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Implementation of the New FASB Financial Statement Presentation Standard: Mastering the Most Difficult Challenges

Part Two
Today’s Presenters

Rachel Flanders, CPA
• Principal, Public Sector Group – Non-Profit, CliftonLarsonAllen, LLP

Cathy Clarke, CPA
• Chief Assurance Officer, CliftonLarsonAllen, LLP

Learning Objectives

• Identify the most significant and complex challenges in adopting FASB’s new financial statement standard.

• Determine policies, procedures, and systems that should be in place as a result of the standard.

• Identify implementation techniques that could assist in converting a not-for-profit’s financial statements and footnotes to the new standard.
ASU 2016-14 Changes

Topics covered in Part One:
- New liquidity and availability disclosures required
- Net asset classes reduced from three to two

Topics covered today:
- All not-for-profits (NFPs) must report expenses by nature and function in one place, and describe the methods used to allocate among functional categories
- Net investment return replaces other alternatives
- Use of direct method in a statement of cash flows eliminates reconciliation of change in net assets to cash flows from (used for) operating activities
- Additional disclosures for underwater endowments
Tools - Implementation Checklist

General Implementation

1. The presentation of financial statements for Not-for-Profit (NFP) entities is effective for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018. Early application is permitted.
   a) Has your organization decided to early adopt the new provisions or plan to adopt at the above noted effective date?
   b) Has your organization drafted a footnote for a change in accounting principal?
   c) Have proper individuals attended training to understand the new changes in financial reporting?
   d) Has your organization discussed with its auditors the impact of the new changes related to audit timing and planning?
   e) Has your organization identified the team members who will lead the implementation of the new financial reporting requirements?

2. The new guidance shall be applied on a retrospective basis. However, if presenting comparative financial statements, an NFP would have the option to omit the following information for any periods presented before the year of adoption: i) Analysis of expenses by both functional and natural classification, ii) Disclosures about liquidity and availability of resources.
   a) Does your organization present comparative financial statements? If so, while analyzing the below steps remember that retrospective application is required, except for the omissions noted above.

3. In the year of adoption, an NFP shall disclose the nature of any reclassifications or restatements and their effects, if any, on changes in the net asset classes for year presented.
   a) Has your organization identified restatements and reclassifications?
   b) If the above answer is yes, has a footnote been drafted noting the nature and effects on changes in the net asset classes for year presented?

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Functional Expenses
Requirements for Reporting Expenses

- All NFPs, including Voluntary Health and Welfare Entities, must present an analysis of expenses by function and nature in one location
  - Present a separate statement of functional expenses
  - Present a table in the notes
  - Incorporate into the statement of activities

- Include a description of the method(s) used to allocate costs among program and support functions

- The ASU includes improved and expanded guidance about management & general expenses
Option to Present on Statement of Activities

<table>
<thead>
<tr>
<th>Expenses:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Grant activities -</td>
<td></td>
</tr>
<tr>
<td>Grants</td>
<td>12,125</td>
</tr>
<tr>
<td>Salaries, benefits and taxes</td>
<td>1,808</td>
</tr>
<tr>
<td>Occupancy costs</td>
<td>970</td>
</tr>
<tr>
<td>Depreciation</td>
<td>845</td>
</tr>
<tr>
<td>Supplies</td>
<td>1,255</td>
</tr>
<tr>
<td>Other</td>
<td>56</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>17,059</strong></td>
</tr>
</tbody>
</table>

| Management and general -                |        |
| Salaries, benefits and taxes            | 452    |
| Occupancy costs                         | 243    |
| Depreciation                            | 211    |
| Supplies                                | 314    |
| Other                                   | 14     |
| **Total**                               | **1,234** |

**Total expenses**                          **18,293**

Implementation – Expenses

- Determine where/how to present all expenses by nature and function in one place
  - In a statement of functional expenses
  - In the statement of activities
  - In a note to the financial statements
  - Note - presentation in a supplementary schedule is prohibited

- If not already in place, develop formal allocation methodologies to be used to allocate expenses among programs and supporting services

- Draft the note disclosure of the methods utilized in the allocation process
Refresher – Types of Expense Allocations

**FUNCTIONAL**
- Required by accounting standards
- Included in audit and 990 and specifically identified on Guidestar
- Used by donors, charity watchdogs, etc.

