



April 18, 2008

Mr. Russell G. Golden
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference Proposed FSP FAS 117-a

Dear Mr. Golden:

On behalf of the National Association of College and University Business Officers (NACUBO), and the associations listed below, we submit the following comments on the proposed FASB Staff Position (FSP) 117-a, "Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Management of Institutional Funds Act, and Enhanced Disclosures." NACUBO's comments on the proposal were developed with input from our member institutions and our Accounting Principles Council (APC). The APC consists of experienced business officers from various types of institutions who, collectively, possess a thorough knowledge of higher education accounting and reporting issues and practices.

NACUBO is a nonprofit professional organization representing chief financial and administrative officers at more than 2,100 colleges and universities. In its capacity as a professional association, NACUBO issues accounting and reporting guidance for the higher education industry and educates over 1,500 higher education professionals annually on accounting and reporting issues and practices. Each year NACUBO also conducts the most widespread higher education industry research on endowments. NACUBO's 2007 Endowment Study indicates that higher education institutions manage approximately \$230 billion in donor-restricted endowment funds. This significant amount of donor-restricted endowment funds demonstrates the enormous need for endowment accounting and reporting guidance from FASB related to the relatively new Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA).

Background

In January 2007 NACUBO's APC met with FASB staff and discussed several changes that UPMIFA introduced to the Uniform Management of Institutional Funds Act of 1972 (UMIFA). NACUBO's concerns related to the following high level changes:

- UPMIFA eliminates the concept of "historic dollar value" (HDV). Under UMIFA, institutions could only spend amounts above HDV. When FASB Statement No. 117 was enacted, institutions coalesced around HDV as a safe harbor for the amount classified as permanently restricted net assets (PRNA) even though they managed their endowments to retain much more than that historical amount.
- UPMIFA stresses prudent management of the entire endowment fund as governing boards approve spending decisions related to the fund in its entirety (a holistic approach) rather than stressing prudent spending of amounts above HDV as UMIFA does.
- UPMIFA states that "unless stated otherwise in the gift instrument, the assets in an endowment fund are donor-restricted assets until appropriated for expenditure by the institution." There is no similar clause in UMIFA.

With states' enactment of UPMIFA in progress, NACUBO specifically sought guidance on whether elimination of HDV would mean that no part of an endowment fund is permanently restricted; or conversely, if UPMIFA's paradigm shift to a more holistic view of endowment fund management and its statement that the fund is restricted until appropriated for expenditure means that the entire donor-restricted endowment fund is temporarily or permanently restricted until spending decisions are made.

Question 1— Is the guidance for net asset classification of donor-restricted endowment funds for not-for-profit organizations subject to UPMIFA appropriate and can it be applied consistently? If not, why not?

NACUBO is appreciative that the objective of the proposed FSP is to provide the guidance that we (and we assume other constituents) requested. Although FASB's synopsis of the history and issues in paragraphs 2 – 5 address higher education's inquiries and concerns, we think the guidance in paragraphs 6 – 10 falls a bit short.

Paragraph 6 helps us understand that some portion of a donor-restricted endowment fund is classified as PRNA. This answers our question concerning UPMIFA's elimination of HDV. The Board is clarifying that institutions must decide what is permanent and that the elimination of HDV does not preclude the classification of some portion of the donor-restricted endowment as PRNA. Although Item (b) in paragraph 6 uses terminology – "governing board determination" – that is consistent with SFAS 117, we think the requirement for governing board determination is misplaced. We disagree with the requirement because it requires governing boards to make decisions that UPMIFA does not require. Although the law treats all sources of endowment assets (gifts, appreciation,

income) as homogeneous, FASB requires an individual endowment fund to be classified in two—or, in many cases, three—net asset classes based on decisions that may or may not be informed and likely inconsistent from one institution to another. Ultimately, amounts classified as PRNA may not be held in perpetuity under UPMIFA. Meaning, spending in the future may need to occur from PRNA – which would be permissible under the law – yet not permissible under FASB’s current reporting framework.

Paragraph 7 reinforces the requirement of a “governing board’s determination” by more stalwartly indicating that the governing board must interpret the relevant law related to donor-restricted endowment funds in a consistent manner each year. The paragraph further implies that the interpretation of relevant law revolves around the concept of maintaining the purchasing power of a donor-restricted endowment fund. In this paragraph purchasing power becomes an inflation-adjusted construct that serves as a proxy for the amount of the donor-restricted endowment fund that the organization must maintain. Because the maintenance of purchasing power is addressed only in the comments to UPMIFA and the statute does not include the term or requirement as a mandate, we believe the FASB is over-stepping its role and inappropriately imposing a legal interpretation upon the sector.

