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University of California GASB 35 Financial Statement Presentation

Issues Resolution Memo No. 132

Classification of Endowment and Similar Funds for Financial Reporting Purposes

Define Issues

The University must further classify endowment and similar fund assets into restricted expendable, restricted nonexpendable and unrestricted net assets to comply with the GASB financial reporting standards for the Statement of Net Assets as outlined in GASB statement No. 34. This classification is required for the University's Fiscal Year beginning July 1, 2001 and requires comparative information for the prior year.

Background

During 1999, the Government Accounting Standards Board (GASB) introduced GASB Statements 34 and 35. In order to implement fully the financial reporting requirements outlined by the GASB for the Statement of Net Assets, the University must report permanent endowment assets or permanent fund principal amounts as additions to either restricted expendable net assets or restricted nonexpendable net assets. Income, realized gains or losses and unrealized appreciation or depreciation must be reported as restricted expendable, restricted nonexpendable or unrestricted net assets depending upon the existence or nonexistence of externally imposed constraints (restrictions). Endowment and similar fund assets not defined as restricted must be reported as unrestricted net assets.

This classification requirement substantially revises how public institutions traditionally present endowment and similar funds for external financial reporting.

Currently, the University classifies each fund within the endowment and similar fund group with a specific fund type and purpose restriction code at the time it is established. Fund types include:

- True Endowment (by definition the fund's corpus must remain inviolate (restricted origination))
- Funds Functioning as Endowment (restricted and unrestricted origination)
- Annuity and Life Income Funds (restricted origination)

The purpose restriction governs the purpose for which the fund may be used, specific use of the income, whether principal may be expended and the conditions under which withdrawals can be made.¹

A listing of restriction codes is presented in Appendix 3.A (specific) and Appendix 3.B (purpose)

It is the OP Financial Management Office's responsibility to verify that each fund in the Endowment and Similar Funds group is established in accordance with the terms of the fund as stipulated by the donor.

Traditionally, at fiscal year end, the University allocates realized gains/(losses) and unrealized appreciation/(depreciation) to the fund type groups based on the restricted and unrestricted classification of the fund principal (corpus), for external reporting purposes. Realized gains and losses are held in a separate fund and are not posted to an individual endowment and similar fund's principal.

The University has identified the general restriction and purpose restriction codes contained within the current OP G/L Endowment Reporting (ENR) database as the primary identifiers for the classification of endowment and similar fund assets into restricted expendable or restricted nonexpendable net assets or unrestricted net assets.

The specific restriction codes, as introduced above, are the identifier of fund type and external and internal constraints placed on the fund corpus. The purpose restriction codes are the major identifier for the constraints classifying income, realized gains/(losses) and unrealized appreciation/(depreciation).

Secondary identifiers for the constraints classifying income are specific special handling codes (3 characters) and the fund income distribution code (1 character). The University is in the process of identifying what specific special handling codes in the current system, if any, may further apply to these classifications.

The current system of internal accounting for endowment and similar funds will not change. However, the traditional method of allocating gains and losses at fiscal year end to the fund type level will change. Realized gain/(loss) and unrealized appreciation/(depreciation) will be allocated to each fund and subsequently classified to *restricted expendable*, *restricted nonexpendable* or *unrestricted net assets* depending on restrictions designated by the donor.

Unlike the traditional approach for true endowments, whereby the classification of both realized gains/(loss) and unrealized appreciation/(depreciation) are not separated from the same classification of the fund's corpus, they will now follow the same classification as fund income.

¹ UCOP Accounting Manual, Endowment and Similar Funds E-525, Page 4 Section II B.

The impact of this classification revision on the University's traditional accounting and reporting for this funds group is graphically represented in Exhibit 1.

Exhibit 2 presents the flow of reclassification from currently available coding, in the internal Endowment and Investment accounting system, to the University's Corporate Financial System (CFS) fund and account groups (external reporting), in a matrix format for the three endowment and similar fund types classifications.

