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# Nonprofit Accounting & Reporting for Endowments

*Presented by*

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#KLRWebinarSeries

# Endowments- What are they?

# Endowments – what are they?

A transfer of money or property  
donated to an institution.

# Endowments – what are they?

## ▶ Lore vs. Law

**Lore:** The body of knowledge, especially of a traditional, anecdotal, or popular nature, on a particular subject.

**Law:** A system of rules and guidelines which are enforced through social institutions to govern behavior, wherever possible.

# Endowment Lore

- ▶ The donor gives a sum of money to an institution for their endowment.
- ▶ The institution invests the money.
- ▶ The institution can only spend the interest and dividends.
- ▶ Any capital gains (net of losses) must be maintained so that the endowment keeps pace with inflation.
- ▶ The money that the donor gave, plus the capital gains is restricted in perpetuity – the institution can never spend it.

# Endowment Lore

- ▶ The interest and dividends that the institution can spend may be spent for any purpose within the tax-exempt mission of the institution.
- ▶ A donor may impose a restriction on how the institution may spend the interest and dividends.

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# Evolution from Lore to Law

- ▶ In the late 1960's the nature of investments began to change.
- ▶ Interest and dividends did not pour forth from all investments and different forms of investment became available.
- ▶ Institutions began to invest depending on their need for spendable interest and dividends rather than investing in a manner that was designed to maximize their investment return.

# Evolution from Lore to Law

- ▶ National Conference of Commissioners on Uniform State Laws (NCCUSL)
- ▶ Uniform Management of Institutional Funds Act (UMIFA)
- ▶ Approved by NCCUSL in August 1972
- ▶ Written in state law by most states in 1973 and thereafter.

# UMIFA Changes

# UMIFA provided in law:

- ▶ A standard of prudent use of appreciation in invested funds;
- ▶ Specific investment authority;
- ▶ Authority to delegate investment decisions;
- ▶ A standard of business care and prudence to guide governing boards in the exercise of their duties under the law; and
- ▶ A method of releasing restrictions on use of funds or selection of investments by donor acquiescence or court action.

# Income vs. Appreciation

Investments at beginning of period	\$ 10,000
Interest and dividends received	4,000
Realized capital gains	600
Unrealized capital gains	900
Withdrawals	<u>- 4,000</u>
Investments at end of period	\$ <u>11,500</u>

Income = \$4,000 or \$5,500

# Income vs. Appreciation

Investments at beginning of period	\$ 10,000
Interest and dividends received	400
Realized capital gains	6,000
Unrealized capital gains	900
Withdrawals	<u>- 4,000</u>
Investments at end of period	\$ <u>13,300</u>

Income = \$400 or \$7,300

# Spending Policy

- ▶ The Board has adopted an endowment spending policy that calls for appropriating 5% of the average market value of the endowment measured over the previous 12-quarters ending June 30 prior to the beginning of the next calendar year.

# UMIFA Changes

September 30, 2008	\$ 1,548,652,
December 31, 2008	1,598,452
March 31, 2009	1,625,848
June 30, 2009	1,635,842
September 30, 2009	1,633,524
December 31, 2009	1,754,251
March 31, 2010	1,425,412
June 30, 2010	1,498,452
September 30, 2010	1,501,165
December 31, 2010	1,509,854
March 31, 2011	1,500,568
June 30, 2011	1,512,548
Average	\$ 1,562,047

Appropriation:

\$1,562,047  
    x 5%  
\$ 78,102



# Growth of the Endowment

- ▶ Old LORE – spend only interest & dividends; save the rest
- ▶ UMIFA – (LAW) RI said the endowment principal must keep pace with inflation.  
MA said that a spending policy of greater than 7% faces a rebuttable presumption of imprudence.
- ▶ Historic Dollar Value: the original donation and any additions required either by the donor or by law.
- ▶ A fund is not allowed to fall below its Historic Dollar Value - stop appropriations if this is the case.

# Historic Dollar Value

- ▶ After 2000 the Historic Dollar Value concept ran into some opposition at the institutions benefiting from endowments.
- ▶ The National Conference of Commissioners of Uniform State Laws approved the Uniform Prudent Management of Institutional Funds Act – UPMIFA in July 2006
- ▶ A version of UPMIFA has been passed by most states. (Only Pennsylvania and Mississippi have yet to enact an UPMIFA law as of March 2012)

# UPMIFA

- ▶ Modernizes the rules governing expenditures from endowment funds.
- ▶ Spells out the factors a charity should consider in making investment decisions. UPMIFA specifically states that the *preservation of the endowment fund* is a factor affecting decisions.
- ▶ Improves the spending rule by providing better guidance to charities about spending from endowment funds. UPMIFA eliminated the concept of historic dollar value.
- ▶ Recognizes that the inability of a charity to spend anything from an endowment is likely to be contrary to donor intent to provide current benefits to the charity.