**INDIRECT COST RATE**
- Used by those with federal contracts
- Specific direction given through Uniform Guidance (Title 2, Subtitle A, Chapter II, Part 200, Subpart E and Appendix IV)
- Used by the Federal Government and tested in single audits

**FULLY-LOADED**
- Optional
- Allocates all expenses to programs to identify true resource requirements
- Used for management and board decision-making

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3 ALLOCATION TYPES

→ All expenses are identified within three categories:
  - **Program**
    - Direct mission work
  - **Management and General**
    - Accounting, budgeting, grant applications, billing, annual report, HR functions, other administration
  - **Fundraising and Development**
    - Soliciting contributions
3 ALLOCATION TYPES

→ Used for cost reimbursable grants, contracts, and other agreements awarded by the Federal Government
→ The purpose is to identify what proportion of indirect cost each program should bear
→ The rate is a ratio between total indirect expenses and some direct cost base

INDIRECT COST RATE

• Used by those with federal contracts
• Specific direction given through Uniform Guidance (Title 2, Subtitle A, Chapter II, Part 200, Subpart E and Appendix IV)
• Used by the Federal Government and tested in single audits

3 ALLOCATION TYPES

→ Theoretically assumes that a program cannot run without administrative and fundraising support; likewise it assumes that the administration and fundraising components would not exist other than for the support of programs
→ Allows management and boards to identify the “true” cost of each program in order to make more well-informed decisions about program expansion, contraction, elimination, or subsidies
3 ALLOCATION TYPES

• Allocations are not mutually exclusive

• Your organization may use one, two, or all three types of allocations for different purposes

• You may be able to use the information gathered for one type of allocation, organized in a new way, to depict another type of allocation

NOTE: If you are/want to use multiple allocations, it is helpful to call them something other than "allocations"—they are easily confused!

Tools – Implementation Checklist

**Reporting of Expenses by Nature and Function**

1) All NFP’s shall report information about all expenses (by nature and function) in one location - on the face of the statement of activities, as a schedule in the notes to the financial statements, or in a separate financial statement.
   a) Has your organization decided where to present all expenses by nature and function?

2) The relationship between functional and natural classification for all expenses shall be presented in an analysis that disaggregates functional expense classifications, such as major classes of program services and supporting activities by their natural expense classifications, such as salaries, rent, electricity, supplies, depreciation, awards and grants to others, and professional fees.
   a) Does your organization track expenses by both natural and functional classifications?
   b) Does your organization have a written policy or methodology as to how expenses are classified into functional expense categories including consideration for any needed allocations?

**Allocations**

Activities that represent direct conduct or direct supervision of program or other supporting activities would require allocation from management and general activities. Additionally, certain costs benefit more than one function and, therefore, shall be allocated. For example, information technology generally can be identified as benefitting various functions, such as accounting and financial reporting, human resources, fundraising, and program delivery. Information technology costs generally would therefore be allocated among the functions receiving direct benefit.
Tools – Implementation Checklist (continued)

Example Note 1: Functional Expenses

The table below presents expenses by both their nature and function for fiscal year 20XX.

<table>
<thead>
<tr>
<th>Program Activities</th>
<th>Supporting Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Management Fund-</td>
</tr>
<tr>
<td></td>
<td>and General Raising Supporting</td>
</tr>
<tr>
<td></td>
<td>Total Expenses</td>
</tr>
<tr>
<td>Salaries and benefits $7,400</td>
<td>$1,110 $960 $3,090 $15,115</td>
</tr>
<tr>
<td>Grants to other organizations</td>
<td>2,075 750 1,922 $4,750</td>
</tr>
<tr>
<td>Supplies and travel 165 1000 490</td>
<td>140 390 600 2,250</td>
</tr>
<tr>
<td>Services and professional fees</td>
<td>Office and occupancy 1,160 600</td>
</tr>
<tr>
<td>Depreciation 1,440 800 570</td>
<td>$2,810</td>
</tr>
<tr>
<td>Interest 196 109 77</td>
<td></td>
</tr>
<tr>
<td>Total expenses 13,296 8,649 5,837</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$2,638 $2,150 $4,188 33,970</td>
</tr>
</tbody>
</table>

The financial statements report certain categories of expenses that are attributable to more than one program or supporting function. Therefore, these expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include depreciation, interest, and office and occupancy, which are both allocated on a square footage basis, as well as salaries and benefits which are allocated on the basis of estimates of time and effort.