Paragraph 8 attempts to provide clarity on subsection 4(a) and/or 4(d) of UPMIFA. In reinforcing the guidance provided in EITF Topic No. D-49, we question whether FASB is recognizing the legal ramifications created by UPMIFA. Subsection 4a of UPMIFA states that “assets in an endowment fund are donor-restricted assets until appropriated for expenditure by the institution.” The Uniform Law Commission’s (ULC) Drafting Committee for UPMIFA believes that this wording creates a restriction. However, FASB believes this language does not go far enough beyond ordinary business care and prudence to justify extending a donor’s restriction. NACUBO questions whether the many complex features of endowment management and spending decisions can so clearly be characterized as an ordinary aspect of daily business operations – donor- restricted endowments carry a fiduciary obligation in perpetuity.

Paragraph 9 goes even further stating that laws such as UPMIFA do not create or extend donor restrictions by imposing a constraint on an organization’s use of an asset. In discussion with ULC members, NACUBO has learned that UPMIFA seeks to clarify that a donor-imposed restriction extends to the entire donor-restricted endowment fund. UPMIFA takes a holistic view of the donor-restricted endowment fund and as such the donor-imposed restriction is that the fund be held in perpetuity by the organization. Perhaps the FASB is uncomfortable with recognizing this as an extension of a donor-imposed restriction because the action that releases the legal restriction (appropriation) is an act under the control of the organization. Although an element of classification based on management intent would be introduced into the financial statements, in our mind that is no more unacceptable than requiring the organization to determine the amount that is classified as permanent.

A common thread in paragraphs 6 – 10 is the disconnection between interpretations of the law with FASB’s current reporting framework. If an organization’s governing board

interprets UPMIFA as the ULC does (periodic decisions about what can be prudently spent, rather than annual decisions as to what must be retained permanently), then there will not be a satisfactory net asset category – in the current FASB reporting framework – for the organization to use. If the organization classifies the donor-restricted endowment as temporarily restricted, there will be no acknowledgment of the permanent intent of the donor. If the organization classifies the donor-restricted endowment as permanently restricted, the organization will not be able to spend from the fund. If the organization classifies some portion of the fund as PRNA and the remainder otherwise, the decision of how much goes where is neither legally binding on the organization nor objectively determinable. FASB's current reporting framework is a poor fit for donor-restricted endowment funds, especially under the holistic approach of UPMIFA.

The framework also creates challenges for the rating agencies that must make adjustments for the portions of the donor-restricted endowment funds included in temporarily restricted and unrestricted net asset categories. Many institutions have publicly traded debt whose financial statements are used by creditors, financial institutions and rating agencies. The potentially inconsistent reclassification between net asset classes, under the proposed guidance, may be confusing to those external users of the financial statements.

The Board acknowledges in its basis for conclusions that they are not convinced that the enactment of UPMIFA necessitates a reconsideration of the current reporting framework. The Board also notes that, if needed, such a change would be best done after the completion of the not-for-profit phases of the Board's conceptual framework project – which is a long-term joint effort with the International Accounting Standards Board. Although such annotations are respected and the difficulty of major change should never be underestimated, we are concerned that a revised framework will never be addressed or if addressed will be too far in the future. NACUBO recognizes that a major change in the current reporting framework would impact the vast majority of independent higher education institutions and the not-for-profit foundations that hold donor-restricted endowments for public institutions. However, moving forward with guidance that is inadequate to address all issues is not the answer.

During a recent educational program on the proposed FSP, a majority of attendees from higher education institutions indicated that the FASB had failed to provide clear guidance. For the reasons cited in the preceding paragraphs, we do not believe the proposed guidance is appropriate or sufficient. We also are not convinced that institutions will be able to consistently apply the guidance. If FASB does not revise the definitions of net asset categories to accommodate the nuances and complexities of donor-restricted endowment funds, higher education institutions will continue to categorize portions of donor-restricted endowment funds across net asset categories in a potentially arbitrary manner. For example, some have said that they will encourage their governing boards to define the permanent portion of endowments as what UMIFA called HDV even though that provision no longer exists in the law. Most, if not all institutions, manage their endowment funds to grow beyond that historic amount. The apportionment across net asset categories will likely not be consistent from institution to institution if a

governing board determination of amounts that are PRNA is made in a unique way – or not at all.

To summarize, we strongly urge FASB to:

- Remove the requirement in paragraph 7 for the governing board to interpret relevant law in order to determine what needs to be retained permanently to maintain the purchasing power of a donor-restricted endowment fund.
- Remove the related disclosure requirement in paragraph 12a concerning the governing board’s interpretation of the law. Consider replacing this with a requirement to disclose the state law and the limitations it puts on the ability to spend donor-restricted net assets.
- Acknowledge that UPMIFA does not require a determination of an amount to be retained permanently and instead focuses on the endowment as a homogenous holistic resource.
- Consider redefining the PRNA definition to accommodate the unique nature of donor-restricted endowments that are to be retained and used by an organization in perpetuity.
- Reinforce that board-designated endowment funds are classified in unrestricted net assets if created from unrestricted resources or in temporarily restricted net assets if created with restricted resources on which the restriction has not lapsed.