# UPMIFA Decision Factors

- ▶ Duration and preservation of the Fund
- ▶ Purposes of the institution and purposes of the Fund
- ▶ General economic conditions
- ▶ Effect of inflation and deflation
- ▶ Expected total return of the Fund
- ▶ Other resources available to the institution
- ▶ Investment policy of the institution

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- ▶ Investment policy of the institution

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- ▶ **Investment policy of the institution**

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# UPMIFA vs. UMIFA

- ▶ Key changes that came with UPMIFA:
  - Removal of Historic Dollar Value concept
  - Removal of hard floor below which spending must stop
  - Removal of mechanism to limit spending levels

# UPMIFA Decision Factors

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# Keeping Pace with Inflation

- ▶ In 2012 Jack Smith gives his University alma mater \$50,000 to serve as an endowment, the income from which is to be used to buy business books for the library each year. The University has a 4% endowment spending policy.
- ▶ In 2013 the University appropriates \$2,000 from the endowment fund and is able to purchase 20 books in library quality bindings for the business library.
- ▶ The \$50,000 fund realized a total return of \$4,300 during 2013.



# Keeping Pace with Inflation

<b>ABC University</b>					
<b>Endowment Fund Worksheet</b>					
Fund	Fund	Balance	Spending	Earnings	Balance
<u>Name</u>	<u>Purpose</u>	<u>2012</u>	<u>2013</u>	<u>2013</u>	<u>2013</u>
Jack Smith	Business Books	50,000	2,000	4,300	52,300

# Keeping Pace with Inflation

In 2013, 20 library-quality books cost an average of \$100/ea.

In 2014, 20 library-quality books will cost an average of \$103 each if inflation is approximately 3%.

The balance of the fund is \$52,300

4% of this (the spending policy) is \$2,092

That is enough to buy 20 books at an average cost of \$104.60 during 2014

In 2064, 20 library-quality books may cost an average of \$300 each. The UPMIFA law requires that ABC University manage this endowment to be able to make that purchase in 2064.

# Endowment Fund Policies & Procedures

- ▶ Sound Endowment Management Practices coupled with Effective Endowment Reporting results in Increased Endowment Giving

# Endowment Fund Policies & Procedures

- ▶ Gift Acceptance Policy
  - What will you accept?
  - What restrictions will you accept?
  - What level is required for a named fund?
- ▶ Spending Policy
- ▶ Investment Policy

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- ▶ Spending Policy
- ▶ Investment Policy

# Endowment Fund Reporting

- ▶ Communication with Donors: past, present and future
- ▶ Income produced by the endowment
- ▶ Growth of the endowment – current balance

# Accounting for Endowments

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Investments	50,000	
Permanently Restricted Gifts		50,000

# Accounting for Endowments

- ▶ When an endowment slips “below water”

	<u>Operating</u>	<u>Endowment</u>
Assets		
Liabilities		
Net Assets		

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

# Accounting for Endowments

- ▶ When an endowment slips “below water”

	<u>Operating</u>	<u>Endowment</u>
Assets	2,450,000	50,000
Liabilities	1,890,000	
Net Assets		
Unrestricted	560,000	
Permanently Restricted		50,000

Assets = Liabilities + Equity

# Accounting for Endowments

- ▶ When an endowment slips “below water”

	<u>Operating</u>	<u>Endowment</u>
Assets	2,450,000	
Investments		45,000
Inter-fund (Payable)		
Receivable	(5,000)	5,000
Liabilities	1,890,000	
Net Assets		
Unrestricted	555,000	
Permanently		50,000
Restricted		

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Cash – Operating Fund	2,000	
Temporarily restricted investment income		2,000

# Accounting for Endowments

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Cash – Operating Fund	2,000	
Temporarily restricted investment income		2,000
Investment income (loss)	2,000	
Investments		2,000



# Accounting for Endowments

## ▶ Statement of Operations

	<u>Operating</u>	<u>Endowment</u>
Revenues:		
Investment Income		
Expenses		
Change in Unrestricted Net Assets		
Revenues:		
Investment Income	2,000	(2,000)
Assets released from restrictions		
Change in Temporarily Restricted Net Assets	2,000	(2,000)
Revenues:		
Change in Permanently Restricted Net Assets		

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Investments	4,300	
Investment income		4,300

# Accounting for Endowments

Investment account 12/31/12 balance	\$ 50,000
Withdrawal of spending policy amount	(2,000)
Total return investment income	<u>4,300</u>
Investment Balance 12/31/13	\$ 52,300

# Accounting for Endowments

Investment account 12/31/12 balance	\$ 50,000
Withdrawal of spending policy amount	(2,000)
Total return investment income	<u>4,300</u>
Investment Balance 12/31/13	\$ 52,300

Endowment Fund Net Investment Income = \$2,300

A change in temporarily restricted net assets.