Management and General Expenses

- Business management
- General recordkeeping and payroll
- Budgeting
- Financing, including unallocated interest costs
- Soliciting funds other than contributions and membership dues
- Administering government, foundation, and similar customer-sponsored contracts, including billing and collecting fees and grant and contract financial reporting
- Disseminating information to inform the public of the NFP’s stewardship of contributed funds
- Producing and disseminating the annual report
- Employee benefits management and oversight (human resources)
- All other management and administration except for the direct conduct or direct supervision of program services, fundraising activities, or membership development activities
When to Allocate M&G Expenses

- Activities that represent direct conduct or direct supervision of program or other supporting activities require allocation from management & general activities to those program or other supporting activities

- Examples from the ASU
  - IT - benefits various functions and generally would be allocated
  - CEO – could be allocated to program, fundraising, M&G
  - CFO – could be allocated to M&G and investment expense
  - HR – generally would assign all to M&G
  - Grant Accounting and Reporting – program reports would be program (grant-related) but financial reports and related accounting would be M&G

Tools – Implementation Checklist (continued)

Case Study A: CEO Allocation
The broad responsibilities of a CEO generally include administrative and programmatic oversight. At NFP A, the CEO spends a portion of time directly overseeing the research program. Additionally, a portion of time is spent with current and potential donors on fundraising cultivation activities. A portion of the CEO’s compensation and benefits and other expenses would be allocated to the research program and to the fundraising function representing the portion of time spent on those activities because they reflect direct conduct or direct supervision. If the remainder of the CEO’s time is spent in other areas of NFP A, those activities would not constitute direct conduct or direct supervision, and the allocable portion of compensation and benefit amounts would remain in management and general activities.

Case Study B: CFO Allocation
The CFO at NFP B has primary responsibility for (a) accounting and reporting, (b) short-term budgeting and long-term financial planning, (c) cash management, and (d) direct oversight of the NFP’s endowment. A portion of the CFO’s compensation and benefits and other expenses would be allocated to management and general activities for the accounting and reporting, short-term budgeting and long-term financial planning, and cash management functions because they benefit the overall organization. A portion would also be allocated to investment expenses for management of the investment strategy of the endowment and would be netted against investment return. However, any portion of time spent supervising the accounting for investments or other fiduciary oversight would not be allocated to investment expenses because that time is related to an accounting and general management activity that benefits the overall organization and should be allocated to management and general activities.
Tools – Implementation Checklist (continued)

Case Study C: Human Resources Department Allocation
The human resources department at NFP C generally is involved in the recruitment of all personnel of the NFP. If NFP C hired an employee to work in Program A, the human resources department's related costs would not be allocated to that program. Rather, those costs would remain a component of management and general activities, because the human resources department's efforts to hire an employee for a particular function are not deemed to be direct conduct or direct supervision of programmatic activity.

Case Study D: Grant Accounting and Reporting Allocation
NFP D receives federal grants and employs an accountant who is responsible for grant accounting and reporting. In some cases, under the terms of the grant agreement, a fiscal report is required to be filed that details expenses incurred and charged against the grant. The fiscal report is not part of the direct conduct or direct supervision of the grant but rather is an accounting function. Therefore, the grant accountant’s compensation and benefits would not be allocated to the programmatic area. However, a scientific report prepared by a principal investigator who is responsible for the research activity would be indicative of direct conduct and/or direct supervision of the grant activity, and the principal investigator’s compensation and benefits would be allocated to the grant.

Tools – Implementation Checklist (continued)

3) A description of the methods used to allocate costs among program and support functions shall be disclosed in the notes to financial statements.
   a) Does your organization have a formal policy documenting the basis for allocations of expenses to support the required note disclosure?

Example Note 2: Functional Expenses
The financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of the Organization. Those expenses include depreciation and amortization, the president's office, communications department, and information technology department. Depreciation is allocated based on a square footage basis, the president's office is allocated based on estimates of time and effort, certain costs of the communications department are allocated based on the benefit received, and the information technology department is allocated based on estimates of time and costs of specific technology utilized.
FUNCTIONAL ALLOCATIONS

Step 1: Separate Direct from Indirect Expenses

DIRECT EXPENSES

Program A
Program B
Program C

Allocate

INDIRECT EXPENSES

Step 2: Identify Allocation Methods for Indirect Expenses

Staff Time

• Full Time Equivalents
• Total Salary

Square Footage

Functional allocations are an estimate. Use your best judgment.

