This document reflects the result of analyses, discussions and review by UCOP staff to date. The document is subject to change pending additional discussions with PwC; however, it represents the best information available to date.

University of California
Governmental Accounting Standards Board (GASB) Statement No. 52*, Land and Other Real Estate Held as Investments by Endowments.*

Issues Resolution Memo No. 52-1

Determining Implementation Issues Resulting from GASB Statement No. 52

(Updated: January 18, 2008)

Background

GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, requires endowments to report their land and other real estate investments at fair value, not historical cost.

GASB Statement No. 52:

- Is effective for the University for FY 2008–2009. Earlier application is encouraged. Depending on materiality, in the first period that this Statement is applied, changes made to comply with this Statement should be treated as an adjustment of prior periods, and financial statements presented for the periods affected should be restated. If restatement of the financial statements is not practical, the cumulative effect of applying this Statement should be reported as a restatement of beginning net assets for the earliest period restated (generally the current period). In the first period this Statement is applied, the financial statements should disclose the nature of the restatement and its effect.
- Does not apply to the separately audited UCRP financial statements since they have no endowments.
- Does not apply to the separately audited UC Retirement Savings Plans, including the UCRP, 403(b), 457(b) and PERS–VERIP plans since they have no endowments.
- Does not apply to the separately audited UCRHBT financial statements since it has no endowments.
- <u>Does</u> apply to the campus foundations since they have endowments, to the extent they include land or other real estate.

- Does not apply to the separately audited Medical Center or CEB financial statements since they have no endowments. However, if they do hold endowments in the future that are invested in land or real estate, Statement No. 52 will apply.
- Does not apply to the separately audited Health and Welfare Plan financial statements since they have no endowments.

GASB Statement No. 52 may be ordered from the GASB's website at www.gasb.org. There is no Implementation Guide from the GASB for this Statement.

Define Issues

The University and campus foundations must review the newly-required financial reporting and disclosure requirements contained in GASB Statement No. 52 to determine how they apply to the University's financial statements and the separate campus foundation financial statements.

Authoritative Guidance and Approach

The authoritative guidance for the University and campus foundation financial statements is presented below.

Application to Permanent and Term Endowments, and Quasi Endowments (FFE's)

Paragraph 2 in GASB Statement No. 52 states:

> This Statement establishes standards for accounting and financial reporting for land and other real estate held as investments by endowments. Endowments include permanent and term endowments, and permanent funds. This Statement does not apply to lands granted by the Federal government in connection with a state being admitted to the United States. It also does not apply to quasi-endowments. This Statement applies to all state and local governments.

It is clear that land or other real estate held by a permanent or term endowment should be recorded at fair value.

Paragraph 22 of GASB Statement No. 31 defines an investment as "a security or other asset acquired primarily for the purpose of obtaining income or profit." The University's approach is if land or other real estate is being held as a quasi-endowment, the purpose should be considered to determine if the land or other real estate should be recorded at fair value, if held for the purpose of obtaining income or profit, or historical cost, if used in operations.

Fair Value Reported as a Component of Unrealized Gain or Loss Each Year

Paragraph 4 in GASB Statement No. 52 states:

> Land and other real estate held as investments by endowments should be reported at fair value at the reporting date. Changes in fair value during the period should be reported as investment income.

The change in the fair value of land or other real estate will be included in unrealized gains or losses in the statement of revenues, expenses and changes in net assets.

Investments in real estate through publicly traded funds or partnerships have previously been reported at fair value based upon quoted market prices or valuations.

Valuation Determinations

Paragraph 18 in GASB Statement No. 52 states:

> ….The fair value of real estate investments often is determined by a periodic appraisal of the property by a certified real estate appraiser. In periods in which an appraisal is not obtained, governments should consider the extent to which changes in the real estate market may have affected the value of its properties since the last appraisal and adjust the reported fair value accordingly. Further, some entities use other methods to determine the fair value of an real estate – for example, an estimate of fair value based on the present value of expected future cash flows.

Paragraph 19 in GASB Statement No. 52 goes on to say:

> The Board notes that there are many factors that can be considered when estimating the fair value of land and other real estate, making the estimation of fair value dependent on the unique facts and circumstances of the specific land or other real estate. Therefore, the Board did not believe that a global methodology, or even alternative methodologies, for estimating the fair value of land and other real estate should be developed for the Statement. The Board notes that methods and significant assumptions should consider cost-benefit constraints.

The level of expertise and sophistication that should be considered in valuing land or other real estate at the end of each year should, in part, depend on the materiality of land or other real estate in the portfolio, including the effect of the change in value of land or other real estate on the change in net assets for the year. In the circumstance where land or other real estate is a relatively insignificant portion of the portfolio, or has been recently valued in conjunction with its acquisition, a review of the fair value by University real estate specialists may be sufficient. On the other hand, of land or other real estate becomes a more significant portion of the portfolio, more sophisticated techniques, including the use of an independent appraiser, should be considered.