Financial statements must be prepared in accordance with GAAP (generally accepted accounting principles) and are subject to audit under GAAS (generally accepted auditing standards).

Authoritative Guidance

Authoritative Guidance is provided by GASB Statement No. 34 and the GASB Implementation Guide. Respective GASB No. 34 paragraphs are presented in Appendix 1 and respective GASB Implementation Guide Questions are presented in Appendix 2.

Recommended Approach

In defining a policy for both accounting and reporting of endowment and similar assets, the University will classify as *restricted nonexpendable net assets* the corpus of True Endowment and Annuity and Life Income funds that have a restricted origination as designated by the original donor. In addition, for True Endowment, if the donor designated purpose is *add-to-principal*, the income, realized gain/loss and unrealized gain/loss attributable to the fund, will be classified as *restricted nonexpendable net assets*. Both realized and unrealized gain/loss for Annuity and Life Income funds will be classified as *restricted nonexpendable net assets*.

The University will classify as *restricted expendable net assets* the corpus, income, realized gain/loss and unrealized gain/loss of Quasi Endowment funds that carry a donor stipulated restricted origination. The income, realized gain/loss and unrealized gain/loss of True Endowment funds and the income of Annuity and Life Income funds with restricted originations will be classified as *restricted expendable net assets*.

The University will classify as *unrestricted net assets* the corpus of Quasi Endowment funds and the income, realized and unrealized gain/loss for both True Endowments and Quasi Endowment funds that are specified as unrestricted by the donor(s).

Next Steps—Required Actions

The University will define a methodology for separating fund corpus from income, realized gains/(losses) and unrealized appreciation/(depreciation) for endowment and similar funds. The focus of this methodology will be based on pre and post 1992 information. 1992 marks the first year that historical fund accounting information is available in electronic form.

The University will test a subset of fund agreements to determine if donor intentions are coded properly. The scope of this is yet to be defined.

Responsibility (OP)	Required Completion Date	Action Item/Task
OP	15-May-02	Research and Identify any Additions or Exceptions to Current Restriction Codes —Investigate the Endowment Reporting (ENR) Database of the OP G/L to determine if other fields need to be identified for partial add to principal funds.
OP	31-May-02	Sample ENR for Correct Coding —Select a subset of endowment and similar funds and review original documentation for correct coding of restriction codes within ENR.
OP	31-Jul-02	Complete Reclassification for Net Assets —Apply methodology and logic to reclassification of Net Assets for Fiscal Year End 2000 and Fiscal Year End 2001.
OP	2-Aug-02	Present Revised IRM 132 to PwC —Provide revised IRM to PwC for review and comment.

Appendix 1—Authoritative Guidance: GASB Statement No. 34

In discussing the reporting of Restricted Net Assets GASB Statement No. 34, Paragraph 34 outlines the requirement for when net assets should be reported as restricted:

GASB 34, Paragraph 34—Net assets should be reported as restricted when constraints placed on net asset use are either²⁴:

- a. Externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments
- b. Imposed by law through constitutional provisions or enabling legislation.

*Enabling legislation*²⁵, as the term is used in this Statement, authorizes the government to assess, levy, charge, or otherwise mandate payment of resources (from external resource providers) *and* includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

In reporting restricted net assets GASB Statement No. 34, Paragraph 35 recommends that entities further classify restricted net assets to expendable and nonexpendable when the assets are permanent endowments or permanent fund principal amounts:

GASB 34, Paragraph 35—When permanent endowments or permanent fund principal amounts are included, “restricted net assets” should be displayed in two additional components—expendable and nonexpendable. Nonexpendable net assets are those that are required to be retained in perpetuity.

²⁴ Because different measurement focuses and bases of accounting are used in the statement of net assets than in governmental fund statements, and because the definition of *reserved* includes more than resources that are *restricted* (as discussed in this paragraph), amounts reported *as reserved fund balances* in governmental funds will generally be different from amounts reported *as restricted net assets* in the statement of net assets.

²⁵ Enabling legislation also included restrictions on asset use established by a governmental utility’s own governing board when the utility reports are based on FASB Statement 71.