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FUNCTIONAL ALLOCATIONS

Step 3: Determine Method for Each Expense

Staff Time
- Office supplies
- Telephone
- Travel

Allocation Method

The way staff spend their time is the primary driver for these expenses

Step 4: Apply Allocations to Indirect Expenses

Allocation Method

Staff Time:
- 25% - A
- 25% - B
- 15% - C
- 25% - Admin
- 10% - Fundraising

Indirect Expense
- Office supplies: $10,000

Allocation
- Program A: $2,500
- Program B: $2,500
- Program C: $1,500
- Admin: $2,500
- Fundraising: $1,000
FUNCTIONAL ALLOCATIONS
• Funders often judge an organization by their program percentage.

Step 5: Report and Defend

Investment Return
Net Investment Return

- Presented on a net basis, with all external and direct internal investment management and custodial expenses netted against the return
- No longer required to report investment income components and related expenses separately
- Internal expenses include the direct conduct or direct supervision of the strategic and tactical activities involved in generating investment return
  - Salaries, benefits, travel, and other costs associated with staff responsible for development and execution of investment strategy, including supervising, selecting and monitoring external managers
  - Excludes costs not associated with generating investment return, such as administrative management, contracts, and pooled-fund administration

Programmatic Investments Excluded

- This guidance is not applicable to programmatic investments
  - Programmatic Investing: The activity of making loans or other investments that are directed at carrying out an NFP's purpose for existence rather than investing in the general production of income or appreciation of an asset (for example, total return investing). An example of programmatic investing is a loan made to lower-income individuals to promote home ownership.
Implementation – Investment Expenses

- Report external and direct internal investment expenses as a component of net investment return
- Exclude those expenses from the presentation of expenses by nature and function
- Establish procedures to accumulate the investment expenses to be netted against investment return

Tools – Implementation Checklist

<table>
<thead>
<tr>
<th>Investment Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Investment expenses shall be reported on the statement of activities netted against investment return and reported in the net asset category in which the net investment return is reported. Investment expenses include both internal and external investment expenses.</td>
</tr>
<tr>
<td>a) Does your organization currently net all internal and external investment expenses with investment return?</td>
</tr>
<tr>
<td>2) Direct internal investment expenses involve the direct conduct or direct supervision of the strategic and tactical activities involved in generating investment return. These include, but are not limited to i) salaries, benefits, travel, and other costs associated with the officer and staff responsible for the development and execution of investment strategy and ii) allocable costs associated with internal investment management and supervising, selecting, and monitoring of external investment management firms. Direct internal investment expenses do not include items that are not associated with the generating investment return. For example, the costs associated with utilization and other such aspects of endowment management would not be allocated.</td>
</tr>
<tr>
<td>a) Does your organization have internal investment expenses? If so, are they currently tracked in a manner so they can be netted against investment return?</td>
</tr>
</tbody>
</table>
Statement of Cash Flows

• NFPs may use either the direct or indirect method

• If the direct method is used, NFPs are no longer required to show the reconciliation of the change in net assets to cash flows from operating activities

• Other proposed changes under consideration were deferred to Phase 2:
  – Reclassifications among types of activities (i.e. operating, investing and financing)
  – Changes to improve alignment of the statement of cash flows with the statement of activities
Operating Cash Flows – Which is Better?

- User surveys indicate a strong preference of the direct method – FASB is listening!

