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Report on Classification of Net Assets
by Community Foundations

EXECUTIVE SUMMARY

The purpose of this paper is to assist community foundations with implementation of accounting standards, specifically the reporting and classification of net assets.

RECOMMENDED GENERAL PRACTICE

When determining the classification of net assets, the following should be taken into consideration:

1. The longstanding taxonomy used by community foundations to classify funds as unrestricted, restricted, designated and advised should have no bearing on accounting decisions to classify net assets using FASB's classifications of unrestricted, temporarily restricted or permanently restricted.

2. As a general rule, unless there is a compelling reason to do otherwise based on donor intent, community foundations should classify all net assets as unrestricted (FASB classifications). However, there are exceptions:

    a. Funds subject to time restrictions should be classified as temporarily restricted.

    b. Funds should be only be classified as permanently restricted when both of the following conditions are met:

        i. The donor does not allow principal invasions in the gift instrument.

        ii. The governing documents of the community foundation do not provide for the invasion of corpus.

3. The variance power addresses restrictions due to purpose. Funds of a community foundation having the variance power should generally be classified as unrestricted (FASB classifications).

4. Community foundations having the variance power should be able to classify all designated funds as net assets, provided proper disclosure and documentation exists.

5. The power to invade principal addresses restrictions due to spendability. If a foundation has the power to invade principal then its funds should be classified as unrestricted unless there is a compelling reason based on donor intent, governing documents, or state law to do otherwise.

6. Advised funds, considered unrestricted funds in community foundation taxonomy, should be considered unrestricted in FASB classifications unless they are subject to donor imposed spendability restrictions.

ADDITIONAL COMMENTARY

1. This summary was jointly prepared by the FASB Committee of the Fiscal and Administrative Officers Group and the Legal Advisory Subcommittee of the Committee on Community Foundations.

2. Due to the uniqueness of the governing instruments of many community foundations, exceptions to generally recommended practice are possible and are not covered in this executive summary. Where such exceptions are thought to exist, the community foundation should consult with legal counsel, independent auditors, and other advisors to ascertain how FASB Statements No. 116 and 117 apply.

3. The Committee on Community Foundations will need to continue to monitor the practices of the community foundation field as well as discussions of interpretation and administration of FASB Statements No. 116 and 117 by various regulatory and accounting bodies. Because action by the latter could take place at any time, the FASB Committee and the Legal Advisory Subcommittee recommend that the Committee on Community Foundations reinstate the FASB Task Force for this very purpose.

September 4, 1997

INTRODUCTION AND BACKGROUND

In June 1993, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 116, Accounting for Contributions Received and Contributions Made, (FASB Statement No. 116) and Statement of Financial Accounting Standards No. 117, Financial Statements of Not-for-Profit Organizations, (FASB Statement No. 117). These statements involved profound changes in the financial accounting and reporting required of community foundations. Among other matters, the two FASB standards included the following requirements that were at variance, in whole or in part, with financial accounting and reporting practices previously followed by community foundations.

- The net assets or equity of community foundations were to be classified based on the presence or absence of donor-imposed stipulations into three categories-permanently restricted, temporarily restricted, and unrestricted.

- Receivables and contribution revenue were to be recognized at their fair value upon the receipt of a donor's unconditional promise to give, supported by verifiable evidence.

- Grants payable and expenses were to be recognized based on unconditional promises, supported by verifiable evidence, made by community foundations. Generally, such payables and expenses would be recognized upon Board approval of a grant.

- A complete set of financial statements was to include:

  - a statement of financial position
  - a statement of activities and
  - a statement of cash flows

To deal with such changes and offer guidance to community foundations, the Fiscal and Administrative Officers Group (FAOG) and the Committee on Community Foundations of the Council on Foundations Finance and Administrative Subcommittee formed a FASB Task Force in the fall of 1993.

The goals of the FASB Task Force were to:

- Encourage consistency in the application of the new standards

- Minimize duplicate efforts by individual community foundations

- Give community foundations a stronger voice in the decisions of the FASB and the American Institute of Certified Public Accountants (the AICPA)

- Provide implementation guidance for the two standards

In October 1994, the FASB Task Force issued an Exposure Draft of Issues Papers Related to Accounting for Contributions Received and Contributions Made and Financial Statements of Not-for-Profit Organizations (the Exposure Draft). The Exposure Draft included chapters addressing four broad topics, namely:

- Contributions received (including classification of net assets)
- Contributions made
- Accounting for investment related income
- Financial statement display

During the same time period, the Not-for-Profit Organizations Committee of the AICPA was developing and had exposed for comment a revised Accounting and Auditing Guide (the AICPA Audit Guide) covering all private not-for-profit organizations. Considering the tentative conclusions included in the proposed AICPA Audit Guide and meetings with the AICPA Not-for-Profit Organizations Committee, it became apparent late in 1994 that the major immediate issue arising from the FASB Statements for community foundations was the "agency issue". The "agency issue" was the term used to describe an issue arising from paragraph 4 of FASB Statement No. 116. That paragraph states in part:

> "This Statement does not apply to transfers of assets which the reporting entity acts as an agent, trustee, or intermediary, rather than as a donor or donee."

In paragraphs 52-54, FASB Statement No. 116 went on to indicate that the determination of whether a transfer of resources was an agency transaction or a contribution depended on the amount of discretion exercised by the entity receiving the resources.

Certain members of the AICPA Not-for-Profit Organizations Committee and others argued that community foundations did not exercise any substantial discretion over gifts establishing "designated" funds and thus such transfers should not be recognized as contributions by community foundations. Others, including the FASB Task Force, argued that the variance power, among other things, gave community foundations the power to exercise substantial discretion over such designated funds. In May of 1995, the FASB Task Force and the Committee on Community Foundations formally asked the FASB to interpret paragraph 4 of Statement No. 116 to address this issue. In September of 1996, FASB issued FASB Interpretation No. 42, Accounting for Transfers of Assets in Which a Not-for-Profit Organization is Granted Variance Power. That interpretation, which was effective for fiscal years ending after September 15, 1996 indicated:

> "A recipient organization that is directed by a resource provider to distribute the transferred assets, income from those assets, or both to a specified third-party beneficiary acts as a donee and a donor, rather than an agent, trustee, or intermediary if the resource provider explicitly grants the recipient organization the unilateral power to redirect the use of the transferred assets to another beneficiary."

Although FASB Interpretation No. 42 satisfactorily resolved the "agency issue", other issues arising from the implementation of the new FASB standards began to emerge.

During fiscal years ending on or after December 31, 1995, most community foundations issued financial statements prepared in accordance with the provisions of the FASB Statements No. 116 and No. 117. In the course of preparing those statements, financial officers of community foundations and their outside auditors became aware of certain common implementation issues. After a number of community foundations issued their first financial statements prepared in accordance with FASB Statements No. 116 and No. 117, it became apparent that entities were reaching different interpretations in applying certain provisions of those statements. Moreover, as all these community foundations received unqualified (clean) opinions from their outside auditors, it was clear that auditing firms (including the Big Six) held differing views on how the new FASB Statements should be applied to community foundations. To address those inconsistencies, FAOG undertook this project to:

- Ascertain, in a more formal way, how community foundations were implementing FASB Statements No. 116 and No. 117, and

- Offer recommendations to resolve any inconsistent practices.

FAOG appointed a FASB Committee consisting of seven financial and administrative officers of community foundations. The Council on Foundations retained one of the Big Six public accounting firms, KPMG Peat Marwick, to serve as consultant to the project. As a first step in that project, a survey instrument was prepared whose aim was to identify:

- Issues encountered in complying with the new accounting standards

- Inconsistencies in practice, and

- Best practices

As part of the survey, community foundations were also asked to forward their latest financial statements.

The survey instrument consisted of 30 questions that focused on four areas. The first area, General Information, questions 1 - 7, focused on the responding community foundation's size, its method of accounting and the time it needed to implement the new standards. This section also addressed the nature of the auditor's opinion.

The second section, Governance and Classification of Net Assets, questions 8 - 16, focused on the legal structure and governing instrument of the responding community foundations. Topics addressed included:

- Trust vs. Corporate form

- Source of power, if any, to invade original principal/corpus
- Nature of variance power
- State law addressing treatment of net appreciation of investments
- Nature of a spending rate, if any

This section included two matrices (trust form and corporate form) asking respondents to show how they classified net assets in the three categories required by the new FASB standards. One side of each matrix illustrated how community foundations' traditional types of funds - i.e., unrestricted, designated, donor-advised, and field of interest - were classified using the FASB net asset categories while the other side of the matrix illustrated how sources of funds, - i.e., corpus (original gift), interest and dividends, and gains and losses -- were classified under the FASB methodology.

The third section, Grants, questions 17-22, focused on the existence and valuation of grants payable at year-end and policies adopted to record such grants.

The final section, Contributions, questions 23-30, focused on three topics, namely:

- Existence and valuation of contributions receivable at year-end
- Accounting and reporting of irrevocable split interest agreements
- Existence of and accounting for organizational endowment funds

The following tables summarize the characteristics of the community foundations who responded to the survey.

Size (in millions)	
0-25	23
25-50	10
50-100	8
100-500	13
500-1,000	1
over 1,000	2
	57

Organizations	
Corporate	37
Trust	6
Both Corporate & Trust	11
D/N/A*	3
	57

Power to Invade Principal/Corpus	
Yes	33
No	19
D/N/A*	5
	57

Variance Power	
No variance power	6
Power by reference	16
Included in gift instrument	31
D/N/A*	4
	57

Power to Invade Realized Gains	
Yes	27
No	24
D/N/A*	6
	57
	==

Utilization of Spending Rate	
Yes	39
No	14
D/N/A*	4
	57
	==

*D/N/A -- Respondent did not answer the survey question.

There are certain conclusions that can be drawn from the above responses. First, the size and overall form of organization of the responding entities seem to be representative of the overall population of community foundations. Second, the answers suggest that respondents may have misunderstood certain questions. For example, certain entities were unclear as to the extent of their variance power. Third, there was also an apparent inconsistency in the number of respondents indicating they have spending rates and the lower number who indicated they have power to invade realized gains and/or corpus. For community foundations in corporate form to have a spending rate, they need to have the power to spend net appreciation of investments based either on law [i.e., the Uniform Management of Institutional Funds Act (UMIFA)] or the power to invade principal. For community foundations in trust form to have a spending rate, they must have the power to invade principal.

The following tables summarize the results of the survey with respect to the classification of source of funds into the FASB categories of net assets.

<u>Corpus</u>

All unrestricted	18
All temporarily restricted	4
All permanently restricted	11
Mixed classification	17
D/N/A*	7
	57
	==

<u>Dividends and Interest</u>

All unrestricted	23
All temporarily restricted	4
Mixed classification	23
D/N/A*	7
	57
	==

<u>Gains and Losses</u>

All unrestricted	24
All temporarily restricted	5
All permanently restricted	2
Mixed classification	19
D/N/A*	7
	57
	==

*D/N/A -- Respondent did not answer the survey question.

Certain conclusions can be drawn from the above data. Some differences noted in classification may relate to factual differences (i.e., state law, nature of governing and/or gift instrument) between community foundations. The extent of the differences, however, does suggest that individual entities may be interpreting the FASB standards differently. Considering the extent of these differences, the FASB Committee decided to focus its efforts on identifying the nature of differences in interpretations that led to the different classification of net assets noted above. To accomplish this, the committee undertook a detailed analysis of the financial statements respondents had submitted.

As part of that analysis, Committee members reviewed all 57 financial statements received, compared the financial statements to the survey responses for inconsistencies, and in certain cases, communicated directly with respondents. Most inconsistencies were noted in the classification of net assets. Detailed analysis identified four major issues affecting the classification -- (1) variance power, (2) power to invade, (3) spending rates, (4) advised funds.

The nature of the differing interpretations and the resulting issues considered are detailed in the next section of this paper. The Committee discusses the background and substance of each issue and recommends treatment.

MAJOR ISSUES

Variance Power:

Background

Frederick Goff designed and developed the community foundation concept. Goff was an attorney and bank president who had seen posthumous gifts for charitable purposes often held in the grip of the "Dead Hand". He saw charitable trusts that were not of much benefit to the community because of changes in circumstances from when their original purpose was designed. While a trustee may petition the courts for relief under the cy pres statute, the process may be costly and time consuming. Besides, the statute is very narrow and did not provide the relief Goff believed served donors best. New York state law defines cy pres:

> "...whenever it appears to such court that circumstance have so changed since the execution of an instrument making a disposition for religious, charitable, educational or benevolent purposes as to render impracticable or impossible a literal compliance with the terms of such disposition…" NYSEPTL Sec. 8-1.1©

Goff developed the variance power and incorporated it into his "community foundation concept". The wording in the original 1914 "Resolution Creating the Cleveland Foundation" stated

> "...the Trustee shall respect and be governed by the wishes as so expressed, but only in so far as the purposes indicated shall seem to the Trustees,… wise and most widely beneficial, absolute discretion being vested in ...the Board of Directors...".

Community foundations have a description of the variance power in their Resolution and Declaration of Trust and/or Corporate By-laws. Often the wording is similar to that stated in the Treasury Regulations. Treasury Regulation Section 1.170A-9(e)(11)(v)(B) states:

> "…the governing body must have the power …To modify any restriction or condition on the distribution of funds for any specified charitable purposes or to specified organization if in the sole judgment of the governing body (without the necessity of the approval of any participating trustee, custodian, or agent), such restriction or condition becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served."

Community foundations were designed to be flexible, to provide for donors a vehicle to ensure their charitable interests were served in perpetuity. The variance power is intrinsic to a community foundation.

The AICPA initially concluded that community foundations were acting as agents in the case of designated funds. This meant that community foundations would show designated funds as liabilities, not net assets; designated grantees would show them as "assets held in trust by others". The FASB Task Force argued that the variance power gave community foundations discretion over these funds, and while they would do their utmost to honor the donor's wishes, they could redirect the income. FASB agreed and issued Interpretation No. 42, Accounting for Transfers of Assets in Which a Not-for-Profit Organization is Granted Variance Power. FASB stated that the variance power was not conditional in the Basis for Conclusions, paragraphs 14-15.

Survey Findings

Certain foundations did not consider the effect of the variance power in classifying certain expendable funds, such as interest and dividends in designated and field-of-interest funds. Others dismissed the effect stating the variance power was given by donors to the community foundations to help fulfill the donor's original intentions and when that becomes incapable of fulfillment then the variance power is to be exercised to keep the gift from becoming obsolete or meaningless. It is the opinion of these community foundations that the financial statements should be presented as though the donor's intentions (restrictions) are the primary basis for the classification of net assets. As a result, they classified such funds as temporarily restricted.

Other community foundations gave effect to the variance power in classifying expendable funds and classified all such funds as unrestricted. Finally, certain foundations believed that variance power applies to both purpose restrictions and spendability and accordingly classified everything as unrestricted.

Recommendations

The Committee suggests that due to the variance power, expendable funds should be classified as unrestricted.

In order for net assets to be classified as temporarily restricted, FASB No. 116 requires that the gift have a donor-imposed restriction that is "satisfied either by the passage of time or the actions of the organization". Designated and field of interest funds appear to have donor restrictions as to purpose. However, the decision to respect the donor's wishes and not exercise the variance power rests solely with the governing board of a community foundation. The donor recognizes this discretion by granting the variance power and through the use of precatory language in the gift instrument. Phrases such as "I desire" or "I wish" are most often used. Going back to Mr. Goff, the reason a donor establishes a fund at a community foundation is to empower representatives from the community to easily change the charitable purpose if "such restriction or condition becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served."

The definition of a donor-imposed restriction given in both FASB No. 116 and 117 is shown below:

> A donor stipulation that specifies a use for the contributed asset that is more specific than broad limits resulting from the nature of the organization, the environment in which it operates, and the purposes specified in its articles of incorporation or comparable documents for an unincorporated association. A restriction on an organization's use of the asset contributed may be temporary or permanent.

The Committee concluded that this type of discretion granted to the board of a community foundation through the variance power is inconsistent with the definition of a donor-imposed restriction.

Power to Invade:

Background

Community foundations are given the power to invade either through state law or their governing documents. For community foundations in trust form, this power is often described in their Resolution and Declaration of Trust as the "appropriation of corpus". Community foundations in corporate form usually assume this power from state law if their state has adopted UMIFA. That is, if one defines principal as the historic gift plus realized and unrealized gains, UMIFA permits invasion to spend some portion of the investment gains. For community foundations in trust form, this "appropriation of corpus" may be limited to a certain percentage over a specified time period, such as 2% a year or 20% over five years.

The impact of this power to invade or appropriate on the classification of net assets will depend on whether or not the community foundation's governing body may change the percentage as well as state law. Most community foundations in trust form have this power. In fact, they must have this power to implement a spending policy unless their variance power or state law allows them to classify investment gains as income.

Through the survey and discussions with the legal subcommittee of the Committee on Community Foundations, the FASB Committee determined that for most community foundations, the variance power does not allow them to invade principal; however, some community foundations have defined variance power so broadly in their governing documents, that it does give them the power to invade.

Survey Findings

Most community foundations concluded that the power (including the right to change the percentage of invasion) should require that all trust principal be classified as unrestricted. Some community foundations treated this power as a time restriction and accordingly classified all principal as temporarily restricted. One community foundation reflected as a transfer from permanently restricted to temporarily restricted the percentage of net assets subject to the power to invade. It based this accounting on its adoption of a spending rate. Other community foundations were silent as to whether they have this power and its effect on net assets.

Recommendations

The Committee suggests that net assets subject to the power to invade should be classified either as temporarily restricted or unrestricted net assets. If a community foundation cannot change the percentage it may appropriate, the net assets should be classified as temporarily restricted due to a time restriction. (It will take hundreds of years and no investment gains to essentially spend out a fund at 2% a year.) This presumes there is no state law that requires a certain amount of corpus never be spent. If the governing body or trustees may change the percentage, even if the possibility that they would ever change it to 100% is remote, the net assets should be classified as unrestricted.

