

CLIENT CONNECTION



General Conference Auditing Service, 12501 Old Columbia Pike, Silver Spring, MD 20904
telephone: 301-680-5040; fax: 301-680-5054

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Endowment Funds

The Uniform Prudent Management of Institutional Funds Act (UPMIFA) was approved at the July 2006 annual meeting of the National Conference of Commissioners on Uniform State Laws. UPMIFA is an update to the previous laws governing donor restricted endowment funds which was enacted by 47 states. The fundamentals of the previous law were that the endowment assets would be prudently invested in diversified portfolios seeking growth and income and the appreciation in the endowment assets would be spent only for the stipulated endowment purpose. These two fundamentals of the previous law are expanded upon in UPMIFA.

As of June 9, 2008, there were 25 states that have enacted laws based on UPMIFA. Other states are in the process of approving an UPMIFA law. It is important to note that each state has the ability to include modifications to their UPMIFA law. As an administrator, treasurer or accountant of a denomination organization, it is your responsibility to determine if your organization is complying with the laws and regulations of that jurisdiction. To see if your state has an UPMIFA law, please click on the following web link:

<http://www.upmifa.org/DesktopDefault.aspx?tabindex=3&tabid=70>

The key UPMIFA provisions regarding donor restricted endowments are:

- Investments are required to be "in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances."
- Investment costs are only to be the "costs that are appropriate and reasonable."
- Investment decisions must reflect the overall resources of the organization and its charitable purpose.
- Investment decisions must be in relation to the entire portfolio and as part of an investment strategy "having risk and return objectives reasonably suited to the fund and to the institution."
- The institution "may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines to be prudent for the uses, benefits, purposes, and duration for which the endowment fund is established."

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- States have the option to include a provision in their UPMIFA law to safeguard against excessive expenditure.

It is important for administrators and treasurers to understand that donors contribute to an endowment fund with the explicit understanding that their donations will be invested properly and appropriately used according to the endowment document. Organizations that do not manage their endowment funds in a prudent manner face the possibility of violating the donors trust as well as government laws and regulations.

The UPMIFA law seeks to protect the donor. This is accomplished by including a comprehensive analysis of how an organization is to treat the modification of restrictions on donor restricted endowments. There may be times when an organization is unable to fulfill the stipulated purpose of the endowment. For example, if an academy has a donor restricted endowment whereby the earnings on the endowment corpus is to be used to pay for school bus transportation and the academy no longer has a bus, this would be an impractical use.

UPMIFA requires an organization to obtain donor consent in order to change the use restrictions. However, if the donor is not available, the organization can request a court of law to approve a modification of the restriction. The court will most likely authorize a modification of the restriction as long as it meets with the organization's nonprofit mission. Each state may have an established dollar and age limit that determines whether an organization is required to seek the court's approval for changing the restriction. UPMIFA does not require court approval for endowment assets less than \$25,000 and older than 20 years.

If your organization has donor restricted endowments, please review the applicable laws and regulations in your jurisdiction. It is vitally important that your organization comply with applicable laws and regulations. A lack of understanding of the law is not a valid reason for not complying with it. Furthermore, donor confidence and continued support may decrease if applicable laws and regulations are not complied with.

Accounting Implications

The Financial Accounting Standards Board (FASB) released on August 6, 2008, a staff position regarding the accounting and reporting of endowments that are subject to UPMIFA. The FASB Staff Position (FSP) is effective for fiscal years ending after December 15, 2008.

The FSP provides accounting guidance on donor restricted endowment funds and board designated endowments. The FSP is valid whether or not an UPMIFA law has been enacted.

