct internal investment expenses

The endowment rollforward requires investment return, net to be shown but not the components of investment return

Separate portfolios may be reported separately. For example, if you have an active cash management policy for operating cash you may not want to net that with your endowment investment income

Short-term treasury opportunities – Short-term rate opportunities such as prime money funds, treasury bills, etc.

Disclosures of what is considered cash & restricted cash for the Statement of Cash Flows. (This was clarified in FASB's ASU 2016-18)

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Questions?

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- FASB (Financial Accounting Standards Board)

  https://www.fasb.org

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