Spending Rate:

Background

Historically for all charitable funds, investment income was defined as interest and dividends. However, after charitable assets invested in fixed income securities were eroded by high periods of inflation, there was a push to redefine investment income. Many states have adopted some form of UMIFA that changed the definition of investment income for corporate entities to include all investment gains. The definition of investment income for trusts has been slower to change, but has in some states.

In order to adopt a spending rate, a community foundation must define investment income to include realized and unrealized gains and losses. A community foundation may be able to define investment income this way through state law (UMIFA), its governing instruments (power to invade or variance power), or the instrument of gift itself.

Survey Findings

Most community foundations treated any net appreciation that can be spent as either unrestricted or temporarily restricted. Certain community foundations classified net appreciation on investments as permanently restricted net assets and report realized gains spent under a spending rate as a reclassification from permanently restricted to either temporarily restricted or unrestricted

Recommendations

The Committee suggests that if a community foundation has adopted a spending policy, then it has defined investment income as interest, dividends, realized and unrealized gains. This investment income should be classified as unrestricted, or as temporarily restricted if there are time restrictions or such classification is required by state law.

Advised Funds:

Background

Community foundations offer donors a choice of funds to help them accomplish their charitable objectives. Over the past several years, many donors have established advised funds. The IRS training manual offers the following definition:

> "Fund(s) where the donor or his/her designate retains the privilege to suggest the charity or community project to receive the fund's income. The suggestions are not binding on the community foundation, which retains final authority to determine the use of such income."

The language used in an advised fund agreement is usually the same as an unrestricted or field-of-interest fund with an additional paragraph. While there are some variations, the wording is similar.

> "An advisory Committee consisting of ________ and _______ may from time to time make suggestions to the (community foundation) concerning grants ... Such suggestions may be accepted or rejected, in whole or in part, by the (community foundation) in its sole and absolute discretion."

Survey Findings

Most foundations classified donor-advised funds as unrestricted. Fourteen community foundations classified dividends and interest in these funds as temporarily restricted. One entity said that its basis for this treatment was they were awaiting "direction" from the donor to spend. The reasons others adopted this treatment were unclear.

Recommendations

The Committee suggests that all donor advised funds should be classified as unrestricted. Community foundations have an obligation to identify specific charitable needs most deserving of support in the community. One of the ways to accomplish this is to educate donors. As a result, many community foundations segregate advised funds from other unrestricted funds for grant making purposes. The governing body of a community foundation will often decide to make grants from these funds by working with the advisors. This restriction is imposed by the board and not the donor, so the net assets are not restricted as to purpose.

CONCLUSIONS

When the FASB committee began assessing the impact of the new accounting standards on community foundations, they were first confronted with the possibility that community foundations were acting as agents and had no net assets. The last few years have been spent trying to educate the accounting profession about community foundations. The accounting profession has been convinced that community foundations are not agents as evidenced by FASB Interpretation No. 42.

The classification of net assets for community foundations is discussed below. The important factors to take into consideration when determining the classification of net assets are the foundation's governing documents, the gift instrument and state law.

Net Assets Classified as Permanently Restricted

Net assets should be classified as permanently restricted only when both of the following conditions are met.

1. The donor does not allow principal invasions in the gift instrument.
2. The governing documents of the community foundation do not provide for the invasion of corpus.

With respect to gains that are defined as income under UMIFA or a community foundation's governing documents and therefore spendable, such items should not be classified as permanently restricted, but rather as unrestricted or temporarily restricted. Accounting for gains spent or gains available for spending as transfers from permanently restricted net assets is inconsistent with FASB Statement No. 116's definition of permanently restricted.

Net Assets Classified as Temporarily Restricted

Due to the variance power, the net assets of a community foundation generally are not subject to purpose restrictions. However, they may be subject to time restrictions and, if so restricted, should be classified as temporarily restricted. The most common type of gifts with time restrictions are contributions receivable and various types of split interest arrangements. Another example is when a community foundation cannot change the percentage of corpus it may invade, the net assets should be classified as temporarily restricted.

Net Assets Classified as Unrestricted

The FASB Committee has concluded that most of the time, community foundations should classify all net assets as unrestricted. The Committee recognizes that many community foundations are troubled at showing all net assets as unrestricted since they are supposed to provide a permanent endowment for the community based on the interests of donors in that community. However, such concerns may be met by appropriately labeling the components of unrestricted net assets, a practice permitted under FASB Statement No. 117. The two most frequently used labeling conventions are by 1) fund type - field-of-interest, donor advised, etc. or 2) available for grants, available for administration, and endowment.

Donors give to community foundations knowing their wishes will be respected, but they also rely on the community foundation to keep their gift from becoming obsolete or meaningless. To do this, they give community foundations complete discretion over their gifts in order to continue to have a maximum impact on their community.

APPENDIX

Below are the fund classifications used by community foundations and how they relate to the three classifications of net assets defined in FASB Statements No. 116 and 117.

Unrestricted Funds - Income is classified as unrestricted. Investment gains for a community foundation in corporate form in a UMIFA state will also be unrestricted. Gains and/or the original gift may be classified as permanently or temporarily restricted dependent upon the instrument of gift, governing documents and state laws.

Advised Funds - These are the same as unrestricted funds. We are defining these funds as those whereby a community foundation may accept non-binding suggestions from advisors. The governing body of a community foundation may well decide to distribute these funds based only on suggestions received in an effort to enhance and promote philanthropy in the community.

Field-of-Interest Funds - Income is unrestricted as distributions are subject to the variance power. Gains and original gift will be classified the same as unrestricted funds.

Designated Funds - Same as field-of-interest funds.

FASB Revises Statement No. 132 to Include Certain Additional Disclosures about Pensions and Other Postretirement Benefits

Introduction

In response to growing criticism of the existing standards governing the accounting and financial reporting of pension and other postretirement benefit plans, the Financial Accounting Standards Board (FASB) in March 2003 added a project to its agenda to reconsider the disclosures required for such plans by FASB Statement No. 132, *Employers' Disclosures about Pensions and Other Postretirement Plans.* This article focuses on the provisions of the final standard, which FASB issued in December 2003 and has designated as FASB Statement No. 132 (Revised 2003). The complete document is available on their website at www.fasb.org.

FASB Statement No. 132 (Revised 2003) (hereinafter the revised statement) will affect any community foundation that has a defined benefit pension plan and/or a plan(s) that provides other types of postretirement benefits (e.g., health care). The majority of community foundations provide pension benefits solely through defined contribution plans rather than defined benefit plans, and the revised statement does not change the disclosures required for defined contribution plans. As a result, the provisions of the revised statement dealing with defined benefit pension plan information should affect only a small number of community foundations. However, certain community foundations provide health care and other postretirement benefits to their retirees. The revised statement will affect those entities.

To assist FAOG members in understanding how the revised statement may affect their particular community foundation, this article first reviews the substance of the revised statement, focusing on:

- Disclosures added by the revised statement
- Important continuing Statement 132 disclosures
- Effective dates
- Illustrative disclosures

In its concluding section, the article addresses steps affected community foundations can take to prepare to implement the new requited disclosures.

I. Disclosures added by the revised statement

The revised statement adds disclosures in four areas, namely:

- Plan Assets
- Obligations
- Other Information
- Interim period disclosures

Inasmuch as very few, if any, community foundations issue interim reports, this article will not discuss the additional disclosures required in this last area.

Plan Assets

The revised statement requires the following plan asset disclosures:

- the percentage of total plan assets for each major category of plan assets (the specified categories include equity securities, debt securities, real estate, and all other assets)
- a description of the investment strategies and policies employed including target percentages if they are used, and other pertinent factors such as investment goals, risk management practices, allowable and prohibited investment types, including the use of derivatives, diversification, and the relationship between plan assets and benefit obligations
- a description of the basis used to determine the overall expected long-term rate of return on assets assumption.

Obligations

The revised statement requires disclosure of the accumulated benefit obligation for all defined benefit plans. The accumulated benefit obligation represents the actuarial present value of pension benefits earned to date based on employee service and compensation to date. FASB Statement No. 132 currently only requires disclosure of the accumulated benefit obligation for those plans where it exceeds plan assets. The revised statement also requires disclosure of the estimated future benefit payments as of the balance sheet date for each of the five succeeding years, and in the aggregate for the next five years (i.e., years 6-10). In calculating these estimated benefit payments, organizations must use the same assumptions they use to measure the benefit obligations and include estimated future employee service. Finally, the revised statement also requires disclosure of the best estimate, as soon as it is reasonably estimable, of the employer's aggregate expected contribution for the next fiscal year after the balance sheet date.

Other Information

The revised statement sharpens and clarifies the disclosure required by FASB Statement No. 132 about the assumptions used to measure benefit obligations and the net benefit cost or income for the period by requiring use of one table that identifies the assumptions (i.e., assumed discount rates, expected long-term rates of return on assets, and rates of compensation increase) used to determine the benefit obligation and another table for assumptions used to determine net periodic cost. The revised statement also requires disclosure of the measurement date(s) used in benefit measurements that comprise the majority of plan assets and benefit obligations.

II. Important continuing Statement 132 disclosures

The revised statement incorporates all of the disclosure requirements of the original FASB Statement No. 132. While all the additional disclosures discussed in the previous section of this article apply to all entities, "non-public" entities are still exempt from certain of the continuing Statement 132 disclosures. Most, if not all community foundations are considered non-public entities for pension and other postretirement benefits accounting and disclosures.

As was the case with the original FASB Statement 132, the revised statement continues to permit non-public entities to omit (1) the reconciliation of the beginning and ending balances of the fair value of plan assets and benefit obligations, (2) the reconciliation of the funded status of the plan to amounts recognized in financial statements and (3) the disclosure of the impact of a one percent increase or decrease in the health care trend rate used to measure that postretirement benefit obligation.

III. Effective dates

Statement No. 132 remains in effect until the revised statement is adopted. The revised statement is effective for public entities for fiscal years ending after December 15, 2003. The effective date for disclosure of information about (1) foreign plans and (2) estimated future benefit payments is deferred until fiscal years ending after June 15, 2004. Nonpublic entities are not required to adopt the new disclosures required by the revised statement until fiscal years ending after June 15, 2004.

The delayed effective date for nonpublic entities will mean that community foundations with fiscal years ending June 30, 2004 will be required to adopt the revised statement prior to community foundations with fiscal years ending December 31, 2003. When adopting the revised statement, community foundations will be required to make all the new disclosures required by the revised statement and restate the disclosures for earlier annual periods presented for comparative purposes for the percentages of each major category of plan assets held, the accumulated benefit obligation, and the assumptions used in accounting for the plans. However, if obtaining this information relating to earlier periods is not practicable, the notes to the financial statements shall include all available information and identify the information not available. All other disclosures should only be presented as of the date of the most recent balance sheet.

IV. Illustrative Disclosures

Appendix C of the revised statement includes three illustrations of the disclosures required by the revised statement. FAOG members should find Illustration 1, Disclosures about Pension and Other Postretirement Plans in the Annual Financial Statements of a Publicly Traded Entity, the most helpful. This illustration relates to annual financial statements while the other two illustrations relate to the interim period disclosures required by the revised statement. Illustration 1 is also quite comprehensive and includes the disclosures required for both pension and other postretirement plans. The illustration also identifies quite clearly the disclosures that non-public entities are not required to make. The illustration, however, does not include the narrative descriptions of (1) the basis used to determine the overall long-term rate-of-return-on-assets assumption and (2) investment policies and strategies as those narrative descriptions are meant to be entity specific.

Conclusion

FASB concluded that the costs to implement the revised statement should be modest. They based that conclusion on their belief that “many, if not most, of the new disclosures represent either disaggregation of information already disclosed, such as the fair value of plan assets, or information already used in the determination of disclosed amounts.”

Given the effective date of the revised statement, accounting, finance, and human resource officials at community foundations should immediately ascertain how the revised statement will affect them and identify any potential problems in implementing the additional disclosure requirements set forth in the revised statement. Those tasks will involve identifying pension and other postretirement benefit plans for which disclosures will change and identifying new or additional information that is required. Accounting personnel should work with the foundation's human resources or benefits personnel, those responsible for the plan's investments, such as external investment trustees and portfolio managers, and outside actuaries and independent auditors to determine how (and at what cost) the additional information required by the revised statement can be obtained and audited.

May 7, 2004

Accounting Practices Committee:

Mary Wilson, Chair	The Pittsburgh Foundation
Ray Biddiscombe	Columbus Foundation
Carol Crenshaw	The Chicago Community Trust
Leslie Griffith	Oklahoma City Community Foundation, Inc
Kathy Hebert	The Greater New Orleans Foundation
Mandy Hess	Greater Milwaukee Foundation
Jonnie Jenkins	Wyoming Community Foundation
Carroll Lavalleur	Lincoln Community Foundation, Inc
Susan Nicholson	The Community Foundation of Louisville, Inc.
Pat Quick	Stark Community Foundation
Juan J. Reyes	Puerto Rico Community Foundation
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Applying Embedded Derivatives: Application of Statement 133 to a Not-for Profit Organization's Obligation Arising from an Irrevocable Split Interest Agreement* to *Community Foundations

Executive Summary

In April 2002 the Derivatives Implementation Group of the Financial Accounting Standards Board (FASB) issued *Statement 133 Implementation Issue No. B35 Embedded Derivatives: Application of Statement 133 to a Not-for Profit Organization's Obligation Arising from an Irrevocable Split Interest Agreement* (Issue B35).

The purpose of this paper is to explain where and when an additional calculation is needed to properly record the liability associated with certain split interest agreements. This guidance applies only if the charity is trustee or has control of the assets and applies only to the following types of agreements, all which have a term certain:

- A Charitable Remainder Unitrusts for a fixed term of years with a variable payment
- A Charitable Remainder Unitrust for the greater of a fixed term or lives with a variable payment
- A Charitable Lead Annuity Trust or a Charitable Lead Unitrust for a fixed term of years with **either** a fixed or a variable payment
- A Charitable Lead Annuity Trust or a Charitable Lead Unitrust for a fixed term of years or lives, whichever is longer, but only if the last measuring life dies before the fixed term is up

The guidance in this implementation issue is effective for fiscal years beginning after June 15, 2002. As is always the case, a foundation should consider materiality and discuss the impact of this statement with their audit firm before implementation. The Accounting Practices Committee believes this advice is particularly important in this case since Issue B35 is very complex and may apply to only a few split interest agreements.

Prepared by the Accounting Practices Committee of the Community Foundation's Fiscal and Administrative Officers Group

December 31, 2002

Applying Embedded Derivatives: Application of Statement 133 to a Not-for Profit Organization's Obligation Arising from an Irrevocable Split Interest Agreement* to *Community Foundations

In April 2002 the Derivatives Implementation Group of the Financial Accounting Standards Board (FASB) issued *Statement 133 Implementation Issue No. B35 Embedded Derivatives: Application of Statement 133 to a Not-for Profit Organization's Obligation Arising from an Irrevocable Split Interest Agreement* (Issue B35). It addresses the question "when does a not-for-profit (NFP) organization's obligation arising from an irrevocable split-interest agreement contain an embedded derivative agreement that should be bifurcated and accounted for as a derivative instrument pursuant to the requirements of paragraph 12 in [FASB] Statement 133?" The effect of recognizing such a derivative is to ensure that the liability associated with certain split interest agreements is measured at fair value under generally accepted accounting principles (GAAP).

The guidance in the implementation issue is effective for fiscal years beginning after June 15, 2002. As is always the case, a foundation should consider materiality and discuss the impact of this statement with its audit firm before implementation. We believe this advice is particularly important in this case since, as discussed below, Issue B35 is complex and may apply to only a few split interest agreements.

The purpose of this paper is to summarize the guidance in Issue B35 and provide assistance to Community Foundations in implementing Issue B35. Financial officers who believe the guidance may affect their foundation, may wish to read the guidance in its entirety.

What is a split-interest agreement?
The AICPA Not-for-Profit Audit and Accounting Guide (the AICPA Audit Guide) defines a split interest agreement as a trust or other arrangement initiated by donors under which NFP organizations receive benefits that are shared with either the donor or third party beneficiaries. These gifts include lead interests such as a charitable lead trust as well as remainder interests such as a charitable remainder trust, gift annuity or gift annuity trust.

A typical split-interest agreement has two components: A lead interest and a remainder interest. The lead interest is the right to cash flows during the term of the agreement which usually starts upon the signing of the agreement and terminates either (1) after a specified number of years (period certain) or (2) upon the death of the donor or the death of the lead interest beneficiary (life-contingent). The remainder interest is the right to receive all or a portion of the assets remaining at the end of the agreement's term.

Does this implementation issue apply to all split interest agreements?
No, Issue B35 applies only to those split interest agreements with a term certain. FASB Statement 133 exempts life insurance contracts and other agreements under which benefits are payable only as the result of an identifiable insurable event (death of the insured). That exemption also covers contracts where the obligation is solely life-contingent (that is, it ceases or

arises based solely on the death of an identified individual). Accordingly, Issue B35 does not apply to split interest agreements with life contingencies (i.e., agreements where payment to beneficiaries, other than the foundation, of the lead interest ceases or payment of the remainder interest is triggered based on the death of an individual named in the agreement, generally the donor). As a result, this guidance applies only to the following types of agreements:

- A Charitable Remainder Unitrust for a fixed term of years with a variable payment
- A Charitable Remainder Unitrust for the greater of a fixed term or lives with a variable payment
- A Charitable Lead Annuity Trust or a Charitable Lead Unitrust for a fixed term of years with **either** a fixed or a variable payment
- A Charitable Lead Annuity Trust or a Charitable Lead Unitrust for a fixed term of years or lives, whichever is longer, but only if the last measuring life dies before the fixed term is up

Also, the guidance applies **only** if the charity is trustee or has control of the assets.