In discussing the reporting of Unrestricted Net Assets GASB Statement No. 34, Paragraph 36 outlines when net assets should be reported as unrestricted:

GASB 34, Paragraph 36—Unrestricted net assets consist of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

GASB Statement No. 34, Paragraph 37 provides clarification of the difference between internal and external constraints:

GASB 34, Paragraph 37—In the governmental environment, net assets often are *designated* to indicate that management does not consider them to be available for general operations. In contrast to *restricted* net assets, these types of constraints on resources are *internal* and management can remove or modify them. As described in paragraph 34, however, *enabling legislation* established by the reporting government should not be construed as an *internal constraint*. Designations of net assets should not be reported on the face of the statement of net assets.

Appendix 2—Authoritative Guidance: GASB Implementation Guide

The GASB Implementation Guide provides further authoritative guidance in a question and answer format presented as follows:

Question 17

Q—How should public institutions classify quasi-endowments?

A—Resources used to create quasi-endowments (funds functioning as endowments) may be either restricted or unrestricted. Quasi-endowments created with restricted resources must be reported as expendable restricted net assets. Those created with unrestricted resources must be reported with unrestricted net assets, but could be described in a note to the financial statements indicating that they have been designated for long-term investment.

Question 25

Q—Can public institutions show designations for net assets, such as for quasi-endowments, on the face of financial statements?

A—No. GASB Statement 34 prohibits public institutions from showing designations of unrestricted net assets on the face of financial statements. Designations can be disclosed in the notes to the financial statements. GASB Statement, paragraph 37, provides the requirement on this issue. Additionally, public institutions are required to show restricted net assets as expendable or nonexpendable on the face of the financial statements, and must provide details regarding the major categories of restrictions within the expendable and nonexpendable categories. Nonexpendable net assets are net assets that are required to be maintained in perpetuity, for example, permanent endowments.

Question 26

Q—How are restricted net assets defined under GASB Statement 34?

A—GASB Statement 34, paragraph 34 states that “net assets should be reported as restricted when constraints placed on net asset use are either: (a) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws and regulations of other governments or (b) imposed by law through constitutional provisions or enabling legislation.” Internally established constraints are designations and do not meet the GASB definition for restrictions.

Question 29

Q—How are permanent endowments classified with respect to being expendable or nonexpendable?

A—Permanent endowments have the characteristics of voluntary non-exchange transactions. The stipulation that the principal be maintained in perpetuity is a time requirement. Therefore, the principal portions are permanently nonexpendable additions to net assets. Only the income and possibly some portion of realized gains are expendable by the institution, depending on the donor’s specifications and applicable state law. Thus, the principal is nonexpendable while the investment

income and – depending on the facts and circumstances – the unrealized appreciation is expendable.

Question 30

Q—How should an institution treat a permanent endowment that was established with an original gift of \$100,000 but now has accumulated gains of \$900,000 for a total current value of \$1,000,000?

A—The answer depends on the restrictions established by the donor and applicable state law. If a donor required only the \$100,000 gift, exclusive of unrealized gains, to be maintained in perpetuity, then \$100,000 will be displayed as nonexpendable restricted net assets and \$900,000 as expendable restricted or unrestricted net assets, depending on the facts and circumstances surrounding the donor’s gift as well as applicable state law.

Question 42

Q—Does GASB Statements 34 or 35 require the priority of release of restricted resources when both restricted and unrestricted resources are available to satisfy an expense?

A—No. The priority of release is based on the institution’s policy governing the use of resources. This policy election should be disclosed in the notes to the financial statements (GASB Statement 34, paragraph 115h). However, paragraph 63 basis for conclusions of GASB Statement 33 states “...governments should report net assets resulting from transactions with purpose restrictions as restricted net assets (or a reservation of fund balance for governmental funds) until the resources are used for the specified purpose or for as long as the provider requires the resources to be maintained intact (for example, endowment principal). Thus, the disbursement of unrestricted resources for the same purpose should not result in a lifting of the restriction on an equivalent amount of restricted resources.”

