Nonprofit Navigator

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Endowments: Be careful not to overspend
By Colette Kamps, CPA

Permanently restricted endowment funds are established and traced for accounting purposes when a donor makes a contribution to a nonprofit organization and specifies that the contributed amount is to be maintained in perpetuity, with only the earnings on the assets to be used by the organization. The Uniform Prudent Management of Institutional Funds Act (UPMIFA) establishes the legal responsibility of organizations in managing these endowment funds. Section 4 of UPMIFA specifically discusses the nonprofit organization's responsibility for amounts appropriated for expenditure (or spending) from the endowment funds. It requires that the organization spend or accumulate earnings in the fund in a prudent manner, considering things like preserving the fund, economic conditions and the expectation for future investment return.

Establishing a spending policy

Due to this legal standard of prudence, most organizations will establish their own internal endowment spending policy in compliance with UPMIFA. A typical spending policy will state how much (or the maximum) the organization will spend on the endowment fund balance each year, based on a percentage of the balance. For example, the spending policy may state that the organization will spend 3% of the endowment balance based on a rolling average of the previous 12 quarters, to be measured at May 31 each year. Other organizations may state that they will spend *up to* a certain percentage. Prudence is demonstrated by the establishment of a reasonable policy, but also by the organization's commitment to ensuring that the policy is followed.

So, how does an organization ensure that they don't spend in an amount above what their policy states? It is imperative to have a process for calculating the amount available to spend each year and to have a system for properly tracking the amounts included in the funds. It's a good idea to include a period-end date for calculation for consistency in the calculation. Also, including this calculated amount in the annual budget is an effective way to ensure that the amount has been calculated and that the correct amount has been withdrawn for use in operations.

Calculating spending amount

But the calculated amount will not be correct if the endowment funds are not tracked properly. The total endowment fund balance equals the original contribution (the "corpus" or "principal") plus any unspent earnings on those assets. Endowment fund balances are most easily tracked when each fund is maintained in a separate investment account and the only withdrawals from the account are the annual spending amounts. But if an organization includes several endowments in one investment account or includes unrestricted investments in the same account, it is necessary to separately track the portion of the investments that represents the endowment funds. It may make the most sense to track them on a spreadsheet. UPMIFA states that spending greater than 7% is considered imprudent, so it's important to track the funds and calculate the expenditure accurately to ensure prudence and compliance with the organization's own internal policy.

If you have any questions, Colette can be reached at (480) 839-4900 or ColetteK@hhcpa.com.

Fast Facts

- 150+ team members
- 50% are CPAs
- Arizona's largest locally owned accounting firm
- Your money stays in the state
- Well-known leader in CPA services for AZ nonprofits
- Nonprofit CPAs volunteer on boards and committees for local charities
- Your team provides complimentary CPE and customized presentations for nonprofit boards and staff

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Debt issuance costs

Has your entity made the change?

By Sharlynn M. Garza, CPA

The Financial Accounting Standards Board has issued new guidance in order to simplify the presentation of debt issuance costs and debt discounts and premiums. There was inconsistency on how these items were presented on the balance sheet.

Additionally, upon further review, the Board noted that the current presentation of debt issuance costs as an asset conflicts with the guidance in FASB Concepts Statement No. 6, Elements of Financial Statements, which describes one of the characteristics of an asset as providing a future benefit. Since debt issuance costs do not provide any future economic benefit to entities, it would not be appropriate to classify it as an asset. With ASU 2015-03, debt issuance costs will now be required to be presented as a direct deduction from the carrying amount of the debt. There is no change in the guidance related to how debt issuance costs should be recognized and measured – only the presentation has changed. Also, this ASU will bring the presentation of debt issuance costs more in line with the International Financial Reporting Standards, which classifies debt costs as a deduction from the carrying value of the liability.

Another change is related to the amortization of the debt issuance costs. Before ASU 2015-03, amortization of debt costs was recorded as an amortization expense on the profit and loss statement or statement of activities. Amortization of debt costs would now be classified as interest expense.

ASU 2015-03 is effective for entities with fiscal years beginning after December 15, 2015. For entities with a December 31 year end, it will be required to be implemented for the 2016 year end. For those with a fiscal year end of June 30, this would take effect as of June 30, 2017. Early implementation is allowed.

In the first year of adoption, there will be required additional disclosures to explain the change in accounting principle, including the reason for and nature of the change, and the transition method. If the financial statements issued are comparative, entities will also be required to retrospectively adjust prior year balances to be in line with the current guidance. Disclosures will need to describe the prior-period information that has been retrospectively adjusted and the effect of the change on the financial statement line items, which would be the debt issuance cost asset and the debt liability on the balance sheet and amortization expense and interest expense on the profit and loss or statement of activities. As for the actual presentation on the balance sheet, an entity can present the debt liability as a net amount of the face of the balance sheet and provide details of the debt liability and debt issuance costs in the footnotes to the financial statements. Another option would be to show both the debt liability and the reduction for the debt issuance costs directly on the face of the balance sheet. Either presentation format is acceptable.

If your entity currently has debt issuance costs on the books and has not adopted this guidance early, now is the time to start thinking about this. For those entities with a calendar year-end, this guidance is applicable now.

If you have any questions, Sharlynn can be reached at (480) 839-4900 or SharlynnG@hhcpa.com.

Coordinates

Skill development is a driving force for Millennials volunteering. According to the Millennial Impact Project, 25% say they volunteer through their work to utilize their skills while more than 75% say they'd be more likely to volunteer if they could use their expertise.

The Salvation Army got a surge in donations thanks to Dallas Cowboy Ezekiel Elliot. He jumped into a giant Red Kettle to celebrate a touchdown and made a $21,000 donation. After, the Salvation Army saw a 61% increase in donations from the same time the previous week.