What is an embedded derivative?
Paragraph 6 of FASB Statement 133 defines a derivative instrument as a financial instrument or other contract with all three of the following characteristics:

(a) It has one or more **underlyings** and one or more **notional amounts**. Those terms determine the amount for which a derivative is settled. An underlying is a variable such as a specified security price or interest rate. A notional amount is the number of units (e.g., shares, currency units) specified in a contract.

(b) It requires no initial net investment or an initial net investment that is smaller than would be required for similar types of contracts.

(c) Its terms require or permit net settlement or other methods of settlement that put the recipient in a position not substantially different than net settlement.

Paragraph 12 of FASB Statement 133 indicates that contracts that do not in their entirety meet the above definition of a derivative (e.g., bonds, insurance policies, and leases) may contain "embedded" derivative instruments – *"implicit or explicit terms that can affect some or all of the cash flows or the value of the exchanges required by the contract in a manner similar to a derivative instrument. The effect of embedding a derivative instrument in another type of contract (the host contract) is that some or all of the cash flows or other exchanges that otherwise would be required by the host contract, whether unconditional or contingent upon the occurrence of a specified event, will be modified based on one or more underlying".*

Issue B35 indicates that split-interest agreements, while contracts that in their entirety do not meet the definition of a derivative instrument, may, under certain circumstances contain "embedded" derivatives (as defined above). The clearest examples of such a case are charitable lead or remainder unitrusts that contain variable payment terms, i.e., payments to the lead interest and remainder interest are based on a percentage of the fair value of the trust measured at different points in the life of the trust. The right to receive such variable payments meets the FASB Statement 133 definition of a derivative – it contains an underlying, the fair value of the trust; a notational amount – the stated percentage return, and is subject to net settlement – the payment to the lead interest or remainder interest is simply made after taking account of changes in fair value of the trust.

Why must the embedded derivative, if present in a split-interest agreement, be shown separately?

Paragraph 12 of FASB Statement 133 sets forth the conditions under which an embedded derivative must be separated from the host contract and accounted for as a derivative instrument, namely:

(a) The economic characteristics and risks of the embedded derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract
(b) The contract that embodies both the embedded derivative instrument and the host contract is not remeasured at fair value under otherwise applicable GAAP with changes in fair value reported in earnings as they occur
(c) A separate instrument with the same terms as the embedded instrument would be a derivative instrument subject to the requirements of FASB Statement 133

The right to receive variable payments (the prime example of an embedded derivative in a split-interest agreement) meets both criteria (a) and (c). Moreover, Issue B35 notes that the liability under split-interest agreements is currently not measured at fair value under generally accepted accounting principles (GAAP) because the AICPA Audit Guide requires that the discount rate used in estimating the present value of the future expected payments to the beneficiary be determined at the time the contribution is initially recognized and is not revised subsequently. Thus, the current accounting for certain split-interest agreements (i.e., those with embedded derivatives) conflicts with FASB Statement 133. The guidance in Issue B35 seeks to resolve that conflict.

How is a split-interest agreement currently reflected on a Statement of Financial Position?

If a donor gives the NFP organization the right to control the contributed assets by either naming them as trustee of the trust holding the assets or by granting them the right to hold the assets as general assets of their organization, the assets are recorded on the NFP organization's statement of financial position at their fair value when received. A corresponding liability is also recorded for the NFP organization's obligation to make future cash payments to the donor or the donor's beneficiary. This liability is measured based on the present value of the future expected payments to the beneficiary. The AICPA Audit Guide requires that the discount rate used in estimating the present value of the payments be determined at the time the contribution is initially recognized and not be revised subsequently.

If the NFP organization is party to a split-interest agreement but does not maintain control of the donor's contributed assets, the NFP records an asset representing their entitlement to the lead interest payments or the remainder interest as stipulated in the agreement. Since the NFP organization does not have an obligation to pay either the remainder or the lead interest to a designated beneficiary, the NFP does not record a liability and Issue B35 is not applicable.

How does Issue B35 change this?

As mentioned above, in most cases when a NFP establishes a liability it is done using the discount rate in effect at the time the contribution is recognized and is not subsequently revised. Since the discount rate is never revised, Issue B35 points out that the liability is not measured at fair value under generally accepted accounting principles requiring that the value of the embedded be identified and accounted for separately.

As mentioned earlier Issue B35 does not apply when the NFP organization does not have control of the contributed assets, since there has been no liability recorded for such agreements.

How do you value the embedded derivative?
Unfortunately Issue B35 does not explicitly provide for a calculation of the embedded derivative. We believe that the value of the embedded derivative could either be an asset or a liability and would generally be equal to the difference between the liability calculated using a discounted cash flow or "present value" methodology required by chapter 6 of the AICPA Audit Guide (i.e., the discount rate at inception of the contract) and the liability calculated using the methodology set forth in FASB Concepts Statement No 7, *Using Cash Flow Information and Present Value in Accounting Measurements.*

FASB Concepts Statement 7 introduces the expected cash flow approach, which differs from the traditional approach to calculating present value by focusing on explicit assumptions about the range of possible estimated future cash flows and their respective probabilities. Presumably the difference between the liabilities calculated under these two different methodologies would be the value of the embedded derivative.

What if I already calculate the value of the liability using a current discount rate?
Based on a limited review of practices by community foundations it appears that many foundations calculate the liability associated with the present value of the future expected payments to the beneficiary under split-interest agreements using the current discount rate as opposed to the rate at the time the gift was originally made. Although such a practice is not in accordance with current GAAP (i.e., the AICPA Audit Guide), the liability may already reflect fair market value and implementation of the guidance in Issue B35 is not likely needed. This situation should be discussed with your audit firm.

The following example illustrates the steps taken to calculate the embedded derivative:

Assume the following:
A community foundation is trustee of a charitable remainder trust required to make 20 cash payments to the donor that are equal to 7% of the fair value of the assets as of the beginning of each year. That is, it is a Charitable Remainder Trust (CRT) with a period certain and variable payments.

- The donor made a gift of $500,000 to fund a CRT on December 31, 1998 when the IRS discount rate was 5.4%
- The community foundation has a June 30 year end
- The value of the trust on June 30, 1999 was $495,000
- The IRS discount rate for June 1999 was 6.4%

- Using the discount rate of 5.4% (the rate on the date of the gift) the liability recorded as of June 30, 1999 would be $372,000
- Updating the discount rate and using 6.4% (the rate on June 30, 1999) the liability would be $371,000 (assuming that use of the current discount rate would approximate the result reached using the expected cash flow approach of FASB Concepts Statement 7)

In this case presumably the embedded derivative would be $1,000 (the difference between $372,000 and $371,000) and would be an asset.

If the value of the liability using the updated discount rate were larger than the value of the liability calculated using the original discount rate, the embedded derivative (the difference between the two) would be classified as a liability. Whether an asset or a liability, materiality should dictate whether the embedded derivative is shown as a separate line item on an organization's Statement of Financial Position. If a liability, it will most likely be included with the liability for the other split interest gifts. If it is an asset it will most likely be included with "other assets" or if material could be shown separately as "Embedded Derivative on Split Interest Agreements".

Once again, Issue B35 applies only for certain split interest agreements with non-life contingent payments. As mentioned earlier, a foundation should consider materiality and discuss the impact of this guidance with its audit firm before implementation.

December 31, 2002

Accounting Practices Committee:

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Kit Conroy	**The New York Community Trust**
Carol Crenshaw	**The Chicago Community Trust**
Mandy Hess	**Greater Milwaukee Foundation**
Susan Nicholson	**The Community Foundation of Louisville**
Pam Keogh	**Greater Worcester Community Foundation**
Pat Quick	**Stark Community Foundation**
Juan J. Reyes	**Puerto Rico Community Foundation**
Christine Searson	**The San Francisco Foundation**
Tony Stidham	**The Greater Cincinnati Foundation**
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STATEMENT OF FINANCIAL STANDARDS NO. 136

TRANSFERS OF ASSETS TO A NOT-FOR-PROFIT ORGANIZATION OR CHARITABLE TRUST THAT RAISES OR HOLDS CONTRIBUTIONS FOR OTHERS

AN IMPLEMENTATION GUIDE FOR COMMUNITY FOUNDATIONS

Implementation of FAS 136, Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others

Introduction

In June, 1999 The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust that Raises or Holds Contributions for Others* (FAS 136). This Statement establishes standards for transactions in which a not-for-profit organization (such as a community foundation) accepts a contribution from a donor and agrees to transfer those assets, the return on investment of those assets or both to another entity that is specified by the donor. It also establishes standards for transactions that take place in a similar manner but must be accounted for as a liability, not a contribution, by the recipient organization because the transfer is revocable or reciprocal.

FAS 136 is effective for financial statements prepared for fiscal periods beginning after December 15, 1999. Accordingly, calendar year foundations will need to adopt the statement for December, 2000 financial statements. Foundations having a June 30 fiscal year end, will need to apply it to June 30, 2001 financial statements although earlier adoption is encouraged.

It is important to realize that the implementation of FAS 136 in no way alters or affects the current legal definitions or tax laws. More specifically, nothing in FAS 136 impacts the calculation of revenue or assets for purposes of preparing Form 990, including the public support calculation found in Schedule A.

This paper was developed by the Accounting Practices Committee of the Community Foundations' Fiscal and Administrative Officers Group, to assist community foundations in their implementation of FAS 136 and to discuss its implications. To achieve that objective, the paper consists of the following sections:

- Background
- Impact of FAS 136 on Community Foundations
- Specific Examples
- Recommended Course of Action
- Financial Statement and Annual Report Presentation
- Tax Treatment
- Other Implementation Issues
- Impact on Beneficiary Organizations
- Conclusion

Background

A chronology of events leading to the issuance of FAS 136 is important and helpful in understanding the substance of the document.

In June 1993, FASB issued FAS 116, *Accounting for Contributions Received and Contributions Made,* and FAS 117, *Financial Statements of Not-for-Profit Organizations*. Together, the two statements called for revolutionary changes in financial reporting for all not-for-profit organizations (NPOs).

As organizations started to implement these two standards, a serious practice issue arose relating to the applicability of FAS 116 to certain gifts made to community foundations. FAS 116 (paragraph 4) stated that it “does not apply to transfers of assets in which the reporting entity acts as an agent, trustee, or intermediary rather than as a donor or donee”. An issue arose as to how to apply this guidance to organizations like community foundations, United Ways, and college-related foundations whose basic mission is to raise funds from the public and distribute those funds to beneficiaries either specified by the donor or selected through some type of allocation process. The “Basis for Conclusions” section of FAS 116 (paragraphs 52-54) sought to explain the Board’s thinking behind paragraph 4. It noted that the decision as to whether a transfer was a contribution appeared to turn on whether the recipient had discretion in determining how the gift would be used. These same paragraphs also illustrated how the Board felt this “discretion” test should be applied in practice:

> “The recipient of assets who is an agent or trustee has little or no discretion in determining how the assets transferred will be used. For example, if a recipient receives cash that it must disburse to any who meet guidelines specified by a resource provider or return the cash, those receipts may be deposits held by the recipient as agent rather than contributions received as a donee. . ..” (Paragraph 53)
>
> “In contrast, if the resource provider allows the recipient to establish, define, and carry out the programs that disburse the cash, products, or services to the recipient’s beneficiaries, the recipient generally is involved in receiving and making contributions.” (Paragraph 54)

Following FASB’s issuance of FAS 116 and FAS 117, the Community Foundation Fiscal and Administrative Officers Group (FAOG) formed a task force to develop uniform guidance for community foundations in implementing the FASB statements. Early in its work, the task force identified paragraph 4 as a potential issue and concluded that, because transfers to community foundations establishing designated funds were generally subject to the variance power, such transfers were subject to the type of discretion FASB described in paragraph 54 and, accordingly, should be reported as contributions. To ensure acceptance of its guidance, the Task Force shared its conclusions with others, including representatives of the then “Big Six “ public accounting firms. Those representatives were, in most cases, also members of the AICPA Not-for-Profit Organizations Committee, which was in the process of drafting a new accounting and audit guide for use by the profession in auditing NPOs subject to FAS 116 and FAS 117.

In those meetings, it became apparent that the majority of the “Big Six” representatives did not agree with the task force’s conclusion regarding the effect of the variance power. Rather, they believed that the variance power was “conditional” and, accordingly, concluded that most transfers to community foundations establishing designated funds should not be reported as contributions, but rather as liabilities to the specified beneficiaries of such funds.

Seeking to obtain a definitive interpretation, members of the task force along with members of the Committee on Community Foundations of the Council on Foundations met with FASB and requested that the Board interpret how paragraph 4 of FAS 116 applied to designated funds of community foundations subject to the variance power. In May 1995, FASB agreed to the request and added a project to its agenda.

Other NPOs, United Ways and institutionally-related foundations asked FASB to expand the scope of this project to describe the circumstances in which they could report transfers of assets that ultimately would be transferred to another organization as contributions received. United Ways were particularly concerned about donor choice gifts and the effect that not recording such items as contributions would have on their fund-raising ratios. Institutionally-related foundations desired clarification about the whole range of gifts they receive for related beneficiaries.

FASB agreed to expand the project and address the applicability of paragraph 4 of FAS 116 for all NPOs that "receive and distribute assets for charitable purposes". In December 1995, FASB issued an Exposure Draft (the initial ED) of a proposed interpretation that contained the following major conclusions:

- Transfers of assets to designated funds of community foundations subject to the variance power should be reported as contributions, if the donor specified beneficiaries that were unaffiliated to the donor.

- Transfers of assets to community foundations where the donor named itself or an affiliate as beneficiary of the designated fund established (e.g., agency endowments), even if subject to the variance power, should not be reported as contributions, but rather as liabilities.

- Transfers of assets to NPOs other than community foundations that required transfer to a specified beneficiary should not be reported as contributions by the initial NPO recipient unless the transfer was subject to the variance power.

- The accounting by specified beneficiaries was not addressed.

Respondents to the initial ED generally disagreed with all but the first of the ED's conclusions. As a result, FASB, in September 1996, issued FASB Interpretation No. 42, *Accounting for Transfers of Assets in Which a Not-for-Profit Organization is Granted Variance Power* (Interpretation 42). FASB Interpretations are level A GAAP under the hierarchy of GAAP set forth by the AICPA in Statement of Auditing Standards (SAS) 69. Interpretation 42 had a narrower scope than the initial ED. It clarified that:

> "an organization that receives assets acts as a donee and a donor, rather than as an agent, trustee, or intermediary, if the donor specifies an unaffiliated beneficiary or beneficiaries and explicitly grants the recipient organization variance power, that is, grants the

unilateral power to redirect the use of the assets away from the specified beneficiary or beneficiaries."

FASB deferred decisions on other issues raised in the initial ED to a second phase of the project. Those issues included:

- Accounting for transfers received by recipient organizations that are not granted variance power;
- Accounting for transfers in which the resource provider and the beneficiary are the same or affiliated parties;
- Accounting by specified beneficiaries.

These three issues were addressed in July 1998, when FASB issued an Exposure Draft (revised ED) of a proposed Statement, *Transfers of Assets Involving a Not-for-Profit Organization That Raises or Holds Contributions for Others.*

The revised ED differed from FASB's initial ED in the treatment of transfers to institutionally-related foundations. The revised ED concluded that under certain circumstances, such transfers could be reported as contributions. Under the guidance set forth in the initial ED, all such transfers would have been reported as liabilities of the institutionally-related foundation unless the transfer was subject to variance power. The revised ED retained the provisions of the initial ED that prevented most donor-choice gifts to United Ways and "agency endowments" of community foundations from being accounted for as contributions by the recipient organization. The revised ED also incorporated the guidance of Interpretation 42. The substance of the final standard (issued in June of 1999 as level A GAAP) is essentially the same as the revised ED. However, certain disclosures, clarifications, and illustrative guidance were added to the final standard.

Impact of FAS 136 on Community Foundations

This section of the paper reviews the specific paragraphs of FAS 136 that impact community foundations, as well as the FASB's reasoning in reaching those conclusions. Also included are examples that illustrate the application of the FASB standards.

Designated Funds

The guidance of FASB Interpretation 42 is carried forward in paragraph 12 of FAS 136. Specifically, if a recipient organization (i.e., community foundation) is requested by a donor to distribute the transferred assets, the return on the investment of those assets or both to a specified <u>unaffiliated</u> beneficiary, the community foundation is a donee rather than an agent, trustee or intermediary if the donor explicitly grants the community foundation variance power. As a donee, the community foundation records the assets received as contribution revenue. If the community foundation were considered an agent, trustee or intermediary, a liability rather than contribution revenue would be recorded.

The following important definitions are provided in paragraph 12:

- Variance power - the unilateral power to redirect the use of the transferred assets to another beneficiary.

- Unilateral power - the ability of the community foundation to override the donor's instructions without approval from the donor, the specified beneficiary or any other interested party.

- Explicitly grants - the community foundation's unilateral power to redirect the use of the assets is explicitly referred to in the instrument transferring the assets. (Note: This can be done by incorporating by reference the foundation's articles of incorporation or declaration of trust.)

Prior to the finalization of the standard there was some confusion over what the FASB meant in Paragraph 12 when it said:

> "explicitly grants means that the recipient organization's unilateral power to redirect the use of assets is explicitly referred to in the instrument transferring the asset."

Some interpreted this sentence to mean that the variance power needed to be fully explained in the gift instrument and that references to the community foundation's instrument of trust would not be sufficient. Others believed such incorporation by reference would be adequate to meet the requirements of paragraph 12. This point is clarified in paragraph 84 of FAS 136 as follows:

> " . . . For example, community foundations may obtain the unilateral power to redirect the use of assets transferred to them by donors in written gift instruments. The variance power may be explicitly referred to in the terms of the gift instrument and further explained in the community foundation's declaration of trust, articles of incorporation, or governing instruments."

