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Endowment Accounting Reminders

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Allison Swaters

Managing Director

Kansas City, MO

allison.swaters@forvis.com



Shekita Rawls

Director

Houston, TX

shekita.rawls@forvis.com

Agenda



Definition & Types



Reporting & Accounting



The Definition & Requirements of Underwater
Endowments



Key Considerations on Unitization & Tracking of
Endowment Funds



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, or 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

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”

Board-Designated Endowments With Donor Restrictions, Continued

An example of the exception could be a \$10 million gift for the music department of the school which does not contain a requirement to create an endowment. 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 without donor restrictions

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

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 (shown on the next slide)
- It is optional to bifurcate this within net asset without donor restrictions on the balance sheet

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

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

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 % amounts permitted by law

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

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

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

Unitization

- Definition (noun): *“the configuration of smaller units of information into large coordinated units”*
- In practice, unitization is a form of endowment investing that allows many individual endowment funds to invest in the same pool of assets, whereas each individual endowment fund owns “units” of the pooled endowment investments
- More efficient than investing each individual endowment fund separately

Key Questions for Using Excel

- Unitization is often only run once per year
 - Can you provide timely & accurate information to donors?
 - Do you have a process to create endowment fund statements if requested?
 - Does delayed data create concerns around donor relations & accountability of their endowment account?
 - With the coming enrollment cliff, does once-per-year unitization give you the opportunity to make strategic decisions fast enough?
 - Is the calculation of weighted average of corpus disaggregated sufficiently to address corpus changes during the year, *i.e.*, monthly, quarterly, etc.?
- Lack of segregation of duties
 - Does all the knowledge related to the spreadsheet reside in one person?
 - What if that person leaves?
 - Do you have your process documented in a manner where it could be recompleted by another person?
 - Is there another qualified person to review the end result?
- Errors can go unnoticed
 - Is there a process for the supervision & review over the calculations in the spreadsheet?
 - How do you prevent formula errors?

Key Questions for Using Excel

- Spreadsheet integrity
 - Who can make changes to the formulas, master data, etc.?
 - Are certain cells read-only & others input?
 - Who can access the folder where the file is stored to prevent unauthorized changes?
 - If a change is made, can you tell who made it with version histories?
- Backup & file storage
 - What if the file gets corrupted?
 - What if an error is discovered & cannot be corrected? Do you have the prior-year file saved separately? Or did you manipulate it to start the current-year file?
- Other
 - Are new endowment funds properly classified?
 - Is the description of the fund sufficient to know how funds can be spent? Or is additional information needed outside of the spreadsheet?
 - Does the spreadsheet facilitate external financial reporting, including the preparation of the needed footnotes?

Key Questions When Using Software

- Access controls
 - Who has access to the system?
 - Is that access the correct level of access?
- Monitoring controls
 - What level of reconciliation is in place to prevent or detect system errors?
 - Is the unitization properly following endowment policy?
 - Are donor stipulations/policy on spending corpus or underwater spending being properly followed?
- Recording controls
 - How do you ensure new funds are properly input?

Key Questions When Using Software

- Reporting
 - Does the software support the creating of the external financial statements & footnotes?
 - Can you provide timely information to donors or institution leadership?
- Other
 - Can the system support multiple spending rules or assign rules to each individual endowment fund, as needed?
 - Does the software support multiple users? Or does it offer support when technical difficulties arise?
 - Can the system track changes & provide an audit trail to triage problems?

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

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

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 though 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 five-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

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)

A background image showing several black graduation caps with red tassels being thrown into the air by graduates. The caps are scattered across the upper half of the frame, and the lower half shows the hands and arms of the graduates reaching up. The scene is set outdoors with trees visible in the background.

Questions?

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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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