Disclosures

Paragraph 20 in GASB Statement No. 52 states:

> This Statement amends the scope of Statement No. 31 to apply the disclosure provisions of paragraph 15 of that Statement to land and other real estate held as investments by endowments. Accordingly, endowments should disclose "the methods and assumptions used to estimate the fair value of investments, if that fair value is based on other than quoted market prices." These are the disclosure provisions that already apply to investments in real estate held by external investment pools. The Board believes that these disclosures are appropriate and sufficient.

Implementation

For the University

Although relatively small in comparison to the University's endowment portfolio, the University has historically recorded land and other real estate held as investments in endowments at fair value for the reasons the GASB articulated in Statement no. 52 in its *Basis for Conclusions*. The book value of land and other real estate at June 30, 2007 was $6.15 million and the market value was $13.03 million. The portion of the unrealized gains associated with land and other real estate was $1.26 million for the year ended June 30, 2007.

The University will disclose its early adoption of GASB Statement No. 52 in its June 30, 2008 financial statements with the following disclosure language (draft):

> "GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, was adopted during the year ended June 30, 2008. Statement No. 52 requires endowments to report land and other real estate investments at fair value. Since the University previously reported its endowment real estate investments at fair value, the implementation of GASB Statement No. 52 had no effect on the University's net assets or changes in net assets for the years ended June 30, 2008 and 2007."

The significant accounting policy disclosure will be amended, primarily to address the UCRP's direct investment in real estate, but covers this endowment issue as well, as follows (draft):

> "*Investments.* Investments are recorded at fair value. Securities, including derivative investments, are valued at the last sale price on the last business day of the fiscal year, as quoted on a recognized exchange or an industry standard pricing service, when available. Securities for which no sale was reported as of the close of the last business day of the fiscal year are valued at the quoted bid price of a dealer who regularly trades in the security being valued.
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> Investments include private equities, absolute return funds and real estate. Private equities include venture capital partnerships, buyout and international funds. Interests in private equity and real estate partnerships are based upon valuations provided by the general partners of the respective partnerships as of March 31, adjusted for cash receipts, cash disbursements and securities distributions through June 30. Investments in absolute return partnerships are valued as of May 31, adjusted for cash receipts and cash disbursements through June 30. Interests in certain direct investments in real estate are estimated based upon independent appraisals. The University believes the carrying amount of these financial instruments and real estate is a reasonable estimate of fair value at June 30. Because the private equity, real estate and absolute return partnerships, along with direct investments in real estate, are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ significantly from the value that would be used had a ready market for such investments existed.
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> Investments in registered investment companies are valued based upon the reported net asset value of those companies. Mortgage loans, held as investments, are valued on the basis of their future principal and interest payments discounted at prevailing interest rates for similar instruments. Insurance contracts are valued at contract value, plus reinvested interest, which approximates fair value. Estimates of the fair value of interests in

externally held irrevocable trusts where the University is the beneficiary of either the income or the remainder that will not become a permanent endowment upon distribution to the University are based upon the present value of the expected future income or, if available, the University's proportional interest in the fair value of the trust assets.

Investments denominated in foreign currencies are translated into U.S. dollar equivalents using year-end spot foreign currency exchange rates. Purchases and sales of investments and their related income are translated at the rate of exchange on the respective transaction dates. Realized and unrealized gains and losses resulting from foreign currency changes are included in the University's statement of revenues, expenses and changes in net assets.

Investment transactions are recorded on the date the securities are purchased or sold (trade date). Realized gains or losses are recorded as the difference between the proceeds from the sale and the average cost of the investment sold. Dividend income is recorded on the ex-dividend date and interest income is accrued as earned. Gifts of securities are recorded based on fair value at date of donation."

For the Campus Foundations

Each campus foundation will need to determine whether they have land or other real estate investments that a) fall under the criteria in Statement No. 52, and if so, b) whether it has previously been recorded at historical cost or fair value.

If land and other real estate were previously recorded at fair value, the University's approach and disclosure could potentially be utilized, depending on the materiality.

If land and other real estate was previously recorded at historical cost, and the difference between historical cost and fair value ***is not*** material to the statement of net assets or statement of revenues, expenses and changes in net assets, then it may be possible to implement the requirements of Statement No. 52 for the year ended June 30, 2008 without restating 2007.

If land and other real estate was previously recorded at historical cost, and the difference between historical cost and fair value ***is*** material to the statement of net assets or statement of revenues, expenses and changes in net assets, then the prior year must be restated as outlined in Statement No. 52. In this case a decision must be made whether to implement the change in the 2008-2009 year, or early implement in the 2007-2008 year.

Next Steps—Required Actions

Responsibility	Required Completion Date	Action Item/Task
Foundations	Mar-08	Evaluate their situation and approach for June 2008.
UCOP	Jun-08	Early adopt Statement No. 52 for UC.