Many gift instruments incorporate by reference the variance power. That is, the gift instrument has language such as, "I give and bequeath … in accordance with provisions specified in the Resolution and Declaration of Trust … all of which provisions are hereby incorporated by reference and conclusively assented to and adopted." If this type of language is in the gift instrument, it has the same impact as including every word of the referenced document. Because a description of the variance power would most certainly be included in such a document, the donor has "explicitly" granted the variance power. Other gift instruments may include language such as, "I do not intend to limit in any way the powers which the Corporation derives from its Certification of Incorporation, By-Laws or otherwise." Legally, such funds are certainly subject to the variance power. However, FASB has established more stringent standards for recognizing variance power for accounting purposes. The ultimate test for FASB is whether the donor understood the implications of the variance power. Since one of the advantages of a community foundation is the variance power, it is often described in materials sent to prospective donors or other correspondence with the donor. If needed, these materials can be used as additional documentation to show that it was indeed the donor's intent to grant the variance power. Going forward, it is recommended that gift instruments for designated or field of interest funds include a sentence granting the variance power. This, of course, is not necessary for advised funds since they are by their very nature unrestricted funds.

While an explicit reference to the variance power in the gift instrument is the best evidence of a donor's intent to grant such power to a community foundation, the standard provides an example (paragraph 29) that illustrates FASB's intent to look at the specific facts and circumstances in determining the donor's intent in cases where formal gift agreements with each donor do not exist. In this example, an NPO decides to raise funds to build an endowment. The governing board of the NPO signs an agreement to establish a fund at the local community foundation. The NPO solicits gifts to the fund with campaign materials that inform the donors that the endowment will be owned and held by the community foundation. The materials explain that the gifts will be invested and that the return from their investment will be distributed to the NPO subject to the community foundation's spending policy. The materials also note that the community foundation has the right to redirect the return to another beneficiary without the approval of the donor, the NPO, or any other party if distributions to the NPO become unnecessary, impossible, or inconsistent with the needs of the community. The donor response card also clearly describes the community foundation's right to redirect the return of the fund. The campaign materials indicate that the donors should send their contributions directly to the community foundation.

Based on the facts in this example, the community foundation would recognize the fair value of the gifts as assets and as contribution revenue. By responding to campaign materials and the donor response card that clearly state that the gifts are subject to the community foundation's unilateral power to redirect the return to another beneficiary, donors have explicitly granted variance power.

The above example is very straightforward. All parties concerned clearly followed steps to ensure that the variance power was understood. The donor response card was carefully worded to ensure that the donor explicitly granted the community foundation the unilateral power to redirect the use of the assets. What should be done if the facts and circumstances surrounding a gift are not as straightforward? For example, what if the donor sent the contribution and the donor response card to the NPO instead of the community foundation? FAS 136 advises that such ambiguity should be resolved by a review of the facts and circumstances surrounding the gift, communications with the donor, or both (paragraph 32). If this review determines that the donor intended to make the gift to the fund owned and held by the community foundation and to explicitly grant variance power, the NPO would be an agent responsible for transferring the gift to the community foundation. As such, the community foundation would recognize the value of the gift as contribution revenue.

Agency Endowment Funds

There is one very important exception to the above general rule that transfers received by a community foundation are accounted for as contribution revenue if the donor explicitly grants variance power to the foundation. FAS 136 (paragraph 17) describes the situation where a resource provider (the donor) specifies itself or its affiliate as the beneficiary. This case would occur when an NPO establishes, <u>with its own funds</u>, a fund at a community foundation for its own benefit. In such a case, even though variance power is clearly stated in the gift instrument, the transfer of assets to the community foundation is not contribution revenue and should be accounted for as a liability. Paragraphs 94 and 96 of the statement's "Basis for Conclusions" explain the Board's rationale for this conclusion.

Paragraph 94 concludes that these types of transfers are not contributions because "if a resource provider specifies itself or its affiliate as the beneficiary, it retains a future economic benefit in the transferred assets. Because the transfer of assets is not a nonreciprocal transfer, a contribution neither has been made by the resource provider nor has been received by the beneficiary".

FAS 116 defines a nonreciprocal transfer as "a transaction in which an entity incurs a liability or transfers an asset to another entity (or receives an asset or cancellation of a liability) without directly receiving (or giving) value in exchange." (Paragraph 209)

Paragraph 96 explains why the Board believes it is appropriate to disregard the variance power of the community foundation in these transactions. It indicates:

> "If a resource provider transfers assets to a recipient organization and specifies itself or its affiliate as the beneficiary, the Board believes that a presumption that the transfer is reciprocal, and therefore not a contribution, is necessary even if the resource provider explicitly grants the recipient organization the variance power. At the time of the transfer, the resource provider expects to receive future distributions because it specifies itself or its affiliate as a beneficiary, and by its acceptance of the transfer, the recipient organization agrees that distributions to the resource provider or its affiliate are capable of fulfillment and consistent with the recipient organization's mission. <u>The value of those future distributions, however, may not be commensurate with the value of the transferred assets because the resource provider is at risk of cessation of the distributions as a result of its grant of variance power. If the values exchanged are not commensurate, in concept, the transfer is in part a contribution .... The Board decided that presuming the entire transfer is reciprocal is preferable to requiring that a resource provider compute the contribution portion because that computation would require measuring the risk that the variance power would be exercised.</u> (emphasis added)"

Example 9 of FAS 136 (paragraphs 53-56) provides an example to illustrate the accounting required for such "reciprocal" transfers. In this example, the NPO transfers securities to a community foundation to establish an endowment fund. The transferred securities were a result of a large unrestricted gift to the NPO. The agreement between the community foundation and the NPO states that the transfer is irrevocable, that the assets will not be returned to the NPO and that variance power is explicitly granted to the community foundation. The community foundation has agreed to make annual distributions of the income earned on the fund, subject to the community foundation's spending policy.

In this case, the community foundation is required to recognize an increase in investments and a liability to the NPO. The community foundation records a liability because the transaction is deemed to be reciprocal. That is, the community foundation accepted the assets and, in exchange agreed to make future distributions to the NPO. Although the value of the future distributions may not be commensurate with the value of the assets received (because the NPO is at risk of the payments being terminated), the transaction is recorded as though the values are commensurate. In other words, when the donor is the same as the beneficiary, the gift is not a contribution, but a liability, even when the variance power is present.

FAS 136 (paragraph 96) retains language which the FASB Task Force of the Committee on Community Foundations of the Council on Foundations objected to when it responded to the revised exposure draft that led to the final standard. Fiscal officers and executive directors should be aware of this language and be prepared to address any concerns it raises in their communities. The objectionable language reads as follows:

> " Further, it is not clear whether a not-for-profit organization (resource provider) can grant a recipient organization the legally valid power to redirect the use of transferred assets to another beneficiary if the not-for-profit organization receives those assets with donors' restrictions on their use. The recipient organization might redirect the use of the assets in a way that could violate the resource provider's fiduciary responsibilities to its own donors."

Additional Examples

The facts in the examples taken from FAS 136 are straightforward and illustrate specific aspects of the standard. In the normal course of business, however, ambiguities will arise which complicate the implementation of the standard. The following examples follow the life of a fund and show the differing treatment which may be required depending on the facts and circumstances of each addition to the fund.

Example One

Facts:
John Doe signs an agreement to create the Children's Museum Fund at the County Community Foundation, and makes a $1,000 donation to the Fund. The income for the fund is to be used to support the Children's Museum, a 501-c-3 organization. The fund agreement clearly includes the variance power.

Analysis and Accounting Treatment:
This is a contribution since the variance power was explicitly granted to the County Community Foundation by John Doe, the donor, in the fund agreement.

Example Two

Facts:

After receiving a solicitation letter from the Children's Museum, Jim Smith chooses to add $10,000 to the Children's Museum Fund. The solicitation states, "All donations to the Children's Museum Fund are subject to the Articles of Incorporation and By-Laws of the County Community Foundation all of which provisions are hereby incorporated by reference." The variance power is fully explained in the Articles of Incorporation of the County Community Foundation.

Analysis and Accounting Treatment:

This is also a contribution. Paragraphs 12 of FAS 136 indicates that the donor should be informed explicitly that the gift is subject to the community foundation's right to redirect the return to another beneficiary without the approval of the donor. Paragraph 84 of FAS 136 notes "A recipient organization may obtain the power to redirect the use of assets transferred to it through various means, including standard provisions in donor-choice forms or explicit donor stipulation in gift instruments." The variance power as described in the Articles of Incorporation has been explicitly referred to since it was incorporated by reference in the solicitation material. "Incorporate by reference" is a term of art which puts the donor on notice that he or she should review another document to gain a full understanding of the terms of the gift. As such, this would appear to satisfy the FASB test of making the donor aware of the implications of variance power.

Example Three

Facts:

Several months after the Children's Museum Fund was created, John Doe retires after 25 years of teaching at the County High School. In lieu of a retirement party, Mr. Doe asks his friends and co-workers to send contributions to the Children's Museum Fund. Following this request, John's friends mail 25 checks totaling $2,000 to the Children's Museum for the Children's Museum Fund. The Children's Museum forwards the checks to the Children's Museum Fund at the County Community Foundation.

Analysis and Accounting Treatment:

Whether the $2,000 is a contribution to the County Community Foundation is unclear. A review of facts and circumstances that evidence donor intent (e.g. donor communications) must be evaluated to resolve any ambiguity. Such ambiguities should be resolved within a reasonable timeframe, generally within the reporting period that includes the date the gift was received. If the donors were familiar with this fund and knew that their contributions were being added to a fund for the Children's Museum held at the community foundation that was subject to variance power, an argument could be made that the gift could be appropriately recorded as contribution revenue. Including language in an acknowledgement letter that the gift was being added to the Children's Museum Fund at the County Community Foundation and would be subject to the Foundation's variance power could be used to clarify the donors' intent. The letter could request the donor to contact the County Community Foundation if it was not their intent to have their donation added to such a fund.

If a reasonable case cannot be developed supporting the donor's intent to explicitly grant variance power, the gifts would need to be recorded as a liability. If such were the case, it would generally be necessary to establish a second Children's Museum Fund within the community foundation segregated from the initial Children's Museum Fund to allow for proper accounting of the future earnings and distributions from this portion of the fund.

Example Four

Facts:

The Board of Directors of the Children's Museum are pleased with the endowment fund created by John Doe, and they choose to transfer their existing endowment of $100,000 held by the Museum at a local bank, to the County Community Foundation. They sign an agency endowment agreement that clearly explains the variance power.

Analysis and Accounting Treatment:

In this case, the County Community Foundation would recognize a liability to the Children's Museum. The community foundation records a liability because the transaction is deemed to be reciprocal. The fact that the variance power is clearly discussed and agreed to is irrelevant. As a practical matter the community foundation should establish a second fund, segregating the contributions, earnings and distributions from the original designated fund set up by John Doe.

Recommended Course of Action

To properly implement FAS 136, community foundations will need to identify all funds where a specific NPO has been designated as the beneficiary. Once identified, the funds should be segregated into three groups:

1. **Designated Funds** - funds established by a third party for the benefit of an NPO
2. **Agency Endowment Funds -** funds where the resource provider and the recipient are the same
3. **Hybrid Funds** which are a combination of 1 and 2

Designated Funds

Since FAS 136 carried forward without change the guidance of FASB Interpretation 42, the financial presentation for designated funds will not change. Contributions will continue to be shown as revenue in the statement of activities and will be included as part of net assets.

Agency Endowment Funds

Because these funds are deemed to arise from reciprocal transaction, a liability must be established for their market value at the end of each reporting period. Additions and reductions to the fund originally recorded as contribution revenue, investment income or grants must be reclassified from net assets to the liability. Because this new treatment does not change the way the funds are accounted for on a tax basis **(**see **Tax Treatment),** it is desirable to continue to initially record additions to the fund as contribution revenue. On an annual basis, one adjusting entry should be made reclassifying all such contributions to Agency Endowment Funds to an appropriately named liability account. Likewise, other changes to the market value of funds such as grants expense and investment income (including unrealized gains or losses), should be accumulated and reclassified from the statement of activities to the liability account.

Hybrid Funds

Often community foundations hold endowment funds designating a specific NPO as the beneficiary that are a combination of donations from unrelated third parties as well as donations from the NPO. To properly account for these funds under FAS 136, the community foundation must determine the portion of the current fund that pertains to unrelated third parties and the portion that is attributable to donations from the NPO. The portion that is attributable to unrelated third parties will be treated as contribution revenue and net assets as discussed above for Designated Funds. The portion attributable to transfers from the NPO must be treated as a liability as discussed above for Agency Endowment Funds. Historical documents and a review of the facts and circumstances will be needed to divide the hybrid fund into two separate funds: (1) an Agency Endowment Fund component, and (2) a Designated Fund component. An example illustrates how this could be handled:

The local symphony established an endowment fund at the community foundation in 1980 with $100,000 of operating surplus. From 1980-1992 several fund-raising events were held and $50,000 of contributions from unrelated third party donors was added to the fund. The current market value of the fund is $300,000. Detailed records of the contributions made from 1980-1992 are no longer available. However, discussions with the executive director of the symphony indicate it is unlikely any of the additions made during that time period came directly from the symphony. In 1993, the symphony added $10,000 of operating surplus to the fund. Five percent of the fund has been disbursed annually. The following documents have also surfaced:

- A symphony fund raising brochure from 1981 which mentions that the fund would be maintained at the community foundation.
- A foundation newsletter from 1982 that contains an article on agency endowment funds at the foundation. This article refers to the variance power the foundation has over the funds.
- Historical investment performance summaries reflecting the total return of the foundation's endowment fund.

Using the above information the community foundation would need to split the $300,000 market value into two funds. The first would be an agency endowment fund with historical principal of $110,000. The second fund would be a designated fund with historical principal of $50,000. The remaining $140,000 would be allocated between the two funds using the information relating to investment return and distributions from the fund. Future contributions would be added to the appropriate fund and accounted for accordingly.

Financial Statement and Annual Report Presentation

Recognizing that it may be desirable for certain organizations to report the results of total fund-raising efforts to the public, FAS 136 (paragraph 109) illustrates three different ways a community foundation may reflect total fund raising efforts and contributions received. Of particular interest is the third example which permits the gross amount of all funds received to be reported as "funds raised." Such amounts are then decreased by an adjustment for amounts raised on behalf of others to reflect total contributions received. For example, assume a community foundation receives $6,000 of contributions and $4,000 of additions to agency endowment funds, as well as $200 in other income. If the community foundation followed a method similar to illustration 3 of paragraph 109, additions to agency endowment funds could be reflected as follows in their statement of activities:

Total Amounts raised	$10,000
Less: Amounts received as Agency Endowments (Note A)	4,000
Total contributions	6,000
Other revenue	200
Total support and revenue	$ 6,200

Note A would explain that an agency endowment arises when a transfer is received from an NPO where it specifies itself as the beneficiary. It could also provide additional information on the agency endowments held by the community foundation.

Often, community foundations include a list in their annual report of all organizations receiving grants and the amount received. Traditionally this listing has included grants from agency endowment funds and agrees with the total grants expense shown on the statement of activity. As mentioned earlier, other changes affecting the liabilities established for agency endowments will also need to be reclassified including grants or distributions from agency endowment funds. In other words, distributions from agency endowment funds will no longer be included as part of "grants expense" on the community foundation's statement of activities. However, presenting grants expense in a manner similar to contributions as reflected in illustration 3 of paragraph 109 would allow the listing in the annual report to continue to agree with the statement of activities. For example, assume a community foundation made $20,000 in grants from funds other than agency endowments and $14,000 of distributions from agency endowment funds. If the community foundation followed a method similar to illustration 3 of paragraph 109, distributions from agency endowment funds could be reflected as follows in its statement of activities:

Total grants made	$34,000
Less: Grants made from Agency Endowments (Note A)	14,000
Grants Expense	$20,000

Again, Note A could further explain the community foundation's agency endowments. Another option would be to include such distributions in the listing in the annual report noting that they are distributions in addition to the grants expense reflected in the statement of activity.

Tax Treatment

The changes mandated by FAS 136 only impact statements prepared in accordance with generally accepted accounting principles. Such changes will not impact the preparation of the tax return (Form 990) of a community foundation. For tax purposes, the activity (i.e., contributions and grants) of agency endowments that are subject to variance power will continue to be reflected as changes in net assets. Part IV-A and Part IV-B of Form 990 should be used to reconcile the differences between the revenue and expenses as shown in the audited financial statements and as reported in the tax return.

Other Implementation Issues

Community foundations have the option of reporting changes resulting from FAS 136 as either:

1. A cumulative change in accounting principle in the current period, consistent with paragraph 19 of APB Opinion No. 20, *Accounting Changes*, or

2. Retroactively, by restating opening net assets for the earliest year presented and restating any prior year's financial statements if complete comparative financial statements are presented.

<u>Since there is no grandfather clause for existing agency endowments,</u> under either method of initial application, a calculation must be made to record the liability associated with all agency endowments. FAS 136 (paragraph 110) states that "the provisions in this Statement must be applied retroactively to appropriately reflect the interests of specified beneficiaries in endowment gifts held on their behalf by recipient organizations.".

Impact on Beneficiary Organizations

FAS 136 (paragraph 19) requires an NPO to make several disclosures when it transfers assets to a community foundation and specifies itself as the beneficiary. It must make the following disclosures:

- The identity of the recipient organization (i.e., the community foundation) to which the transfer was made
- Whether variance power was granted and if so, the terms of the variance power
- The terms under which amounts will be distributed to the NPO
- The aggregate amount recognized in the statement of financial position for those transfers and whether that amount is recorded as an interest in the net assets of the recipient organization or as another asset such as "beneficial interest in assets held by others."