Further, GASB Statement 34 paragraph 325 basis for conclusions states: “The Board also took into account the discussion of the expiration of donor restrictions in paragraph 17 of FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*.” That paragraph states, “If an expense is incurred for a purpose for which both unrestricted and temporarily restricted net assets are available, a donor-imposed restriction is fulfilled to the extent of the expense incurred unless the expense is for a purpose that is directly attributable to another specific external source of revenue.” GASB believes that the decision whether to first apply restricted or unrestricted resources to specific expenses should be a management matter and therefore did not include a similar requirement in Statement 34.

Question 43

Q—How should a public institution display a donor’s gift of a lump-sum payment of \$1,000,000 for scholarships for the music department?

A—This is a non-exchange transaction with a purpose restriction. Expendable restricted net assets must be reported until the \$1,000,000 is used for the music scholarships. The institution would display on the statement of revenues, expenses, and changes in net assets a non-operating revenue gift of \$1,000,000. The amount remaining, after

the award of the music scholarships, would result in expendable restricted net assets. The institution would further classify expendable restricted net assets by category (e.g., scholarships).

Appendix 3.A—Restriction Codes: Endowment and Similar Funds

Specific Restriction Code (First Two Digits) 12114

<u>Code No.</u>	<u>Restriction</u>
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Endowment Funds

11	Unrestricted
12	Restricted by The Regents for educational and general purposes—allocated for general purposes or allocated to specific departments or activities
13	Restricted by The Regents for student aid
15	Restricted by donor for educational and general purposes
16	Restricted by donor for student aid
18	Restricted by donor for loan funds

Funds Functioning as Endowment

21	Unrestricted
22	Restricted by The Regents for educational and general purposes—allocated for general purposes or allocated to specific departments or activities
23	Restricted by The Regents for student aid
24	Restricted by The Regents for auxiliary enterprises
25	Restricted by donor for educational and general purposes
26	Restricted by donor for student aid
27	Restricted by donor – purpose to be designated later
28	Loan funds
29	General Endowment Pool reserve

Funds Held in Trust by Others

Held by others with the University as beneficiary of income:

31	Unrestricted
32	Restricted by The Regents for educational and general purposes – allocated for general purposes
35	Restricted by donor for educational and general purposes
36	Restricted by donor for student aid

Annuity and Living Trust Funds

43	Gift Annuity Funds
45	Annuity Fund (1969 Tax Reform Act)
46	Unitrust (1969 Tax Reform Act)
47	Pooled Income (1969 Tax Reform Act)
48	Annuity funds
49	Trust agreements
50	Agency Funds Invested for affiliated organizations of the University as a service

Appendix 3.B—Restriction Codes: Endowment and Similar Funds

Purpose Restriction Code (Second Two Digits) 12114

<u>Code No.</u>	<u>Restriction</u>
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11	General purposes
21	Departmental purposes
22	School purposes

Professorships

31	Chairs
32	Other

Research

41	Cancer research
42	Medical research
43	Other research

Lectures

51	Committee on Arts and Lectures
52	Departmental lectures

Libraries

61	General library
62	Departmental libraries

Student Aid

71	Undergraduate scholarships
72	Graduate scholarships and fellowships
73	Graduate or undergraduate scholarships
74	Prizes and awards
75	Gifts and grants-in-aid
76	Loan funds held in trust--no income
77	Multipurpose student aid

Various purposes

81	Multipurpose funds
82	Miscellaneous purpose funds
83	Income added to principal and principal withdrawn for use
84	Income added to principal to build up fund for ultimate use
85	Income added to loan fund