<table>
<thead>
<tr>
<th>Cash Flows from Operating Activities:</th>
<th>2022</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash received from contributors</td>
<td>$10,465</td>
<td>$10,489</td>
</tr>
<tr>
<td>Cash received from service recipients</td>
<td>$5,020</td>
<td>$5,020</td>
</tr>
<tr>
<td>Interest and dividends received</td>
<td>$8,570</td>
<td>$8,570</td>
</tr>
<tr>
<td>Miscellaneous receipts</td>
<td>$150</td>
<td>$150</td>
</tr>
<tr>
<td>Cash paid to employees</td>
<td>($13,400)</td>
<td></td>
</tr>
<tr>
<td>Cash paid to suppliers</td>
<td>($5,658)</td>
<td>$5,658</td>
</tr>
<tr>
<td>Interest paid</td>
<td>$183</td>
<td>$183</td>
</tr>
<tr>
<td>Grants paid</td>
<td>($5,175)</td>
<td></td>
</tr>
<tr>
<td><strong>Net cash used by operating activities</strong></td>
<td><strong>($230)</strong></td>
<td><strong>($230)</strong></td>
</tr>
</tbody>
</table>

**Indirect Method**

**Direct Method**

<table>
<thead>
<tr>
<th>Cash Flows from Operating Activities:</th>
<th>2022</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Collections from investments</td>
<td>$12,410,429</td>
<td>$12,435,235</td>
</tr>
<tr>
<td>Principal payments of notes and advances</td>
<td>$3,500</td>
<td>$3,500</td>
</tr>
<tr>
<td>Depreciation</td>
<td>$17,500</td>
<td>$17,500</td>
</tr>
<tr>
<td>Net cash used by operating activities</td>
<td>($50,000)</td>
<td>($50,000)</td>
</tr>
</tbody>
</table>
Implementation - Statement of Cash Flows

- If using the direct method, eliminate the reconciliation of the change in net assets to the net cash provided by (used in) operating activities
- If using the indirect method, determine the usefulness of changing to the direct method

Endowment Funds
Tools – Implementation Checklist

4) Endowment funds can be either with donor restrictions or without donor restrictions. Those without donor restrictions are referred to as board-designated endowment funds. A board-designated endowment fund is created when a governing board designates or earmarks a portion of its net assets without donor restrictions to be invested generally for a long but possibly unspecified period of time. Endowment funds with donor restrictions are referred to as donor-restricted endowment funds. A donor-restricted endowment fund results from a gift with a stipulation that those resources be invested either for a long, specified period of time or in perpetuity.

a) Can the current tools used to track endowment funds be converted to track endowments per the revised definitions above? Are any reclassifications required from current funds accounted for as endowments to meet the above definitions?

5) Donor-restricted endowment funds generally result from a donor’s stipulation or by extension of a donor restriction imposed through the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) that limits an NFP’s use of net assets of an endowment fund. The original gifted amount, any additional gifts to that fund, and any resulting investment returns shall initially be classified as net assets with donor restrictions. Therefore, unless stated otherwise in the gift instrument, the assets in an endowment fund are donor-restricted assets until appropriated for expenditure by the NFP’s governing board.

a) Does the current ERP system or other tracking tool the organization uses need to be updated to track endowments per the above guidance?

Tools – Implementation Checklist (continued)

6) The amount of net assets with donor restrictions is reduced by appropriations for expenditure from the donor-restricted endowment fund. Upon appropriation for expenditure, the time restriction expires to the extent of the amount appropriated and, in the absence of any purpose restrictions on the use of the appropriated returns, results in a reclassification of net assets of that amount from net assets with donor restrictions to net assets without donor restrictions. However, if a restricted purpose also exists, the reclassification of net assets shall not occur until that purpose restriction is also met.

a) Does the organization’s current method for tracking net assets released from restriction comply with the above noted guidance?

<table>
<thead>
<tr>
<th>Purpose restrictions accomplished:</th>
<th>$21,380</th>
</tr>
</thead>
<tbody>
<tr>
<td>Program A, expenses</td>
<td>$18,400</td>
</tr>
<tr>
<td>Program B, expenses</td>
<td>4,900</td>
</tr>
<tr>
<td>Program C, expenses</td>
<td>1,500</td>
</tr>
<tr>
<td>Program D, equipment acquired and placed in service</td>
<td>1,000</td>
</tr>
<tr>
<td>Time restrictions expired:</td>
<td></td>
</tr>
<tr>
<td>Passage of specified time</td>
<td>890</td>
</tr>
<tr>
<td>Death of annuity beneficiary</td>
<td>820</td>
</tr>
<tr>
<td>Failure of appropriated endowment returns without purpose restrictions</td>
<td>1,290</td>
</tr>
<tr>
<td>Total restrictions released</td>
<td>$22,380</td>
</tr>
</tbody>
</table>
Tools – Implementation Checklist (continued)

7) A NFP shall disclose, for each period it presents financial statements, a reconciliation of beginning and ending balance of the NFP’s endowment, in total and by net asset class, including, at a minimum, all of the following line items that apply:
   i) Investment return, net
   ii) Contributions
   iii) Amounts appropriated for expenditure
   iv) Reclassification of net assets
   v) Other changes
   a) Does the current tool or method used to prepare the required endowment footnote capture all of the above activity?