Paragraph 106 explains the Board's thinking in requiring specified beneficiaries of such agency endowments to make the disclosures required by paragraph 19 of the Standard. It indicates:

> **“ . . . if an organization transfers assets to another and specifies itself or its affiliate as the beneficiary, the users of its financial statements might not be aware of additional limitations imposed by terms of the agreement with the recipient organization. The Board believes that the disclosures specified in paragraph 19 of this Statement provide information that is useful in assessing management’s stewardship and the organization’s liquidity and exposure to risk.”**

FAS 136 (paragraph 15) states that an unaffiliated beneficiary of a designated fund that is subject to the variance power should not record the assets held at a community foundation. As explained in paragraph 89 this is due to the fact that:

> **“. . .if the recipient organization is explicitly granted variance power, the specified beneficiary does not have a right that meets the criteria for recognition in the financial statements.”**

Community foundations should respond accordingly to any confirmation requests received from auditors of both the beneficiaries of designated and agency endowment funds.

Conclusion

While implementing FAS 136 may be initially onerous for some community foundations, the statement provides long needed clarity for proper presentation of agency endowments. Many community foundations measure their overall growth by asset size. Since this statement makes no changes to total assets, this measurement of growth will remain unchanged. The statement also has no legal impact on the ownership of the assets identified with agency endowments. They continue to be assets owned by the community foundation. Finally, as with any accounting standard, the concept of materiality should be considered in implementing the standard.

November 5, 1999

Accounting Practices Committee:

Kit Conroy	**The New York Community Trust**
Ben Bank	**East Bay Community Foundation**
Ray Biddiscombe	**Columbus Foundation**
Michael Cheney	**The Greater Cincinnati Foundation**
Carol Crenshaw	**The Chicago Community Trust**
Carroll Lavalleur	**Lincoln Community Foundation**
Susan Nicholson	**The Community Foundation of Louisville**
Jim Pitts	**Boston Foundation**
Jack Pohl	**The Saint Paul Foundation**
Carolyn Schwenn	**East Tennessee Foundation**
Herb Folpe	**Technical Advisor, Retired Partner, KPMG**

FASB Statement 158, <u>Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)</u>

A. What the Statement does:

1. Requires employers to:

a. Recognize the overfunded or underfunded status of a defined benefit retirement plan (other than a multiemployer plan) as an asset and liability in its statement of financial position.

1. Funded status is measured as the difference between the fair value of plan assets and the benefit obligation

2. Benefit obligation used

a. Pension plan – projected benefit obligation

b. Other post retirement benefit plan (for example, a retiree health care plan) the accumulated postretirement benefit obligation)

b. Recognize changes in the funded status of plan in the year in which it occurs as a change in unrestricted net assets of a not-for-profit organization.

1. Continue to calculate periodic benefit expense pursuant to FASB Statements 87 and 106

2. Recognize as a separate line item or items within changes in unrestricted net assets, apart from expenses, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost pursuant to FASB Statements 87 and 106

3. Reclassify to net periodic benefit cost a portion of the net gain or loss and prior service costs or credits (enumerated in b.2. above) and a portion of the transition asset or obligation remaining from the initial application of FASB Statements 87 and 106 pursuant to the recognition and amortization provisions of FASB Statements 87, 88, and 106. The contra adjustment or adjustments shall be reported in the same line or items within changes in unrestricted net assets, apart from expenses, as the initially recognized amounts in b.2. above.

4. Consistent with guidance in FASB Statement 1117, the amounts reflected in the separate line noted in b.2. and b.3. above may be shown either within or outside an intermediate measure of operations, if one is presented.

c. Measure the funded status of the plan as of the date of the year-end statement of financial position

2. Changes the disclosures for pension plans and other postretirement plans – disclosures required include:

   a. For each annual statement of activities presented, the net gain or loss and net prior service cost or credit recognized in the statement of activities apart from expenses - separated into amounts arising in the period and amounts reclassified as components of net periodic benefit cost of the period.

   b. For each annual statement of activities presented, the net transition asset or obligation recognized as a component of net periodic benefit cost of the period

   c. For each annual statement of financial position presented, the amounts that have not yet been recognized as components of net periodic benefit cost, showing separately the net gain or loss, net prior service cost or credit, and net transition asset or obligation

   d. The amounts of net gain or loss, net prior service cost or credit, and net transition asset or obligation that arose previously and are expected to be recognized as components of net periodic benefit cost over the fiscal year that follows the most recent statement of financial position presented

   e. The amount and timing of any plan assets expected to be returned to the not-for-profit employer during the 12 month period, or operating cycle if longer, that follows the most recent annual statement of financial position presented.

B. Effective Dates – Not-for-Profit Organizations

1. *Recognition and disclosure provisions*

   a. Fiscal years ending after 6/15/07 (6/30/07 or 12/31/07 for most community foundations)

   b. Community foundations with 12/31/06 year end – need to disclose the following in 2006 financials

      1. Brief description of the provisions of FASB Statement 158

      2. The date that adoption of FAS 158 is required

      3. The date the community foundation plans to adopt the recognition provisions of FAS 158, if earlier

2. *Measurement Date provisions – years ending after 12/15/08 (12/31/08 or 6/30/09 for most community foundations)*

C. Implementation Guidance – Appendix A of the standard

1. Example 3 – Application of the Recognition Provisions and Early Adoption of the Measurement date Provisions of This Statement by a Not-for-Profit Organization – pp. 41 – 47

2. Example is very well done and includes journal entries and illustrative financial statements

This paper was prepared by the Accounting Practices Committee, which consists of accounting professionals working in the community foundation field. The guidance presented is based on their extensive review of authoritative accounting and/or tax literature available as of the date of this paper. Questions about the guidance given in this paper may be directed to members of the Committee, whose names are listed at the end of this paper.

Please consult with your accounting and/or tax advisors for specific advice tailored to your community foundation's particular circumstances.

FASB Issues Interpretation on Guarantees

Introduction

In November 2002, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (the interpretation). This pronouncement, which may significantly affect those community foundations that have loan guarantee programs, interprets FASB Statements No. 5, 57, and 107 and rescinds FASB Interpretation No. 34. FASB's objective in issuing the interpretation is to improve the transparency of a guarantor's financial reporting about the obligations and risks arising from issuing guarantees in two ways, namely:

- Improve the content of the disclosures required by FASB Statement 5, Accounting for Contingencies, about the nature and amount of guarantees in the financial statements of guarantors
- Clarify the requirement for initial recognition of a liability for the obligation incurred by a guarantor in issuing a guarantee, thereby improving the comparability of financial reporting for guarantees issued *with* a separately identified premium (i.e., a payment received by the guarantor for entering into the guarantee) and guarantees issued *without* a separately identified premium.

The need for the interpretation arises from differences the Board has noted in entities' interpretations about (1) the disclosures required of issuers of guarantees and (2) the need for an issuer of a guarantee to recognize an initial liability for its obligation under the guarantee. Certain of the issues addressed by the Board in the interpretation surfaced during the corporate financial reporting scandals (e.g., Enron) of the past few years.

Scope of the Interpretation

The interpretation addresses the disclosures that should be made by a guarantor in its financial statements about its obligations under guarantees. It also clarifies the requirements related to the recognition of a liability by a guarantor at the inception of a guarantee.

The interpretation covers a number of different types of transactions that involve guarantees (e.g., guarantees of principal and interest payments required of other entities under debt agreements, certain types of performance guarantees, and certain types of indemnities). FASB also excludes certain transactions from the entire interpretation and other transactions (e.g., product warranties) from the provisions of the interpretation that require recognition of a liability by the guarantor at the inception of a guarantee. Loan guarantees issued by community foundations on the debt of other not-for-profit organizations clearly fall under the transactions covered by the interpretation.

Substance of the Interpretation

Initial Recognition and Initial Measurement of the Liability for a Guarantor's Obligations

The interpretation indicates that any guarantee contains two elements, namely:

- A non-contingent element wherein the guarantor undertakes an obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur
- A contingent element under which the guarantor undertakes a contingent obligation to make future payments if those triggering events or conditions occur

Contrary to the view of many accountants prior to the interpretation, FASB concludes that the guarantor's non-contingent obligation under a guarantee should be recognized as a liability even though it is *not* probable that payments will be required under that guarantee. Except in the case where the guarantor is required to recognize a liability under FASB Statement 5 for the related contingent loss element of the guarantee, the objective of the initial measurement of the liability for the non-contingent obligation is to recognize and record the fair value of the guarantee at its inception.

The interpretation, however, offers limited guidance on how to ascertain the fair value of the guarantee. For the category directly relevant to community foundations - a guarantee issued as a contribution to an unrelated party, the interpretation provides only general guidance noting that the liability recognized at the inception of such a guarantee should be measured at fair value consistent with the requirement of FASB Statement 116 to measure contributions made at fair value.

In discussing guarantees issued as contributions, the interpretation uses as its example a loan guarantee program of community foundation. (Thus, there is no question of the applicability of the interpretation to such programs.) Paragraph 10c of the interpretation indicates:

> "For example, a community foundation may have a loan guarantee program to assist not-for-profit organizations in obtaining bank financing at a reasonable cost. Under that program, the community foundation may issue a guarantee of a not-for-profit organization's bank debt. <u>Upon the issuance of the guarantee, the community foundation would recognize a liability for the fair value of the guarantee</u> (emphasis added)."

In arriving at this conclusion, the interpretation specifically rejects the argument made by FAOG in responding to the Exposure Draft (the ED) of the proposed interpretation that such loan guarantees are conditional promises not recognized under FASB Statement 116. Rather, FASB concludes:

> "The issuance of that guarantee would not be considered merely a conditional promise to give under paragraph 22 of Statement 116 because, upon the issuance of the guarantee, the not-for-profit organization will have received the gift of the community foundation's credit support, which enables the not-for-profit organization to obtain a lower interest rate on its borrowing."

The interpretation does not prescribe a specific account for the guarantor's offsetting entry when it recognizes the liability at the inception of a guarantee. That offsetting entry depends on the circumstances in which the guarantee was issued. Presumably in the case of a community foundation loan program, if a guarantee were issued to an unrelated party for no consideration on a standalone basis (that is, not in conjunction with any other transaction or ownership relationship), the offsetting entry would be to grants made - an expense. The interpretation does not address the accounting for such a guarantee by the guaranteed party (i.e., the not-for-profit entity). Because the pronouncement is an interpretation of specific FASB standards, the Board indicates that issues related to accounting by guaranteed parties is beyond the scope of the interpretation. It would seem to logically follow that the guaranteed not-for-profit entity should recognize contribution revenue equal to the contribution expense recognized by the community foundation at the inception of the guarantee.

Disclosures Required by the Interpretation

The interpretation expands the disclosures that must be made about a guarantor's obligations under guarantees. While at first blush, these expanded disclosures may seem onerous, they will afford community foundations with loan guarantee programs the opportunity to make their communities aware of another program service they are providing. Under its provisions, community foundations with loan guarantee programs (or other guarantees) must disclose the following information about each guarantee, or each group of similar guarantees, even if the likelihood of the community foundation having to make payments under the guarantee is remote:

- The nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose and the events or circumstances that would require the community foundation to perform under the guarantee
- The maximum potential amount of future payments (undiscounted) the community foundation could be required to make under the guarantee (not reduced by the effect of any amounts that may be recovered under recourse or collateralization provisions in the guarantee). If the terms of the guarantee provide for no limitation to the maximum potential future payments under the guarantee, that fact shall be disclosed. If the community foundation is unable to develop an estimate of the maximum potential

amount of future payments under its guarantee, it must disclose the reasons why it cannot estimate the maximum potential amount

- The current carrying amount of the liability, if any, for the community foundation's obligations under the guarantee (including the amount, if any, recognized under FASB Statement 5)
- The nature of (1) any recourse provisions that would enable the community foundation to recover from third parties any of the amounts paid under the guarantee and (2) any assets held either as collateral or by third parties that, upon the occurrence of any triggering event or condition under the guarantee, the community foundation can obtain and liquidate to recover all or a portion of the amounts paid under the guarantee.

In cases where guarantees are issued to benefit related parties (as defined in FASB Statement 57, Related Party Disclosures) the disclosures required by FASB Statement 57 must be made.

Effective Date and Transition

In a major change from an Exposure Draft (the ED) on the same subject issued earlier in 2002, FASB concluded that the initial recognition and measurement provisions of the interpretation should be applied only on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The ED had proposed that previously issued guarantees be recognized upon adoption of the interpretation with the amount arising from such a change in accounting principle being recognized as a cumulative effect adjustment. That change will greatly simplify adoption of the interpretation. The disclosure requirements of the interpretation are effective for financial statements of interim or annual periods ending after December 15, 2002.

Issues in Adopting the Interpretation

Estimating the Fair Value of the Non-Contingent Element of the Guarantee
Conceptually, the fair value of the non-contingent element of the guarantee issued by a community foundation under a loan guarantee program is the present value of the savings in interest to the not-for-profit organization (NPO) resulting from the guarantee. For example, assume that a NPO needs to borrow $100,000 for one year. A bank will charge the NPO an interest rate of 9% with no guarantee and 3% with a guarantee by a community foundation. Interest will be payable at the end of the year. The fair value of the non-contingent element of the community foundation's guarantee will be the present value of $6,000 payable in one year.
In real world situations, certain factors may make determination of fair value more complicated. Estimating the interest rate the NPO would pay without the community foundation's guarantee may be difficult. In some cases, the NPO may not be able to obtain the loan from conventional sources (e.g., banks) without the guarantee. In such

cases, community foundations would have two options in determining fair value. The first and easier option would be to determine interest rates that would be charged the NPO by non-conventional lenders (e.g., sub-prime lenders) or other lending sources (e.g., personal credit cards). The second option would be to assume that no lender would make the loan. In that case, the community foundation would need to determine fair value using the expected present value techniques set forth in FASB Concepts Statement 7. Paragraph 41 of Concepts Statement 7 indicates that the following general principles should govern any application of present value techniques in measuring assets or liabilities.

- To the extent possible, estimated cash flows and interest rates should reflect assumptions about the future events and uncertainties (e.g., likelihood of default by the NPO) that would be considered in deciding whether to acquire an asset or group of assets in an arms-length transaction for cash.
- Interest rates used to discount cash flows should reflect assumptions that are consistent with those inherent in the estimated cash flows (e.g., if probabilities of default are dealt with explicitly in the assumptions about cash flows, the risk of default should not also be incorporated into the interest rate).
- Estimated cash flows should be free from both bias and factors unrelated to the asset, liability, or group of assets or liabilities in question.
- Estimated cash flows or interest rates should reflect the range of possible outcomes rather than a single most likely, minimum, or maximum possible amount.

For example, assume a community foundation guarantees a $100,000 loan at 6% due in one year to a NPO. Without the guarantee, the NPO would be unable to obtain the loan. The community foundation determines that there is a 20% likelihood that the NPO will default on the loan. Following the general principles of Concepts Statement 7, the fair value of the non-contingent element will be the present value of $21,200 ($106,000 x 20% probability). The interest rate used to determine present value should be a risk free rate because the risk of default has been dealt with explicitly in the assumptions about cash flows. The challenge in such cases will be to determine the probability of default.

Re-Measurement of the Guarantee

If the loan that the community foundation guarantees has a term greater than a year (or if an intervening event affects the fair value of non-contingent element of the guarantee), the community foundation will need to re-measure the liability it recognized at the inception of the guarantee. FASB does not address in detail how such a re-measurement should be done. Paragraph 12 of the Interpretation does indicate that the liability that the guarantor originally recognized (in most cases, for the non-contingent element of the guarantee) would typically be reduced as the guarantor is released from risk under the guarantee. Consistent with that guidance, community foundations that had originally recorded the loan guarantee as grant expense would credit the same account to recognize any release from the risk under the guarantee.

Conclusion

The Interpretation dramatically changes the accounting and financial reporting for guarantees. Community foundations that have loan guarantee programs must therefore carefully assess the impact this FASB pronouncement will have on them. The accounting and finance professionals at such entities need to review the interpretation, identify any implementation issues, and discuss the effect of the pronouncement on their financial statements with senior management, the Board, and the foundation's independent auditors. Given the early effective dates for different parts of the pronouncement, community foundations impacted by the Interpretation should not delay in beginning that process.

INSTRUCTIONS FOR COMPLETING FORM 990 AND FORM 990 SCHEDULE A

FOR COMMUNITY FOUNDATIONS

FORM 990

Completing the Heading of Form 990

Item A – Accounting Period The current year's Form 990 (for example 2004) is used for calendar year fiscal years as well as those foundation's whose fiscal years begin in 2004.

Item B – Checkboxes If there is a change in address, an initial return or a final or amended return check the appropriate box (es).

Item C – Name and address Generally, a foundation should use the pre-addressed mailing label, if it receives one.

Item D – Employer Identification number Enter the community foundation's EIN on this line.

Item E – Telephone number Enter the community foundation's telephone number including area code.

Item F – Accounting Method Typically, the accounting method used to prepare the foundation's financial statements will also be used for tax purposes. The box describing the accounting method used to prepare the foundation's tax return should be checked.

Item G – Website: Community foundations having a web site should enter the address on this line.

Item H – Group return, etc. Generally community foundations do not file a group return. If this were the case for your foundation, this box would not be checked.

Item I – Group exemption number Generally this box would be marked N/A.

Item J – Type of organization Community foundations are exempt under section 501(c)(3).

Item K – Gross receipts of $25,000 or less Most community foundations' gross receipts are in excess of $25,000; and if this is the case for your foundation, this box should not be checked.

Item L – Gross receipts Add lines 6b, 8b, 9b and 10b through line 12 and enter the sum on this line.

Item M – Requirement to attach Form 990 – Schedule B Most community foundations will be required to attach Schedule B – Schedule of Contributors. If the community foundation is **not** required to attach schedule B, this box should be checked.