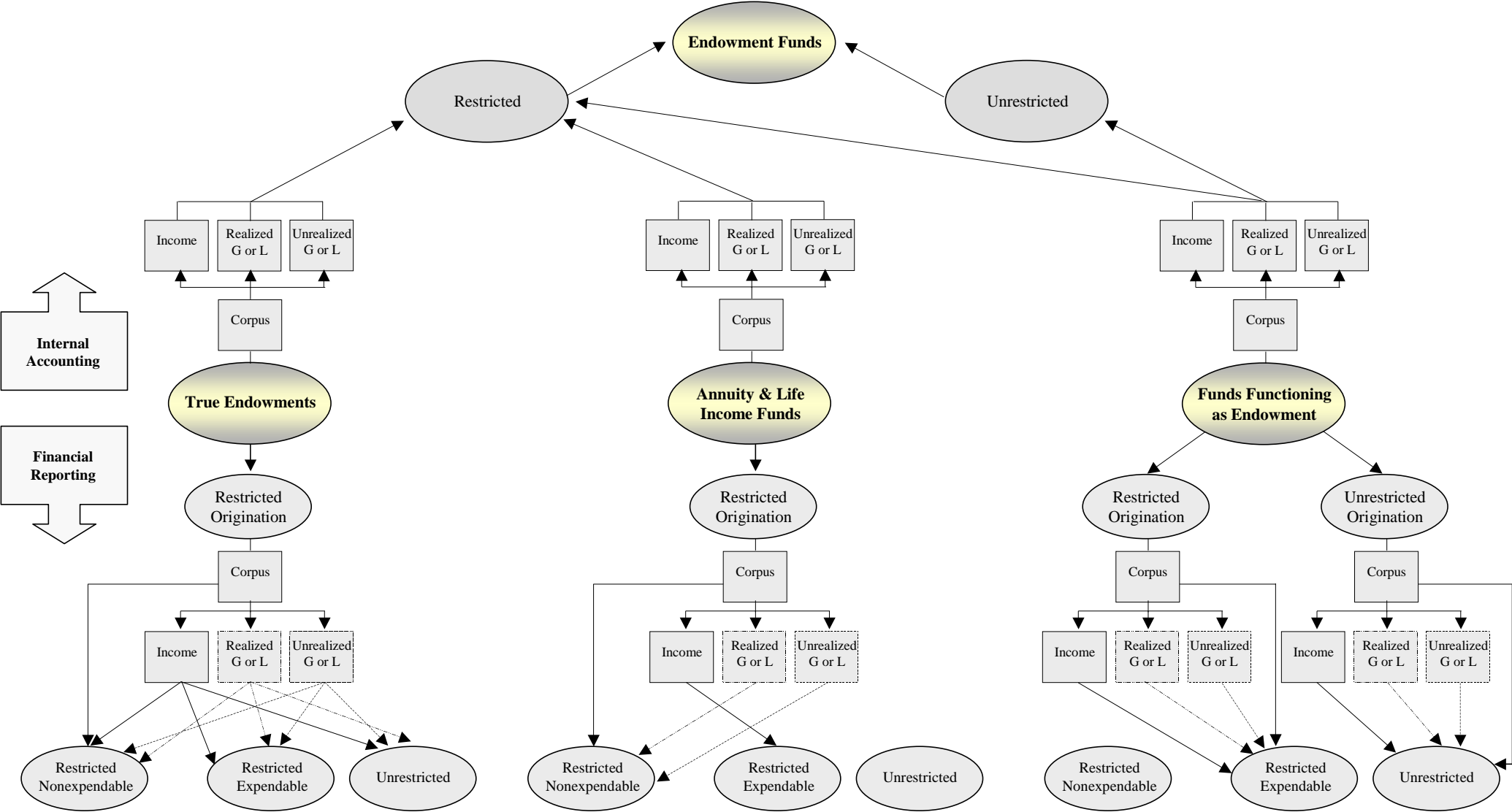
Purpose Restriction Code (Second Two Digits) 12114 (cont'd)

Code No. **Restriction**

Trust and agency funds

91	Annuity funds
92	Trust funds
93	Agency funds

Classification of Endowment Funds for Financial Reporting Purposes
(per GASB 34, ¶ 34-37)