Key provisions of the FSP for organizations that have endowments subject to UPMIFA are:

- The organization is required to “classify a portion of the donor-restricted endowment fund of perpetual duration as permanently restricted net assets.”
 - FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*, states that “the amount classified as permanently restricted shall be the amount of the fund (a) that must be retained permanently in accordance with explicit donor stipulations, or (b) that in the absence of such stipulations, the organization’s governing board determines what must be retained (preserved) permanently consistent with relevant law.”
- “The portion of a donor-restricted endowment fund that is classified as permanently restricted net assets is not reduced by losses on the investments of the fund, except to the extent required by the donor, including losses related to specific investments that the donor requires the organization to hold in perpetuity.”
- “For each donor-restricted endowment fund for which the restriction described in subsection 4(a) of UPMIFA is applicable, a not-for-profit organization shall classify the portion of the fund that is not classified as permanently restricted net assets as temporarily restricted net assets (time restricted) until appropriated for expenditure by the organization.”

The FSP also includes requirements for all endowments funds whether or not it is subject to an enacted version of UPMIFA. Those requirements are:

- Disclosure of the following items in the organization’s financial statements:

- “A description of the governing board’s interpretation of the law(s) that underlies the organization’s net asset classification of donor-restricted endowment funds.”
- “A description of the organization’s policy(ies) for the appropriation of endowment assets for expenditure (its endowment spending policy(ies)).”
- “A description of the organization’s endowment investment policies.” This would include a description of the objectives and risk parameters, spending policies, and strategies employed for reaching the objectives.”
- “The composition of the organization’s endowment by net asset class at the end of the period, in total and by type of endowment fund, showing donor restricted endowment funds separately from board-designated endowment funds.”
- “A reconciliation of the beginning and ending balance of the organization’s endowment, in total and by net asset class, including, at a minimum, the following items (as applicable):”
 - Investment return, separated into investment income and net appreciation or depreciation of investments
 - Amounts appropriated for expenditure
 - Reclassifications
 - Other changes

Accounting for Investment Transactions

The turbulent times on Wall Street will certainly affect the financial statements of denominational organizations. Equity investments along with government and corporate debt investments that are subject to fluctuating fair values based on market conditions have unique accounting rules for reporting values at a specific date and income, gains and losses for a specific time period.

Valuation of Investments

Investments that are subject to accounting at fair value are to be reported at their fair value at the reporting date. This fair value will most likely be different than the cost basis. The difference between the fair value and the cost basis is to be recorded in a valuation account.

For example, 500 shares of Rock Solid Company common stock was purchased two years ago for \$5,000 and the current market value is \$3,500. The valuation account (a contra asset) would report a credit balance of \$1,500.

Unrealized Gains or Losses

The term “unrealized” refers to a gain or loss resulting from the change in fair value of investments and not from an actual sale. In the example above with the 500 shares of Rock Solid Company, assume the prior year market value was \$4,000 and the current year market value is \$3,500. This would result in an unrealized loss of \$500. Notice that a loss of \$500 occurred even though the organization did not sell any stock.

Interest & Dividend Income

Ordinary earnings derived from investments need to be recorded in the accounting period for which it was earned. Keep in mind that earnings on restricted assets may result in restricted and/or unrestricted revenue depending on the donor stipulations.

Sale of Investments

The actual sale of an investment at a price that is different from its cost basis will result in a “realized gain” or “realized loss.” It is important to understand that the accounting gain or loss resulting from the sale of an investment is not the sales price minus the original cost. Accounting principles identify the total gain or loss on an investment reflects all fluctuations in value from the acquisition date to the sales date. This means that for an investment held for more than the current reporting period, unrealized gains or losses have previously been recorded. Thus, realized gain or loss is the sales price minus the carrying value (market value) from the most recent preceding financial statement date.

For additional information, please refer to the chapter on investments in the North American Division Accounting Manual and the AICPA Accounting & Audit Guide for Not-for-Profit Organizations.

Internal Controls for Contributions

Regardless of whether your organization is larger or small, if it receives donations there are a number of internal controls that need to be implemented. The following list contains suggestions to improve the internal controls over processing contributions:

- Record all contributions received
- Comply with restrictions placed on contributions
- Comply with endowment terms and board designation
- Acknowledge contributions

- Properly value and record promises to give
- Properly value and record contributed securities, services and gifts-in-kind
- Comply with the tax laws (IRS or Revenue Canada)

There are certain basic controls that are common to all organizations, regardless of size. Certainly no controls should be implemented whose cost exceeds the possible losses.