Part I – Revenue, Expenses, and Changes in Net Assets or Fund Balances

Line 1 – Contributions, gifts, grants and similar amounts received (in general) Generally, contribution amounts reported on a community foundation's financial statements are reported on these lines of the Form 990. However, for foundations that have adopted FAS 136, these lines should also include contributions to organization (agency) endowment funds. A schedule, not open for public inspection, containing a list of contributors must be prepared. This list is limited to contributors whose gift is in excess of $5,000 or 2% of the amount reported on line 1d of Form 990.

Line 1a – Direct public support Amounts received from individuals, corporations, etc. are reported on this line. Also reported on this line are contribution additions to organization (agency) endowment funds held by the community foundation.

Line 1b – Indirect public support Amounts received from federated fundraising groups, such as the United Way should be shown on this line.

Line 1c – Government contributions (grants) Amounts received from federal, state or local sources should be reported on this line.

Line 1d – Total contributions, etc. The arithmetic total of lines 1a, 1b and 1c is shown on this line. Also reported on this line is the breakdown between the total cash and non-cash contributions. For community foundations, non-cash contributions are most likely to be stocks and bonds, but could be real estate, interest in limited partnerships, insurance policies, etc.

Line 2 – Program service revenue including government fees and contracts
Community foundations would typically report revenue from program related investments on this line. Rental income from an exempt function would also be reported on this line.

Line 3 – Membership dues and assessments Community foundations are not likely to use this line.

Line 4 – Interest on savings and temporary cash investments Interest earned on checking accounts, savings accounts, money market funds, income reserves, etc. should be reported on this line.

Line 5 – Dividends and interest from securities The amount of dividends and interest from stocks and bonds, including stock and bond mutual funds, should be reported on this line. Do not include capital gain dividends. They should be reported on line 8.

Line 6a – Gross rents Rental income from investment property is reported on this line.

Line 6b – Rental expenses All direct and indirect expenses paid or incurred related to investment property is reported on this line. This would include real estate taxes, depreciation, etc.

Line 6c – Net rental income or (loss) Enter the arithmetic difference between lines 6a and 6b.

Line 7 – Other investment income Royalty and limited partnership income would typically be reported on this line.

Line 8a – Gross amount from sales of assets other than inventory Report all sales of securities in column (A) and all other types of investments in column (B). Because community foundations typically have hundreds of investment transactions, it is not practical to list every transaction in the required support schedule. A summary by investment agent, investment pool, or financial institution holding foundation assets is an acceptable solution. The support schedule should indicate, however, that details are available if needed. Also reported on this line are amounts of capital gain distributions from mutual funds.

Line 8b – Less: cost or other basis and sales expenses Report the basis or cost of the securities sold in column (A) and the basis or cost of the other types of investments sold in column (B).

Line 8c – Gain or (loss) Enter the arithmetic difference between lines 8a and 8b.

Line 9 – Special events and activities Occasionally a community foundation may conduct a special fundraising event or activity. Revenue and expenses associated with these activities are reported on lines 9a and 9b. A support schedule describing the event is also required.

Line 9a – Gross revenue (not including $ xxx of contributions reported on line 1a)
The gross revenue, excluding any contributed amount, is reported on this line. For example: A donor contributes $1,000 to attend a community foundation event. The fair value of the meal

and entertainment is $150. $850 would be reported on line 1a and $150 would be reported on line 9a.

Line 9b – Less: direct expenses other than fundraising expenses The direct expenses associated with an event should be shown on this line. Typically, the amount should be substantially the same as the gross revenue, but could be less because certain costs of the event were paid for at less than fair value or were contributed.

Line 9c – Net income or (loss) from special events Enter the arithmetic difference between lines 9a and 9b.

Line 10a – Gross sale of inventory less returns and allowances Typically community foundations would not use this line. However, there could be occasions where books on philanthropy or fundraising techniques, etc. might be printed and sold in furtherance of the foundation’s exempt purpose. Sales of these books would be an example of what should be reported on this line.

Line 10b – Less: cost of goods sold The associated cost of the product, books, etc. should be reported on this line.

Line 10c - Gross profit (loss) from sales of inventory Enter the arithmetic difference between lines 10a and 10b.

Line 11 – Other revenue Typically, community foundations would not use this line. However, examples of other revenue include interest on notes not held as investments or program-related investments, interest on loans to officers, directors, trustees, key employees and other employees, etc. This line should not be used to report administrative fees. Fund fees should be eliminated and not be shown as other revenue.

Line 12 - Total revenue Enter the arithmetic addition of lines 1d, 2, 3, 4, 5, 6c, 7, 8d, 9c, 10c and 11.

Line 13 – Program services Enter the total from line 44, column (B).

Line 14 – Management and general Enter the total from line 44, column (C).

Line 15 – Fundraising Enter the total from line 44, column (D). Note: Every community foundation should have some amount recorded on this line

Line 16 – Payments to affiliates This line is not used by community foundations.

Line 17 – Total expenses Enter the arithmetic total of lines 13, 14, 15 and 16. For community foundations this line should equal line 44, column (A).

Line 18 – Excess or (deficit) for the year Enter the arithmetic difference between lines 17 and line 12.

Line 19 - Net assets or fund balances at beginning of year Enter the amount from line 73, column (A).

Line 20 - Other changes in net assets or fund balances Typically community foundations would report the increase (decrease) in the market value of its investments on this line. Also reportable on this line would be the changes in split-interest obligations associated with pooled income funds, gift annuities, trusts where the foundation serves as trustee, etc.

Line 21 – Net assets or fund balances at end of year Enter the arithmetic addition of lines 18, 19 and 20. This amount should also equal line 73, column (B).

Part II - Statement of Functional Expenses

In general, community foundations should utilize the techniques and disciplines used to complete the functional expense survey for community foundations. Foundation expenses should be allocated between program services expenses, management and general expenses, and fundraising expenses. Because community foundations are both a grantmaking and a fundraising entity, there should always be some allocation of expenses to the fundraising column.

Line 22 – Grants and allocations The total amount of grants approved by the foundation should be reported on this line. Distributions from organization (agency) endowment funds that are not reported on the foundation's financial statements because of FAS 136 should also be included on this line. A support schedule is also required detailing the amount reported on this line. Typically, the list should be shown by the foundation's program areas and indicate by recipient organization the number of grants it received and the total dollar amount of those grants. At a minimum the list should contain the recipient organization name and the amount received. (Instructions also state that unpaid amounts at the due date of the return, including extensions, should also be noted.)

Line 23 – Specific assistance to individuals Community foundations would not typically use this line.

Line 24 – Benefits paid to members Community foundations would not typically use this line.

Line 25 - Compensation of officers, directors, etc. Enter the total compensation paid to officers, directors, and key employees for the year. The amount should equal the total amount reported in Part V – List of Officers, Directors, Trustees and Key Employees.

Line 26 – Other salaries and wages Enter the total of employees' salaries not reported on line 25.

Line 27 – Pension plan contributions Foundation payments made to qualified and nonqualified retirement plans, including fees and other plan expenses, are entered on this line.

Line 28 – Other employee benefits Foundation payments for health, dental, life insurance, disability insurance, etc. should be entered on this line.

Line 29 – Payroll taxes The foundation's share of social security, Medicare, state unemployment, etc. should be entered on this line.

Line 30 - Professional fundraising fees Fees to outside fundraisers are entered on this line.

Line 31 – Accounting fees Accounting and auditing fees charged by outside firms or individuals are entered on this line.

Line 32 – Legal fees Total legal fees charged by outside firms or individuals are entered on this line.

Line 33 – Supplies The cost of office, building and other supplies is entered on this line.

Line 34 – Telephone The total telephone (equipment and service), telegram, and similar expenses are entered on this line. Internet access and provider charges would also be included on this line.

Line 35 – Postage and shipping Postage, overnight delivery, local courier, etc. should be included on this line.

Line 36 – Occupancy All expenses related to the foundation's occupancy should be included on this line. Included would be rent, all utilities (except telephone), cleaning, security, etc.

Line 37 - Equipment rental and maintenance The cost of renting and maintaining office and other equipment should be entered on this line.

Line 38 – Printing and publications The cost of printing and producing the foundation's annual report, newsletters, promotional materials, etc. should be reported on this line. Also reported is the cost of any purchased publications.

Line 39 – Travel Travel expenses, including transportation costs, fares, mileage allowances, meals and lodging are entered on this line.

Line 40 – Conferences, conventions and meetings Registration fees for conferences, such as the annual conference of community foundations are entered on this line.

Line 41 – Interest Interest on foundation operating loans, credit cards, lines of credit, etc. is entered on this line.

Line 42 – Depreciation, depletion, etc. The annual charge for depreciation is entered on this line. A support schedule is required detailing this expense.

Lines 43a through 43e – Other expenses All other foundation operating expenses are entered on these lines. Typical expenses include insurance, other consulting fees, investment management fees, bank trustee fees, etc.

Reporting of Joint Costs Typically, community foundations do not report in "program services" joint costs from a combined educational campaign and fundraising solicitation. However, if a foundation does, the amounts must be broken down and the amounts reported as program services, management and general, and fundraising.

Part III – Statement of Program Service Accomplishments

Statement of exempt purpose This statement permits a foundation to provide the reader of its Form 990 a view of the foundation's program activities. It is an opportunity to raise the level of the public's knowledge of the foundation's work. A good example of what might be reported in this section is the foundation's mission statement and how well it met the mission during this reporting period. This is an area where the foundation can be creative and promote its work.

Lines a through e – Grants and allocations Typically, a community foundation would report its grants and allocations by its major grant making areas, such as the arts, conservation, education, etc. Many community foundations, as a part of their mission statement, define the foundation's areas of grant making. These areas could also be used for listing the number of grants and the total amount approved.

Line f – Total of program service expenses Enter the arithmetic total of lines a through e. The amount should equal the total on line 44, column (B), Program services.

Part IV – Balance Sheets

(Requires both Beginning of year and End of year amounts.)

Line 45 – Cash – non-interest bearing Enter the dollar amount of non-interest bearing checking accounts, petty cash balances, etc.

Line 46 - Savings and temporary cash investment Balances in interest bearing checking accounts, savings accounts, income reserves, etc. are reported on this line. Income from these assets is reported on Part I, line 4.

Line 47a – Accounts receivable Accounts receivable for the sale of goods or the performance of services is entered on this line. Community foundations should use this line for recording accrued interest or dividends.

Line 47b – Less: allowance for doubtful accounts Enter the amount of accounts receivable assumed not to be collectable.

Line 48a – Pledges receivable If a community foundation maintains pledges, the beginning and ending balance is reported on this line.

Line 48b – Less: allowance for doubtful accounts Enter the amount of pledges receivable assumed not to be collectable.

Line 49 - Grants receivable The amount of grants (contributions) from government agencies, foundations and other organizations should be shown on this line.

Line 50 – Receivables from officers, directors, trustees, and key employees If a community foundation has made loans to officers, directors, trustees or other key employees, the balance due is reported on this line. A support schedule is also required, detailing the terms and all other pertinent details of the arrangement.

Line 51a – Other notes and loan receivables Typically, community foundations would use this line to report note and loan amounts related to program-related investments.

Line 51b – Less: allowance for doubtful accounts Enter the amount of note and loan receivables assumed not to be collectable.

Line 52 – Inventories for sale or use Typically community foundations would not use this line.

Line 53 – Prepaid expenses and deferred charges Amounts of short-term and long-term prepayments of expenses attributable to one or more future accounting periods should be entered on this line.

Line 54 – Investment – securities Community foundations should enter the amount of investments (bonds, stocks, mutual funds, etc.) at market value on this line. A support schedule is required for this line. Because of the large number of investments typically held by a community foundation, a summary by investment agent, financial institution, etc. is appropriate, with an explanation that the details are available if required.

Line 55a – Investments – land, buildings and equipment: basis The market value of land, buildings, and equipment held for investment purposes is reported on this line. A support schedule is required for this line. Typically, community foundations do not have large numbers of this type of investment. Consequently, the support schedule should detail each investment.

Line 55b – Less: accumulated depreciation Enter the associated depreciation recorded for investments of land, buildings, and equipment.

Line 56 – Investments – other Typically, community foundations would report on this line investment in limited partnerships, the cash surrender value of insurance policies for which the foundation is the owner and the beneficiary, etc.

Lines 57a – Land, buildings, and equipment: basis Community foundations should report on this line the value of office equipment, computers, etc. used in the operation of the foundation.

Line 57b – Less: accumulated depreciation Enter the associated depreciation recorded for land, buildings and equipment used in the operation of the foundation.

Line 58 – Other assets Community foundations should report on this line any other assets not reported above. A support schedule is required if more space is needed.

Line 59 - Total assets Enter the arithmetic total of lines 45 through 58. The amounts on this line must equal the amounts on line 74 for both the beginning and end of year.

Line 60 – Accounts payable and accrued expenses Amounts due vendors, accrued payroll taxes, etc. are typical community foundation amounts reported on this line.

Line 61 - Grants payable Enter the dollar amount of grants approved but not yet paid. Most community foundations approve multi-year grants, or have approved grants where contingencies (for example, matching requirements or construction ground breaking) have not been met by the recipient organization.

Line 62 – Deferred revenue Included on this line is revenue that the community foundation has received, but not yet earned as of the foundation’s year-end.

Line 63 – Loans from officers, directors, trustees and key employees Amounts owed to officers, directors, trustees or key employees should be reported on this line. A support schedule is required detailing this balance.

Line 64a – Tax-exempt bond liabilities Typically community foundations would not use this line. However, if the community foundation has issued tax-exempt bonds, a detailed support schedule is required.

Line 64b - Mortgages and other notes payable The dollar amount of mortgage and other notes payable is reported on this line. A detailed support schedule is required.

Line 65 - Other liabilities Entered on this line are any other liabilities not previously reported. A separate schedule should be attached if more space is needed.

Line 66 – Total liabilities Enter the arithmetic total of lines 60 through 65.

Organizations that follow SFAS 117 Most community foundations have adopted FAS 117 – Financial Statements of Not-for-Profit Organizations and consequently would use this section of Form 990.

Line 67 – Unrestricted Because of the variance power community foundations possess, generally all of the foundation's net assets should be reported on this line.

Line 68 - Temporarily restricted On occasion a community foundation may receive funds that because of time restrictions, is designated for some future time period. It is appropriate to report those amounts on this line.

Line 69 – Permanently restricted Typically, community foundations would not use this line on Form 990.

Organizations that do not follow SFAS 117 Community foundations choosing to use the income tax basis for financial statement reporting should use this section of Form 990.

Line 70 – Capital stock, trust principal, or current funds Community foundations would typically not use this line.

Line 71 – Paid-in or capital surplus, or land, building, and equipment fund Community foundations would typically not use this line.

Line 72 – Retained earnings, endowment, accumulated income, or other fund Enter the accumulated fund balances for all foundation component funds. This amount would correspond to "total net assets" if reporting under FAS 117.

Line 73 – Total net assets or fund balances Enter the arithmetic total of either lines 67 through 69 or lines 70 through 72. The amount in column (B) should equal the amount reported on line 21 of Part I.

Line 74 – Total liabilities and net assets/fund balances Enter the arithmetic total of lines 66 and 73. This amount should equal the amount reported on line 59 for both the beginning and end of year.

Part IV-A – Reconciliation of Revenue per Audited Financial Statements with Revenue per Return

Community foundations should report in this section of the return revenue recorded on the foundation's financial statements but not recorded on Form 990 as well as revenue recorded on Form 990 but not recorded on the foundation's financial statements. Typical items that should be shown are:

1) Net unrealized gains on investments. This should be the same amount reported on line 20 of Part I.
2) Donated services recorded as revenue on the foundation's financial statements.
3) Investment expenses netted against income on the foundation's financial statements.
4) Net additions to organization (agency) endowment funds not recorded as revenue under FAS 136 on the foundation's financial statements but included as revenue on Form 990. This would include contributions as additions to these funds.

Part IV-B – Reconciliation of Expenses per Audited Financial Statements with Expenses per Return

Community foundations should report in this section of the return, expenses recorded on the foundation's financial statements but not recorded on Form 990 as well as expenses recorded on Form 990 but not recorded on the foundation's financial statements. Typical items that should be shown are:

1) Donated services recorded as expenses on the foundation's financial statements.
2) Investment expenses netted against income on the foundation's financial statements.
3) Net subtractions to organization (agency) endowment funds not recorded as expenses under FAS 136 on the foundation's financial statements but included as an expense on Form 990. This would include grants made from these funds.

Part V – List of Officers, Directors, Trustees and Key Employees

Each person who was an officer, director, trustee, or key employee of the community foundation at any time during the year should be listed in this section. This is typically a sensitive area for community foundations and foundation officials may be tempted to use phrases such as "Information available upon request". This is unacceptable and could

result in penalties to both the foundation and the individual responsible for preparing the return (probably the CFO) for filing an incomplete return.

This section of Form 990 requires the name and address, title and average hours worked, compensation, contributions to employee benefit plans & deferred compensation, as well as expense account and other allowances for each officer, director, trustee and key employee.

A key employee is any person having responsibilities or powers similar to those of officers, directors, or trustees. A chief financial officer and the officer in charge of administration or program operations are both key employees if they have the authority to control the organization's activities, its finances, or both.

The address used for each individual listed should be the preferred address at which officers, etc. want the Internal Revenue to contact them. This would typically be the address of the community foundation.

An attachment may be used if there is insufficient room to list all officers, directors, trustees, and key employees.

Line 75 – Question concerning aggregate compensation of more than $100,000

This question should be answered "Yes" if an officer, director, trustee, or key employee received total compensation of more than $100,000 from the community foundation and all related organizations (such as supporting organizations) and more than $10,000 of this compensation was provided by the related organization.

Community foundation officers with compensation in excess of $100,000, and serving as officers of a supporting organization would have to be listed on the supporting organization's Form 990 as an individual of a related entity with aggregate compensation in excess of $100,000.

Part VI – Other Information

Line 76 – Did the organization engage in any activity not previously reported to the IRS?
If yes, a detailed description of each activity must be attached.