IRM No. 132—Exhibit 2

Conversion Matrix—True Endowment

Internal Reporting to External Reporting

Scenario	UCOP G/L Internal Accounting			Restricted		Unrestricted
	Restriction Code	Purpose Restriction	Special Handling Code	Expendable	Nonexpendable	
				Other	Endowment	
1. Corpus						
a.) If Origination is Restricted or Unrestricted & Designated True Endowment by Donor	11 - 18				159100	
2. Income						
a.) If specified unrestricted by donor	11	11				169400-407100-U
b.) If specified unrestricted by donor with internal restriction designated by UC Regents	12 - 13	any				169400-407100-U
c.) If specified restricted by donor	15 - 18	any except (83 & 84)		169400-407100-R		
i.) If purpose restricted by donor as add to principal	15 - 18	83 & 84			159100	
3. Realized Gain or Loss						
a.) If specified unrestricted by donor	11	11				159400-U
b.) If specified unrestricted by donor with internal restriction designated by UC Regents	12 - 13	any				159400-U
c.) If specified restricted by donor	15 - 18	any except (83 & 84)		159400-R		
i.) If purpose restricted by donor as add to principal	15 - 18	83 & 84			159100	
4. Unrealized Gain or Loss						
a.) If specified unrestricted by donor	11	11				159400-U
b.) If specified unrestricted by donor with internal restriction designated by UC Regents	12 - 13	any				159400-U
c.) If specified restricted by donor	15 - 18	any except (83 & 84)		159400-R		
i.) If purpose restricted by donor as add to principal	15 - 18	83 & 84			159100	

IRM No. 132—Exhibit 2

Conversion Matrix—Annuity & Life Income
Internal Reporting to External Reporting

Scenario	UCOP G/L Internal Accounting			Restricted		Unrestricted
	Restriction Code	Purpose Restriction	Special Handling Code	Expendable	Nonexpendable	
				Other	Annuity & Life Income	
1. Corpus						
a.) If Origination is Restricted & Designated by Donor	43 - 49				159200	
2. Income						
a.) If purpose restricted by donor	43 - 49	any	n/a	169400-407100-R		
3. Realized Gain or Loss						
a.) If purpose restricted by donor	43 - 49	any	n/a		159200	
4. Unrealized Gain or Loss						
a.) If purpose restricted by donor	43 - 49	any	n/a		159200	

IRM No. 132—Exhibit 2

Conversion Matrix—Quasi Endowment (Funds Functioning)

Internal Reporting to External Reporting

Scenario	UCOP G/L Internal Accounting			Restricted		Unrestricted
	Restriction Code	Purpose Restriction	Special Handling Code	Expendable		
				FFE	Other	
1. Corpus						
a.) If Origination is Unrestricted & Designated Funds Functioning as Endowment by Donor	21 - 24					159300-U
b.) If Origination is Restricted & Designated Funds Functioning as Endowment by Donor	25 - 28			159300-R		
2. Income						
a.) If specified unrestricted by donor	21	any				169400-407100-U
b.) If specified unrestricted by donor with internal restriction designated by UC Regents	22 - 24	any				169400-407100-U
c.) If specified restricted by donor	25 - 28	any except (83 & 84)			169400-407100-R	
i.) If purpose restricted by donor as add to principal	25 - 28	83 & 84		159300-R		
3. Realized Gain or Loss						
a.) If specified unrestricted by donor	21	any				159300-U
b.) If specified unrestricted by donor with internal restriction designated by UC Regents	22 - 24	any				159300-U
c.) If specified restricted by donor	25 - 28	any except (83 & 84)			159300-R	
i.) If purpose restricted by donor as add to principal	25 - 28	83 & 84		159300-R		
4. Unrealized Gain or Loss						
a.) If specified unrestricted by donor	21	any				159300-U
b.) If specified unrestricted by donor with internal restriction designated by UC Regents	22 - 24	any				159300-U
c.) If specified restricted by donor	25 - 28	any except (83 & 84)			159300-R	
i.) If purpose restricted by donor as add to principal	25 - 28	83 & 84		159300-R		