Usually reflected as non-operating income in a Statement of Operations that discloses *Income from Operations* separately from other, non-operating income.

# Accounting for Endowments

## ▶ Statement of Operations

	<u>Operating</u>	<u>Endowment</u>
Revenues:		
Investment Income		
Expenses		
Change in Unrestricted Net Assets		
Revenues:		
Investment Income	2,000	2,300
Assets released from restrictions		
Change in Temporarily Restricted Net Assets	2,000	2,300
Revenues:		
Change in Permanently Restricted Net Assets		

# Accounting for Endowments

## ► Balance Sheet

	<u>Operating</u>	<u>Endowment</u>
Assets	2,450,000	50,000
Liabilities	1,890,000	
Net Assets		
Unrestricted	560,000	
Permanently Restricted		50,000

Assets = Liabilities + Equity



# Accounting for Endowments

## ► Balance Sheet

	<u>Operating</u>	<u>Endowment</u>
Assets	2,450,000	52,300
Liabilities	1,890,000	
Net Assets		
Unrestricted	560,000	
Permanently Restricted		50,000

Assets = Liabilities + Equity

# Accounting for Endowments

## ► Balance Sheet

	<u>Operating</u>	<u>Endowment</u>
Assets	2,450,000	52,300
Liabilities	1,890,000	
Net Assets		
Unrestricted	560,000	
Temporarily Restricted		2,300
Permanently Restricted		50,000

Assets = Liabilities + Equity

# Accounting for Endowments

## ► Balance Sheet

	<u>Operating</u>	<u>Endowment</u>
Assets		
Investments		52,300
Other Assets	2,450,000	
Liabilities	1,890,000	
Net Assets		
Unrestricted	560,000	
Temporarily Restricted		2,300
Permanently Restricted		50,000

Assets = Liabilities + Equity

# Accounting for Endowments

## ► Balance Sheet

	<u>Operating</u>	<u>Endowment</u>
Assets		
Investments	2,000	52,300
Other Assets	2,448,000	
Liabilities	1,890,000	
Net Assets		
Unrestricted	560,000	
Temporarily Restricted		2,300
Permanently Restricted		50,000

Assets = Liabilities + Equity

# Accounting for Endowments

## Continuing our Example into 2014:

The spending policy appropriation for 2014 is 4% of \$52,300 or \$2,092.

The organization may withdraw this from the investment account on 1/1/14.

### Operating Fund:

Cash	2,092	
Temporarily Restricted		
Investment Income		2,092

### Endowment Fund:

Temporarily Restricted		
Investment Income	2,092	
Investments		2,092

# Accounting for Endowments

Investment account 12/31/13 balance	\$ 52,300
Withdrawal of spending policy amount	(2,092)
Total return investment income	<u>(1,500)</u>
Investment Balance 12/31/14	\$ 48,708

# Accounting for Endowments

## ► Statement of Operations

	<u>Operating</u>	<u>Endowment</u>
Revenues:		
Investment Income		
Expenses		
Change in Unrestricted Net Assets		
Revenues:		
Investment Income	2,092	(3,592)
Assets released from restrictions		
Change in Temporarily Restricted Net Assets	2,092	(3,592)
Revenues:		
Change in Permanently Restricted Net Assets		

# Accounting for Endowments

- ▶ When an endowment slips “below water”

	<u>Operating</u>	<u>Endowment</u>
Assets		
Investments		48,708
Other Assets	2,450,000	
Liabilities	1,890,000	
Net Assets		
Unrestricted	560,000	
Temporarily Restricted		(1,292)
Permanently Restricted		50,000

Assets = Liabilities + Equity



# Accounting for Endowments

- ▶ When an endowment slips “below water”

	<u>Operating</u>	<u>Endowment</u>
Assets		
Investments		48,708
Other Assets	2,450,000	
Inter-fund liability	(1,292)	1,292
Liabilities	1,890,000	
Net Assets		
Unrestricted	558,708	
Temporarily Restricted		0
Permanently Restricted		50,000

Assets = Liabilities + Equity

# Accounting for Endowments

## ► The impact of inflation

	<u>Actual</u>	<u>Hypothetical</u>
Original gift in 2012	50,000	50,000
2.5% inflation in 2013		1,250
2.5% inflation in 2014		1,281
Balance 12/31/14	48,708	52,531

Thank you for attending

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