Line 77 – Were any changes made in the organizing or governing documents but not reported to the IRS? If yes, a confirmed copy of the changes must be attached.

Line 78a – Did the organization have unrelated business gross income of $1,000 or more during the year covered by this return? If yes, form 990-T must be filed.

Line 78b – If "Yes" has it filed a tax return on Form 990-T for this year? If the answer to line 78a is "yes", the foundation should file Form 990-T and check the "Yes" box on this line as well.

Line 79 – Was there a liquidation, dissolution, termination, or substantial contraction during the year? If yes, a descriptive statement must be attached.

Line 80a – Is the organization related (other than by association with a statewide or nationwide organization) through common membership, governing bodies, trustees, officers, etc. to any other exempt or nonexempt organization? Community foundations with corporate affiliates as well as supporting organizations should answer this question in the affirmative.

Line 80b – If "Yes," enter the name of the organization and whether it is exempt or nonexempt. A list of the corporate affiliates and supporting organizations, along with their individual EIN should be attached. The attached schedule should also indicate that these organizations are exempt.

Line 81a- Enter the amount of political expenditures, direct or indirect. Typically community foundations do not make expenditures intended to influence the selection, nomination, election or appointment of anyone to a Federal, state or local public office.

Line 81b – Did the organization file Form 1120-POL for this year? However, if a community foundation makes political contributions in excess of $100 they must file Form 1120-POL.

Line 82a – Did the organization receive donated services or the use of materials, equipment, or facilities at no charge or at substantially less than fair rental value? Typically, community foundations do receive "in-kind" goods or services at a reduced cost and should answer this question in the affirmative.

Line 82b. – If "Yes", you <u>may</u> indicate the value of these items here. The value of the "in-kind" or other donated services may be reported on this line. It would appear to be good practice to show this amount.

Line 83a – Did the organization comply with the public inspection requirements for returns and exemption applications? Community foundations are required to comply with public inspection requirements and if in compliance, the answer to this question is "yes".

Line 83b – Did the organization comply with the disclosure requirements relating to quid pro quo contributions? Community foundations are required to comply with the disclosure requirements related to quid pro quo contributions and if in compliance, the answer to this question is "yes".

Line 84a – Did the organization solicit any contributions or gifts that were not tax deductible? Typically, community foundations do not receive contributions that are not tax deductible.

Line 84b – If "Yes," did the organization include with every solicitation an express statement that such contributions or gifts were not tax deductible? Typically, community foundations do not receive contributions that are not tax deductible and this question should be answered - N/A.

Line 85a through 85h – Apply to 501(c)(4), (5) or (6) organizations These questions do not apply to community foundations.

Line 86a and 86b – Apply to 501 (c)(7) organizations These questions do not apply to community foundations.

Line 87a and 87b – Apply to 501(c)(12) organizations These questions do not apply to community foundations.

Line 88 – At any time during the year, did the organization own a 50% or greater interest in a taxable corporation or partnership, or an entity disregarded as separate from the organization under Regulation sections 301.7701-2 and 301.7701-3? Typically, community foundations would not own 50% or greater interest in a taxable corporation or partnership. However, by means of a bequest or a gift from a living donor, it conceivably could occur. If the answer is therefore affirmative, Part IX, Information Regarding Taxable Subsidiaries, must be completed.

Line 89a – Enter amount of tax imposed on the organization during the year under: section 4911; section 4912; section 4955. This question, which relates to excise taxes imposed for excess lobbying expenditures, would typically not apply to community foundations.

Line 89b – Did the organization engage in any section 4958 excess benefit transaction during the year or did it become aware of an excess benefit transaction from a prior year? Hopefully, a community foundation has not engaged in any excess benefit transactions. If, however, the community foundation becomes aware of the occurrence of any excess benefit transactions, it must answer this question "Yes".

Line 89c – Enter the amount of tax imposed on the organization managers or disqualified persons during the year under sections 4912, 4955 and 4958. If a tax was imposed on the community foundation or a foundation manager as a result of an excess benefit transaction, the amount of the tax imposed should be reported on this line.

Line 89d – Enter the amount of tax on line 89c, reimbursed by the organization. The amount of tax reported on line 89c and reimbursed by the organization to a disqualified person or organization manager must be reported on this line.

Line 90a – List the states with which a copy of this return is filed Typically community foundations file their Form 990 with one state. If, however, the return is filed with other states, all should be listed.

Line 90b – Number of employees employed in the pay period that includes March 12, 2004 The number of all full and part-time employees as of this date should be reported on this line.

Line 91 – The books are in care of Community foundations might list the individual who typically would be the contact person concerning financial questions about the foundation, usually the President or CFO, or simply indicate that they are in the possession of the community foundation.

Line 92 – Section 4947(a)(1) nonexempt charitable trusts This question does not apply to community foundations.

Part VII – Analysis of Income-Producing Activities

In general, unless a community foundation has unrelated business income, all foundation income producing activity amounts should be reported in column (D), utilizing the appropriate "Exclusion code" in column (C). Since the IRS has provided "standard" exclusion codes, column (E) should not be used, unless an exclusion code does not exist. Amounts reported in column (E) must be explained in Part VIII - Relationship of Activities to the Accomplishment of Exempt Purposes.

Typically, community foundations would use exclusion codes 14, 18 and possibly 1. 1) Exclusion code 14 is for dividends, interest and other substantially similar income from ordinary and routine investments.
2) Exclusion code 18 is for the gain (or loss) from the sale of investments and other non-inventory property.
3) Exclusion code 1 is for income from an activity that is not regularly carried on.

Line 93a through 93e – Program service revenue Corresponds to amounts reported in Part I on Line 2.

Line 93f – Medicare/Medicaid payments Typically not used by community foundations.

Line 93g – Fees and contracts from government agencies Typically not used by community foundations.

Line 94 – Membership dues and assessments Typically not used by community foundations.

Line 95 – Interest on savings and temporary cash investments Corresponds to amounts reported in Part I on Line 4.

Line 96 – Dividends and interest from securities Corresponds to amounts reported in Part I on Line 5.

Line 97a – Net rental income or (loss) from real estate: debt-financed property Corresponds to amounts reported in Part I on Line 6c.

Line 98b - Net rental income or (loss) from real estate: not debt-financed property Corresponds to amounts reported in Part I on Line 6c.

Line 99 – Other investment income Corresponds to amounts reported in Part I on Line 7.

Line 100 – Gain or (loss) from sales of assets other than inventory Corresponds to amounts reported in Part I on Line 8d.

Line 101 – Net income or (loss) from special events Corresponds to amounts reported in Part I on Line 9c.

Line 102 – Gain or (loss) from sales of inventory Corresponds to amounts reported in Part I on Line 10c.

Line 103a through e – Other revenue Corresponds to amounts reported in Part I on Line 11.

Line 104 – Subtotal Enter the arithmetic total of lines 93a through 103e.

Line 105 – Total Enter the arithmetic total of columns (B), (D), and (E).

Note: the amount reported on line 105, plus the amount reported on line 1d, Part I, should equal the amount reported on line 12, Part I.

Part VIII – Relationship of Activities to the Accomplishment of Exempt Purposes

This section of Form 990 is used only if amounts are reported in column (E), Related or exempt function income of Part VII, Analysis of Income Producing Activities. If amounts are reported, include an explanation of how each activity for which income is reported contributed importantly to the accomplishment of the foundation's exempt purposes (other than by providing funds for such purposes).

Part IX – Information Regarding Taxable Subsidiaries and Disregarded Entities

This part of the Form 990 must be completed by a community foundation, if the question on line 88 was answered affirmatively and/or if amounts were reported in column (B) of Part VII. Otherwise it should be marked N/A.

Part X – Information Regarding Transfers Associated with Personal Benefit Contracts

Typically, community foundations do not engage in Personal Benefit Contracts. However, if the foundation received funds to pay premiums for a personal benefit contract or paid premiums for a personal benefit contract, the appropriate boxes should be checked. Forms 8870 and 4720 would also need to be filed with the IRS.

Please Sign Here *Typically the community foundation's Form 990 is signed by either the CEO or CFO.*

Paid Preparer's Use Only If the community foundation's Form 990 is prepared by, for example, the foundation's external auditors, the appropriate information should be entered in this section of the return and signed by the paid preparer. In many instances, the Form 990 is prepared internally and reviewed by the foundation's external auditors.

FORM 990 - SCHEDULE A

All community foundations must complete Form 990 – Schedule A.

Part I – Compensation of the Five Highest Paid Employees Other Than Officers, Directors, and Trustees

This part is similar to Part V of Form 990 and requires the listing of the five foundation employees with the highest compensation over $50,000. Also entered is the number of other employees with annual compensation over $50,000 who are not individually listed in Part I and are not listed in Part V of Form 990.

The address used for each individual listed should be the preferred address at which these employees want the Internal Revenue to contact them. This would typically be the address of the community foundation.

Part II – Compensation of the Five Highest Paid Independent Contractors for Professional Services

Listed in this part are the five highest paid independent contractors (whether individuals, firms, or corporations) who performed personal services of a professional nature for the foundation and in return, received over $50,000 for the year from the foundation. Typically, these would include attorneys, accountants, computer consultants, professional fundraisers, etc. Also entered is the number of other independent contractors who received more than $50,000 for the year and who are not individually listed in Part II.

Part III – Statements About Activities

Line 1 – If a community foundation has attempted to influence national, state, or local legislation, including any attempt to influence public opinion on a legislative matter or referendum, then the box on this line must be marked “Yes”. In addition, the community foundation must complete Part VI-A, if an election was filed under section 501(h), by filing Form 5768. Other community foundations checking “Yes” must complete Part VI-B and attach a statement detailing the lobbying activities. If a community foundation checks the box “No” then neither Part VI-A nor Part VI-B is completed.

Line 2 – During the reporting year, if a community foundation, either directly or indirectly, engaged in any of the acts listed on lines 2a through 2e with any of its trustees, directors, officers, key employees, or members of their families, or with any taxable organization with which any such person is affiliated as an officer, director, trustee, majority owner, or principal beneficiary, the appropriate box should be checked "Yes". In addition, a detailed statement explaining the nature of the transactions should be prepared.

Line 2a – Sale, exchange, or leasing of property? Check "Yes" only if the sale, exchange or the leasing of property with a community foundation's trustee, officer, director, etc. occurred.

Line 2b – Lending of money or other extension of credit? Check "Yes" only if the lending of money or other extension of credit with a community foundation's trustee, officer, director, etc. occurred.

Line 2c – Furnishing of goods, services, or facilities? Check "Yes" only if a trustee, officer, director, etc. furnished goods, services, or facilities to a community foundation.

Line 2d – Payment of compensation (or payment or reimbursement of expenses if more than $1,000)? Generally, community foundations will have to answer this question "Yes", since it will have paid officers (president, executive director, for example) more that $1,000 in compensation. A reference to Part V of Form 990 is appropriate and should provide adequate disclosure and explanation.

Line 2e – Transfer any part of its income or assets? Check "Yes" only if the transfer of any part of a foundation's income or assets to a community foundation's trustee, officer, director, etc. occurred.

Line 3a – Does the organization make grants for scholarships, fellowships, student loans, etc.? If the community foundation makes scholarship grants, then the "Yes" box should be checked.

Line 3b – Do you have a section 403(b) annuity plan for your employees? If the community foundation sponsors a 403(b) tax deferred annuity plan for its employees, then the "Yes" box should be checked.

Line 4a – Did you maintain any separate account for participating donors where donors have the right to provide advice on the use or distribution of funds? Community foundations should check this box "Yes". Supporting organizations/foundations should check this box "No".

Line 4b – Do you provide credit counseling, debt management, credit repair, or debt negotiation services? Generally community foundations do not provide these types of services.

Part IV – Reasons for Non-Private Foundation Status

All community foundations should check the box on line 11b. Supporting organizations should check the box on line 13 and report the name of the community foundation it supports in the space provided.

A community foundation is not a private foundation because it is:

Line 11a – An organization that normally receives a substantial part of its support from a governmental unit or from the general public - It is recommended that **"corporate form"** community foundations check this box.

Line 11b – A community trust – It is recommended that **"trust form"** community foundations check this box.

Line 13 – An organization that is not controlled by any disqualified persons (other than foundation managers) and supports organizations described in: (1) lines 5 through 12 above; or (2) section 501(c)(4), (5), or (6), if they meet the test of section 509(a)(2). Provide the following information about the supported organization(s).

Part IV-A - Support Schedule

This part of Form 990 Schedule A must be completed by all community foundations. This part of the return is used to calculate the percent of public support a community foundation received and is commonly called the public support test.

In general, all data reported in this section of the return is on the "cash" method of accounting.

Line 15 – Gifts, grants and contributions received Enter for the reporting years the total amount of gifts, grants and contributions. Community foundations should exclude "unusual grants" from these amounts. Unusual grants are typically unexpected because of the amount and are large enough to endanger the community foundation's status as normally meeting the public support test. A list (which is not open to public inspection) must be prepared itemizing the amounts and describing the nature of the gift, grant or contribution.

Line 16 – Membership fees received Typically, community foundations do not receive membership fees.

Line 17 – Gross receipts from admissions, etc. Typically, community foundations do not have gross receipts from admissions.

Line 18 – Gross income from interest, dividends, amounts received from payments on securities loans, rents, royalties, and unrelated business taxable income (less section 511

taxes) from business acquired by the organization Enter on this line the total gross income from interest, dividends, etc. on a "cash" basis.

Line 19 – Net income from unrelated business activities not included in line 18 If a community foundation has income from unrelated business income activities these amounts should be reported on line 19.

Line 20 – Tax revenues levied for the organization's benefit and either paid to it or expended on its behalf Community foundations would typically not use this line.

Line 21 – The value of services or facilities furnished to the organization by a governmental unit without charge. Do not include the value of services or facilities generally furnished to the public without charge. If a community foundation receives services or facilities from a governmental unit without charge, the value is reported on line 21.

Line 22 – Other income All other income received by a community foundation (excluding gains or (losses) from the sale of capital assets) should be reported on line 22. A support schedule is required.

Line 23 – Total of lines 15 through 22 Enter the arithmetic total of lines 15 through 22.

Line 24 – Line 23 minus line 17 Enter the arithmetic difference of line 23 less line 17.

Line 25 – Enter 1% of line 23 Multiply the amounts on line 23 by 1% (.01) and enter the result on line 25.

Line 26 – Organizations described on lines 10 or 11 All community foundations should complete this section.

Line 26a – Enter 2% of amount in column (e), line 24 Multiply the amounts on line 24, column (e) by 2% (.02) and enter the result on line 26a.

Line 26b – Attach a list (which is not open to public inspection) showing the name of and amount contributed by each person (other than a government unit or publicly supported organization) whose gifts for 19xx through 20xx exceed the amount shown on line 26a. This schedule should be clearly labeled "Not Open To Public Inspection". The total amount of these "excess" contributions should be reported on line 26b.

Line 26c – Total support for section 509(a)(1) test: Enter line 24, column (e) Enter the amount that appears on line 24, column (e) on line 26c.

Line 26d – Add amounts from column (e) for lines: 18, 19, 22 and 26b. Enter the arithmetic total of lines 18, 19, 22 and 26b on line 26d.

Line 26e – Public support (line 26c minus line 26d total) Enter the arithmetic difference of line 26c less line 26d.

Line 26f – Public support percentage (line 26e (numerator) divided by line 26c (denominator)) Divide line 26e by line 26c and report the result as a percent on line 26f. If this percent is greater than or equal to 33 1/3%, the community foundation has passed the "mechanical" public support test calculation.

If it is less than 33 1/3%, a community foundation may still be classified as publicly supported, based upon the facts in its case and if it receives at least 10% of its support from the general public. A detailed statement of the facts is required.

Line 27a through line 27h – Organizations described on line 12 Community foundations should not complete this section of Form 990 –Schedule A.

Line 28 – Unusual Grants As indicated in the instructions for line 15, a list (which is not open to public inspection) must be prepared itemizing the amounts and describing the nature of the gift, grant or contribution classified as unusual grants by the community foundation.

Part V – Private School Questionnaire

Community foundations should not complete this part of Form 990 Schedule A.

Part VI-A – Lobbying Expenditures by Electing Public Charities

This part of Form 990 Schedule A should be completed by community foundations only if the foundation checked yes to question 1 in Part III and has made an election under section 501(h) by filing Form 5768.

Part VI-B – Lobbying Activity by Non-Electing Public Charities

This part of Form 990 Schedule A should be completed by community foundations only if the foundation checked yes to question 1 in Part III and has not made an election under section 501(h) by filing Form 5768.

Part VII – Information Regarding Transfers To and Transactions and Relationships With Non-Charitable Exempt Organizations

Community foundations should complete this section of Form 990 Schedule A to report on direct and indirect transfers to, direct and indirect transactions with and relationships with any other non-charitable exempt organization. Generally, community foundations do not engage in these types of activities with non-charitable exempt organizations.

FORM 990 - SCHEDULE B

Generally, all community foundations must complete Form 990 – Schedule B.

Prior to the year 2000 version of Form 990, community foundations were required to attach a list of contributors whose accumulated contributions were $5,000 or more and greater than 2% of the amount reported on line 1d of Form 990. This attachment to Form 990 identified the contributor, whether or not the contribution was cash or non-cash and, most importantly, it was not open for public inspection. Because of the IRS's problems with releasing the "Not Open For Public Inspection" information, they have developed "Schedule B" so that it can be easily identified and presumably removed before they release copies of the foundation's Form 990.

Schedule B has three parts. However, community foundations will only use parts I and II. If by some chance the arithmetic works out and you do not have contributions that are $5,000 or more and greater than 2% of the amount reported on line 1d, you will <u>not</u> have to complete Schedule B. However, on page one of the return, you will be required to check box "L", indicating that the organization is not required to attach Schedule B. Established supporting organizations of a community foundation that are no longer receiving major gifts may not have to complete Schedule B.