This concept should not be used by smaller organizations (for example, with limited resources) to avoid basic controls. Sometimes organizations avoid controls because of the perceived “red tape” that comes with controls. There is an obligation to the constituencies of even small organizations for controls to encourage efficiency and effectiveness.

The following are some commonly used controls to help an organization meet the basic internal control objectives:

- Control the opening of incoming mail by having two people perform this duty concurrently.
- Restrictively endorse checks when received.
- Prepare a daily list of cash receipts when the mail is opened.
- Compare the daily list of cash receipts to the bank deposit.
- Deposit all funds intact as soon as possible. All receipts should be deposited intact without using any of the receipted cash to pay bills or replenish the petty cash fund.
- Reconcile contribution revenue with cash deposited using a person independent of the cash receipts function.
- Separate the handling of cash from the processing and recording of receipts.
- Require documentation of noncash contributions for determination of the proper accounting treatment.
- Require approval and support for adjustments, write-offs, or other items reducing contributions and promises to give.
- Resolve complaints from donors using a person independent of the cash receipts function.
- Train volunteers who assist in the cash receipts function.

Organizations need to take a proactive approach to implementing internal controls. The preceding list is what needs to be accomplished. Some ingenuity and creativity on your part will help your organization achieve the goals of safe

and accurate contributions handling without the controls being too difficult or costly.

Steps to Improve Governance Practices

The Internal Revenue Service (IRS) issued a letter describing a number of governance practices it considers important for not-for-profit organizations. The governance practices identified by the IRS are merely recommendations and are not tax laws. However, the recommendations point out some very useful information to help direct organizations towards improving their governance practices. Please click on the following web link to read the IRS letter:

http://www.irs.gov/pub/irs-tege/governance_practices.pdf

Additional information on improving your organization's accountability and best practices can be found by clicking on the following web link:

<http://www.nonprofitcongress.org/?q=capacitybuilding>

Year End Donations

If your organization receives an influx of donations during the month of December, it is important that you review your compliance with the applicable donation tax laws.

United States – Internal Revenue Service

<http://www.irs.gov/pub/irs-pdf/p1771.pdf>

Canada – Canada Revenue Agency

<http://www.cra-arc.gc.ca/tx/chrts/chcklsts/rcpts-eng.html>

<http://www.cra-arc.gc.ca/tx/chrts/menu-eng.html>

Capital One – Credit Card Donations

Capital One Bank and Network For Good have teamed up to provide Capital One Bank issued credit card holders an easy method to make donations to charitable organizations. A full 100% of the donation is provided to the charitable organization. This is possible because Capital One does not charge a transaction fee.

Network For Good utilizes GuideStar's (www.guidestar.org) huge charitable organization database. There are approximately 1.2 million charitable organizations available for donations via Network For Good.

For more information, please visit the following websites:

<https://www.capitalone.com/give>

<http://phx.corporate-ir.net/phoenix.zhtml?c=70667&p=irol-newsArticle&ID=1200646&highlight=>

Not-For-Profit Issues in 2008

The American Institute of Certified Public Accountants has issued a new financial reporting alert book titled, "Not-For-Profit Organizations Accounting Issues and Risks 2008: Strengthening Financial Management and Reporting." This book is designed for management and members of the financial audit review committee.

For more information on this book and how to order it, please click on the following website and search for book #029207:

www.cpa2biz.com

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If someone in your organization should be receiving this newsletter, but is not, please e-mail their contact information to Linda Fredlund:

clientconnection@gc.adventist.org

Please send us your comments, questions, suggestions, or contributions (of articles, not money) to:

Jeremy Smith, Editor
General Conference Auditing Service
PO Box 5005
Westlake Village, CA 91359
Smithje@gc.adventist.org
(805) 413-7138

This newsletter is intended to provide general information about a variety of topics of interest to Administrators of Seventh-day Adventist organizations. If you read an article of interest to you, we suggest that you study further or seek counsel to clarify your understanding of the subject, before taking action. This is a complicated world - be careful.

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