Question 2 – Are the proposed disclosures about an organization’s endowment funds needed, and do they provide sufficient transparency in the new UPMIFA environment? If not, please explain which disclosures are not needed or what additional disclosures are needed.

NACUBO thinks it is important to improve financial reporting transparency related to all types of endowment funds.

As stated earlier, because UPMIFA does not specifically require that purchasing power be maintained, we disagree with the requirement in paragraph 7 and all related disclosure requirements. We especially disagree with a requirement to disclose an amount that the governing board believes must be added to PRNA to maintain purchasing power. We also disagree with the suggested use of an inflationary index such as CPI or HEPI as a benchmark for estimating what must be retained to keep up with inflation. FASB’s recommended disclosure is based on a proposed requirement that does not appear in the uniform statute. Furthermore the disclosure continues to reinforce a compartmentalized view of a donor-restricted endowment fund.

Should the FASB disagree with our position on these disclosures and continue to require the 12(a) disclosure, NACUBO recommends that the Board include additional examples. Additional examples should illustrate the disclosure when a portion of investment return is not added to PRNA. Similarly, an alternate paragraph addressing “interpretation of relevant law” is recommended. The following is an example of suggested wording

changes to example C6, if an organization had interpreted the law as not requiring maintenance of the purchasing power of donor-restricted endowment funds:

a. *Interpretation of Relevant Law*

The description of the fourth component of the endowment fund to be classified as PRNA would be removed from the footnote as well as the discussion of inflationary measures used to approximate the “real” value of the endowment assets. The paragraph might then read as follows:

The Board of Trustees of Organization A has interpreted the State Prudent Management of Institutional Funds Act as requiring the board to adopt investment and spending policies that preserve the purchasing power (real value) of the donor-restricted endowment funds absent explicit donor restrictions to the contrary. As a result of this interpretation, Organization A classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) subsequent gifts to the endowment, and (3) accumulations made pursuant to the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. Investment returns are available for retention or appropriation based on prudent standards and policies established by the governing board; and therefore, are classified as temporarily restricted net assets if the use is restricted by the donor or as unrestricted net assets if it is not.

b. *Tabular Disclosures of Endowment Net Asset Composition by Type of Fund and Changes in Endowment Net Assets*

The footnotes to the tabular disclosures discussing investment return classified as permanently restricted net assets by the Organization could be revised. The revised footnote could state:

Investment return classified as permanently restricted net assets represents only those amounts required to be retained permanently as a result of explicit donor stipulations.

Higher Education can comply with the recommended spending and investment policy disclosures. These disclosures should help readers and stakeholders understand the organization’s approach to endowment management and spending.

The recommended reconciliation or roll forward schedule may take a bit of time in the initial implementation year but will serve to enhance information about an institution’s endowment funds. NACUBO supports this disclosure.

Question 3 – Do you agree with the Board’s decision to require that organizations provide the additional disclosures even if they are not yet subject to a version of UPMIFA? If not, why not?

In order to maintain consistency throughout the higher education industry we think that the disclosures should be required for all institutions with endowment funds. We respectfully request the FASB to include examples of disclosures for organizations in UMIFA states as well as states that have not adopted a uniform law.

Question 4 – Do you agree with the Board’s decision to make the provisions of the FSP effective for fiscal years ending after June 15, 2008, with early application permitted as long as the organization has not previously issued annual financial statements for that fiscal year? If not, why not?

The FSP should be effective for years ending on or after December 31, 2008 and not sooner. Governing boards do not meet with enough frequency to ensure the education that may be required. Additionally, we believe that institutions will need more time to effectively meet all disclosure requirements.

In closing, we wish to express our appreciation for the opportunity to comment. We hope that the Board will address our concerns. We look forward to answering any questions the Board or the staff may have about our response. Please direct your questions to Sue Menditto at 202-861-2542 or sue.menditto@nacubo.org.

Sincerely,



John Walda
President and CEO



Sue Menditto
Director, Accounting Policy

Cc: Jeff Mechanick, FASB Project Manager

The associations listed below join NACUBO in these comments:

American Association of Community Colleges (AACC)
American Association of State Colleges and Universities (AASCU)
American Council on Education (ACE)
Association of American Universities (AAU)
Association of Governing Boards (AGB)
National Association of Independent Colleges and Universities (NAICU)
National Association of State Universities and Land-Grant Colleges (NASULGC)