Tools – Implementation Checklist (continued)

NFP A’s endowment consists of approximately 100 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. As required by GAAP, net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

NFP A is subject to the State Prudent Management of Institutional Funds Act (SPMIFA) and, thus, classifies amounts in its donor-restricted endowment funds as net assets with donor restrictions until the Board of Trustees appropriates such amounts for expenditure and any other purpose restrictions have been met. The Board of Trustees of NFP A has interpreted SPMIFA 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, NFP A considers a fund to be underwater when 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. NFP A has interpreted SPMIFA to permit spending from underwater funds in accordance with the prudent measures required under the law. Additionally, in accordance with SPMIFA, NFP A considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund
2. The purposes of the organization and the donor-restricted endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the organization
7. The investment policies of NFP A

<table>
<thead>
<tr>
<th>Without Donor Restrictions</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Board-designated endowment funds</strong></td>
<td></td>
</tr>
<tr>
<td>Original donor-restricted gift amount and amounts required to be retained by donor</td>
<td>92,759</td>
</tr>
<tr>
<td>Portion subject to appropriation under SPMIFA</td>
<td>35,201</td>
</tr>
<tr>
<td>Transfers</td>
<td>4,358</td>
</tr>
<tr>
<td><strong>Total funds</strong></td>
<td>$ 7,084</td>
</tr>
</tbody>
</table>

Endowment net asset composition by type of fund as at June 30, 20XX:

<table>
<thead>
<tr>
<th>Without Donor Restrictions</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Endowment net assets, beginning of year</strong></td>
<td></td>
</tr>
<tr>
<td>Investment return, net</td>
<td>$ 10</td>
</tr>
<tr>
<td>Contributions</td>
<td>2,000</td>
</tr>
<tr>
<td>Appropriation of endowment assets for expenditure</td>
<td>(170)</td>
</tr>
<tr>
<td>Other changes, transfers to create board-designated endowment funds</td>
<td>500</td>
</tr>
<tr>
<td><strong>Endowment net assets, end of year</strong></td>
<td>$ 7,084</td>
</tr>
</tbody>
</table>
Tools – Implementation Checklist (continued)

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor of SPMFA requires NFP A to retain as a fund or perpetual duration. Deficiencies of this nature exist in three donor-restricted endowment funds, which together have an original value of $3,500, a current fair value of $3,300, and a deficiency of $200 as of June 30, 20XX. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new contributions for donor-restricted endowment funds and continued appropriation for certain programs that was deemed prudent by the Board of Trustees.

NFP A has a policy of appropriating for distribution each year 5% of its endowment fund’s average fair value over the prior 12 quarters through the calendar year-end preceding the fiscal year in which the distribution is planned. In establishing this policy, NFP A considered the long-term expected return on its endowment. Accordingly, over the long-term, NFP A expects the current spending policy to allow its endowment to grow at an average of 5% annually. NFP A 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 intent or relevant laws and regulations. The governing board appropriated for expenditure $75 from underwater endowment funds during the year, which represents 3% of the 12-quarter moving average, not the 5% it generally draws from its endowment.

8) Other required disclosures include:

i) If not provided on the face of the financial statements, discussion of the following: i) Information about the nature and amounts of different types of restrictions that affect how and when, if ever, the resources (net assets) can be used and ii) information about additional limitations placed on net assets, such as information about the amounts and purposes of board designations of net assets without donor restrictions.

ii) Composition of net assets with donor restrictions at the end of the period and how the restrictions affect the use of resources.

a) Does the organization currently track the above noted information in a manner that can be summarized in the required note disclosure?
Tools – Implementation Checklist (continued)

Example Note 1: Net Assets without Donor Restrictions

NFP’s governing board has designated net assets without donor restrictions for the following purposes as of June 30, 2018:

<table>
<thead>
<tr>
<th>Quasi-endowment</th>
<th>$34,658</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquidity reserve</td>
<td>$1,500</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$36,158</strong></td>
</tr>
</tbody>
</table>

Underwater Endowments

- Now defined in Master Glossary
  - Donor-restricted endowment fund for which the fair value of the fund at the reporting date is less than either the original gift amount or the amount required to be maintained by the donor or by law that extends donor restrictions

- The entire balance of the endowment fund is reported in the “with donor restrictions” class of net assets
Underwater Endowments

• New disclosure requirements:
  – Interpretation of the NFP’s ability to spend from underwater endowment funds
  – NFP’s policy, and any actions taken during the period, concerning appropriation from underwater endowment funds
  – For each period presented - each of the following, in the aggregate, for all underwater endowment funds:
    1. The fair value of the underwater endowment funds
    2. The original endowment gift amounts (or level required to be maintained by donor stipulations or by law that extends donor restrictions)
    3. The amount by which the original gift amount exceeds the fair value (the deficiency = 2 less 1)

Implementation – Endowments

• Recast your endowment note to conform to the new two-net-asset categories presentation
• For underwater endowments, determine:
  – The fair value of underwater funds
  – The original gift amount or level required by donor stipulations or law that extends donor restrictions
  – The aggregate amount of the deficiencies of each underwater fund
• Remember that the underwater portion of endowments is now presented entirely in funds with donor restrictions
Implementation – Endowments (continued)

- Remember that investment return is now presented net of external and direct internal investment expenses, and does not require a separate break-out of the components of investment return
- Determine the changes needed to properly identify direct internal investment expenses if you haven’t been doing this before now

Tools – Implementation Checklist

Underwater Endowment Funds:
1. A NFP is required to disclose: i) its interpretation on the ability to spend from underwater endowment funds, ii) its policy to either reduce expenditure or not spend from underwater endowment funds, if any, and if this policy was followed, iii) for each period a statement of financial position is presented each of the following, in the aggregate, for all underwater endowment funds:
   - the fair value of the underwater endowment funds
   - the original endowment gift amount or level required by donor stipulations or by law that extends donor restrictions
   - the aggregate of the amount of the deficiencies of each of the underwater endowment funds

a) Does the current tool or system used to track endowment funds able to determine if an individual endowment fund is underwater (current market value below that of the original gift(s))?
b) If underwater endowment funds exist, has a supporting schedule that contains the amount of the initial gift(s), current fair value and the calculated difference prepared to support the footnote?
Tools – Implementation Checklist (continued)

Underwater Endowment Funds

1) A NFP is required to disclose (i) its interpretation on the ability to spend from underwater endowment funds, (ii) its policy to either reduce expenditure or not spend from underwater endowment funds, if any, and if this policy was followed, (iii) for each period a statement of financial position is presented each of the following, in the aggregate, for all underwater endowment funds:

- the fair value of the underwater endowment funds
- the original endowment gift amount or level required by donor stipulations or by law that extends donor restrictions
- the aggregate of the amount of the deficiencies of each of the underwater endowment funds

a) Does the current tool or system used to track endowment funds able to determine if an individual endowment fund is underwater (current market value below that of the original gift(s))? 
b) If underwater endowment funds exist, has a supporting schedule that contains the amount of the initial gift(s), current fair value and the calculated difference prepared to support the footnote?

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor of SPAFA requires NFP A to retain as a fund or perpetual duration. Deficiencies of this nature exist in three donor restricted endowment funds, which together have an original value of $3,995, an current fair value of $3,995, and a deficiency of $500 as of June 30, 2013. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new contributions for donor restricted endowment funds and continued appropriation for certain programs that was deemed prudent by the Board of Trustees.

NFP A has a policy of appropriating for distribution each year 5% of its endowment fund’s average fair value over the prior 12 quarters through the calendar year-end preceding the fiscal year in which the distribution is planned. In establishing this policy, NFP A considered the long-term expected return on its endowment. Accordingly, over the long-term, NFP A expects the current spending policy to allow its endowment to grow at an average of 3% annually. NFP A 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 intent or relevant laws and regulations. The governing board appropriated for expenditure $75 from underwater endowment funds during the year, which represents 3% of the 12-quarter moving average, not the 5% it generally draws from its endowment.

Thank You!