Schedule B, Part I is to be used for cash contributors meeting the above contribution criterion. Part II is for non-cash contributions. Remember, if you have entries in Part II, then there also should be an amount entered on line 1d of Part I for non-cash contributions.

Filing Tips

The following are some general filing tips and instructions:

1. **Form 990 must be filed by the 15th day of the 5th month after the community foundation's annual accounting period ends. Consequently, a calendar year end foundation must file by May 15th of the following year; a June 30 year-end must file by November 15th, etc.**
2. **All community foundations mail the Form 990 to the same Internal Revenue Service Center in Ogden, Utah 84201-0027.**
3. **When mailing the foundation's Form 990 it is highly recommended that it be sent "certified mail, return receipt requested". It may save some problems later on, should the IRS claim that the Form 990 was not mailed on a timely basis.**
4. **If an extension to file the form 990 is needed, be sure to request it before the due date of the Form 990. When the approved extension is received back from the IRS, be sure to include a copy with the completed Form 990 when it is ultimately mailed. It is recommended that it be placed behind the first page of the completed Form 990.**
5. **If your state accepts a copy of the Form 990 for its annual filing requirement, be sure to remove Schedule B – Schedule of Contributors and any support schedule included for Schedule A – Part IV-A, Line 28 Unusual Grants.**
6. **When making copies for mailing, it is highly recommended that a "Public Inspection" copy be made at the same time. Again, remember to remove Schedule B – Schedule of Contributors and any support schedule included for Schedule A – Part IV-A, Line 28 Unusual Grants.**
7. **Since community foundations must provide a copy of the foundation's Form 990 upon request, when making copies for mailing, it would also be a good time to determine the copying cost that will be charged (if your foundation chooses to charge one). The IRS's guideline is a dollar for the first page and fifteen cents for each additional page. This is in addition to any mailing costs.**
8. **"Public Inspection" copies of the foundation's Form 990, which include the current year's and the prior two years, should be kept in a convenient location at the foundation. A three-hole binder is a convenient method of maintaining the "Public Inspection" copies.**

9. **Remember, unless you want to be high on the IRS's list for an audit, on Part II "The Statement of Functional Expenses" should always have some allocation of expenses in fundraising column.**

<u>Filing Requirements</u>
<u>Form 8282 and Form 8283</u>

Overview and Summary

If your organization receives a gift of "Charitable Deduction Property" (see definition below) and sells it within three years after its receipt, you must file ***Form 8282, Donee Information Return***. **NOTE: The Pension Protection Act of 2006 (H. R. 4) with an effective date of August 17, 2006 changed this holding period from two years to three years.** Form 8282 basically provides the IRS with information it can use to validate the reasonableness of a charitable contribution deducted by a donor on his tax return. In the simplest of cases, you include the description of the property, the date you received it, the date you disposed of it and the amount received upon disposition. The IRS can then compare this to information included on ***Form 8283, Noncash Charitable Contributions***, which is filed with the donor's tax return.

Completion and filing of Form 8283 is the **Donor's** responsibility. Donors must file Form 8283 to report information about noncash charitable contributions. Donors are required to file Form 8283 with their tax return for the year in which the property was contributed and the deduction claimed.

Completion and filing of Form 8282 is the **Donee Organization's** responsibility. Donee Organizations use Form 8282 to report information to the IRS about dispositions of certain charitable deduction property made within **<u>three</u>** years after the donor contributed the property.

A good practice is to make sure that for every Form 8283 an organization signs, the situation is reviewed to determine if it is appropriate to file Form 8282. Additionally, internal procedures should include an evaluation of filing Form 8282 whenever gifts other than cash and publicly traded securities are sold.

Frequently Asked Questions

Q. What is Charitable Deduction Property?
A. Charitable Deduction Property is any property (other than money or publicly traded securities) for which the organization signed, as donee, an appraisal summary.

Q. What is an Appraisal Summary?
A. If a donor makes a contribution of property (other than money or publicly traded securities) with a claimed value of greater than $5,000, he must attach ***Form 8283, Noncash Charitable Contributions***, to the return on which the deduction is shown. Section B of Form 8283 is the Appraisal Summary. The donee must sign part IV of this section.

Q. When is an appraisal required?
A. Generally, an appraisal is required for noncash donations EXCEPT if the property is:
- Nonpublicly traded stock of $10,000 or less
- A vehicle (including a car, boat or airplane) donated after 2004 if the deduction for the vehicle is limited to the gross proceeds from its sale
- Publicly traded securities

- Any donation made after June 30, 2004 of stock in trade, inventory, or property held primarily for sale to customers in the ordinary course of the donors trade or business
- A donation by a C corporation before June 4, 2004. A donation made by a C corporation after June 3, 2004, and reported in Section B of Form 8283 does require an appraisal unless one of the previous exceptions applies.

Note: An appraisal is required for Rule 144/145 stock for a fair market deduction over $5,000.

Q. What are publicly traded securities?
A. These are securities that are:

- Listed on an exchange in which quotations are published daily
- Regularly traded in national or regional over-the-counter markets for which published quotes are available, or
- Shares of a mutual fund for which quotations are published on a daily basis in a newspaper of general circulation throughout the United States

Q. Who should sign Form 8283 for the donee organization?

A. The person who signs for the donee must be an official authorized to sign the donee's tax or information returns, or a person specifically authorized to sign by that official. A copy of Form 8283 is to be given to the donee organization.

Q. Is the Donee Organization attesting to the appraised value by signing the Appraisal Summary?
A. No, by signing Part IV of Section B, Form 8283 the donee organization is simply acknowledging receipt of the property on the date specified on the form. The signature also indicates knowledge of the fact that should the donee organization sell, exchange or otherwise dispose of the property within 3 years after the receipt it is to file Form 8282 with the IRS.

Q. When should Form 8282 be filed?
A. The form must be filed within 125 days after the disposition. Sometimes this will require completion of the form prior to receiving the completed Form 8283 from the donor.

Note: We have contacted consultants in the tax departments of various accounting firms whose advice has indicated that we do not need to file the 8282 until we receive the 8283. They cite the exception noted in the instructions that states that you may file within 60 days after you become aware you were liable if you did not know you had to file until you received an Appraisal Summary (Form 8283 Section B) to sign from a donor. If you have any questions regarding this issue, we suggest you consult your advisor.

Q. Can the filing deadline be extended?
A. No. File the form by the due date and include your organization's name, address, and EIN and complete at least Part III, col. (a). You do not have to complete the remaining items if the information is not available. For example, you may not have all the information necessary to complete all entries if the donor's appraisal summary is not available to you.

Q. Where should the form be filed?
A. It should be sent to the Internal Revenue Service, Ogden, UT 84201-0027**.** A copy of Form 8282 is also to be given to the donor.

Q. Are their penalties for non-compliance?
A. Yes, you may be subject to a penalty if you fail to file Form 8282 by the due date, or fail to file it completely or correctly. The penalty is generally $50.

You may obtain the forms and instructions from the IRS Internet Web Site at http://www.irs.gov/formspubs/or by phone 1-800-829-3676

This paper was prepared by the Accounting Practices Committee, which consists of accounting professionals working in the community foundation field. The guidance presented is based on their extensive review of authoritative accounting and/or tax literature available as of the date of this paper. Questions about the guidance given in this paper may be directed to members of the Committee, whose names are listed at the end of this paper.

Please consult with your accounting and/or tax advisors for specific advice tailored to your community foundation's particular circumstances.

Gift Accounting Basics

Introduction

When a community foundation receives a gift of cash, recording it is straightforward: cash is debited and a contribution revenue account is credited. Often, however, gifts are not so clean cut. Questions arise as to the actual date of the gift, the value to be assigned and whether it should even be recorded as a gift at all. The purpose of this discussion is to provide guidance as to the proper timing and valuation in recording gifts typically received by community foundations.

Statement of Financial Accounting Standards No. 116, *Accounting for Contributions Received and Contributions Made* (FAS 116) provides some basic definitions and guidance on accounting for most gifts received by community foundations. Specifically, it provides the following principles and definitions:

- A contribution is an **unconditional** transfer of cash or **other assets** to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner.

- For purposes of FAS 116 “other assets” include securities, land, buildings, use of facilities or utilities, materials and supplies, intangible assets, services and **unconditional promises** to give those items in the future.

- An **unconditional promise** to give is a promise to give that depends only on passage of time or demand by the promisee for performance.

Under FAS 116 a community foundation is required to recognize contributions (as defined above) as revenue when they are received.

The following discussion provides answers relating to the value, timing and recording of gifts typically received by community foundations.

I. Cash

A contribution of cash is completed upon the unconditional delivery of a check or currency to the foundation.

When is a gift of cash completed?
If mailed: If a community foundation or its agent (broker, bank, custodian, etc.) receives a gift of cash in the ordinary course of the mail, the gift is completed on the date of the mailing if US postal service is used. While many foundations rely (particularly at the end of the year) on the postmark date as the date of mailing, the Income Tax Regulations do not mandate the use of the postmark date. The regulations simply state that the "…mailing of a check which subsequently clears in due course will constitute an effective contribution on the date of delivery or mailing." Since the date the donor mailed the gift is not necessarily known, some foundations have been advised that they may rely on the donor's date on the check as long as it is received within a reasonable number of business days after the first of the year. This is an area where you should consult with your legal counsel and develop a specific policy within your own foundation. Although not a standard to rely on without your legal counsel's advice, it is common for community foundations to consider a range of between 5 to 7 business days as reasonable with gifts received after that range evaluated based on individual facts and circumstances.

If a private delivery service (such as Federal Express or UPS) is used, the gift is completed when received by the foundation.

If delivered personally: If a donor delivers cash to a community foundation the contribution is completed when received by the foundation.

If transferred electronically: If a donor transfers cash to a foundation electronically, the gift is completed when the transfer occurs and the funds are in an account in the name of the community foundation. Merely directing a transfer does not qualify as a completed gift. A transfer must be posted to the community foundation's bank account.

How is the gift valued?
The gift value is the amount of the cash proceeds.

II. Securities

A contribution of stock, bonds or mutual fund shares is completed only upon the unconditional delivery of a properly endorsed security to the foundation or its agent (broker).

When is a gift of securities completed?
If mailed: If a community foundation or its agent (broker, bank, custodian, etc.) receives a paper stock certificate in the ordinary course of the mail, the gift is completed on the date of the

mailing if the US postal service is used. While many foundations rely (particularly at the end of the year) on the postmark date as the date of mailing, the Income Tax Regulations do not mandate the use of the postmark date. Relating to gifts of properly endorsed stock, the regulations state that "…the gift is completed on the date of delivery, or if such certificate is received in the ordinary course of the mails, on the date of mailing". As with gifts of cash, since the date the donor mailed the gift is not necessarily known, some foundations have been advised that they may rely on the donor's date of endorsement as long as it is received within a reasonable number of business days after the first of the year. This is an area where you should consult with your legal counsel and develop a specific policy within your own foundation. Although not a standard to rely on without your legal counsel's advice, it is common for community foundations to consider a range of between 5 to 7 business days as reasonable with gifts received after that range evaluated based on individual facts and circumstances.

If a private delivery service (such as Federal Express or UPS) is used, the gift is completed when received by the foundation.

If delivered: If a donor delivers a paper stock certificate to the issuing corporation for transfer into the name of the community foundation, the contribution is completed when the stock is actually transferred on the corporation's books. More frequently, however, a donor delivers a paper stock certificate to the foundation or to an agent (broker, etc.) of the foundation. In this instance the gift is completed upon receipt by the foundation or broker with the appropriately executed stock power.

If transferred electronically: Most securities are held in "street name". If a donor transfers a security to a community foundation electronically, the gift is completed when the security transfer occurs and the security is in an account in the name of the community foundation. Merely directing a security transfer does not qualify as a completed gift. A transfer must have occurred on the broker records and the transfer posted to the community foundation's brokerage account.

How is the gift valued?

If publicly traded stock: A publicly traded stock is valued using the fair market value of the stock on the date of the gift. The IRS has ruled that an acceptable method of determining the fair market value is to use the mean trading value (average of the high and low trading values) on the date of the gift.

If non-publicly traded stock: In most instances, a donor will need a qualified appraisal to take a tax deduction for non-publicly traded stock. The community foundation can value the gift using the same appraisal. If the community foundation sells the non-publicly traded stock within two years of the gift, Form 8282, "Donee Information Return" is to be filed with the IRS. The "amount received upon disposition" (box III e) is the gross sales proceeds received by the foundation. For more information on the details of this filing requirement please see "Filing Requirements Form 8282 and Form 8283" provided as a separate document by the Accounting Practices Committee in the Fall 2003 FAOG newsletter.

If a bond: A bond is valued using the closing value on the day of the transfer/delivery.

If mutual fund shares: Mutual fund shares are valued using the closing net asset value (NAV) on the day of the transfer/delivery.

NOTE: In accordance with Financial Accounting Standards 144, *Accounting for Impairment or Disposal of Long-Lived Assets*, if a community foundation receives a gift of securities that represent a majority financial interest (generally 51% of common shares outstanding) in a business enterprise, it is required to consolidate the assets, liabilities and changes in the net assets of such an entity in its financial statements for the time period it holds such securities. Community foundations that wish to avoid this result should consider arranging for the sale of such securities simultaneous with their receipt (or shortly thereafter) from the donor.

III. Pledges and Bequests

Pledges and bequests are “promises to give” –written or oral agreements to contribute cash or other assets. They are contributions if they are unconditional, that is, if they do not depend on a specified and uncertain event to be binding.

When is a gift made by a pledge or bequest completed?
If a community foundation receives a pledge and the pledge is unconditional, the gift is completed when the pledge is received, regardless of whether the foundation would legally pursue collection of the pledge. The community foundation debits a contribution receivable account and credits a contribution revenue account. Based upon the foundation’s collection experience an allowance for uncollectible pledges may be required.

If a community foundation receives a bequest, the gift is completed when it becomes irrevocable. Generally, this means when the probate court declares the will valid and authorizes distribution of assets. Until a court finalizes a will it can be contested and is not considered irrevocable. Additionally, because a donor can modify a will at any time prior to death, until the donor dies bequests are conditional promises and never recorded as revenue.

How is the gift valued?
The amount of the gift and receivable to be recorded for pledges and bequests is the fair market value of the asset(s) to be received. If a pledge or bequest is to be paid over a number of years, FAS 116 requires the receivable to be discounted to its present value using an appropriate rate of interest. If the value of a bequest is not known, or cannot be reasonably estimated, the gift and receivable should not be recorded. For example, if a foundation is named as the residual beneficiary of a large estate, and the value of the estate assets, taxes, and other claims against the estate has not yet been determined, the gift should not be recorded. When these amounts can be estimated with reasonable accuracy, the foundation records the gift and receivable.

IV. Credit Card Gifts

Credit card donations can be made in several different ways – online, over the telephone or by pledge card sent via the mail with the necessary credit card information in order to process the gift.

When is a gift made by a credit card completed?
If a community foundation receives a gift made by credit card, the gift is completed on the date the credit card donation is received or postmarked, not necessarily when the credit card payment is processed. However, the foundation should process the credit card as close to the receipt date as possible; because the date the charge is processed is the date the donor is allowed to take the deduction for tax purposes.

How is the gift valued?
A gift made by credit card is recorded at the gross amount of the donation. The associated fees should be charged as expense either to the fund or as an administrative expense, depending on the policy of the community foundation.

V. Gifts–In–Kind

If material, donated supplies and equipment should be recorded as a contribution using the fair market value.

When is a gift-in-kind completed?
If a community foundation receives a gift-in-kind, the gift is completed when it is received.

How is the gift valued?
Donated supplies and equipment used in the ordinary course of a community foundation's business should be recorded using the fair market value or the amount which the organization would normally have to pay for similar items. A value for used office equipment and the like should be obtained from a dealer in such items. The contribution is offset by an expense recording the use of the item or items. If the gift is office furniture or equipment with a value that, if purchased, would require it to be capitalized, the contribution should be offset by an entry recording the item as an asset on the books of the community foundation. The asset will be depreciated along with other similar items owned by the community foundation.

Accounting and valuation rules for contributions of items received for fundraising purposes (i.e. auctions or other similar fundraising sales) can be found in paragraph 5.56 of the AICPA Audit and Accounting Guide for Not-for-Profit Organizations.

VI. Contributed services

In certain specific circumstances a community foundation should place a value on contributed services and record them as contributions in their financial statements.

When are contributed services a gift?
If a community foundation receives contributed services, a contribution should be recognized if either of the following conditions is satisfied:

- The services create or enhance non-financial assets or

- The services require specialized skills, and are provided by persons possessing those skills and would typically have to be purchased by the not-for-profit organization if not provided by donation. Examples of such services are those provided by accountants, investment advisors, teachers, electricians, lawyers, doctors and other professionals and craftspeople.

If neither criteria is met SFAS No. 116 precludes recording a value for these services, although disclosure in a footnote is encouraged.

How is the gift valued?

If contributions of contributed services are reported they should be recorded at their fair value (regardless of whether the community foundation could afford to purchase the services at their fair value). The dollar value assigned to contributed services should be reflected in the income section of the financial statements. In most cases it will be offset by an expense based on the nature of the work performed. If the enhanced asset was a fixed asset that has been capitalized, the offset would be to an applicable fixed asset account and the amount would be depreciated.

Materiality is an important factor in determining whether the value of contributed services is to be recorded. There is a cost to keep records necessary to track the value of contributed services and unless the resulting amounts are significant it is wasteful for the organization to record them.

VII. Life Insurance policies

When is a gift of a life insurance policy completed?

A gift of life insurance is completed when the community foundation is named as the owner of the policy and the **irrevocable beneficiary**. If the donor is the owner, the community foundation is the revocable beneficiary; that is, the donor may change the beneficiary at any time. In such a case nothing is recorded because the gift is conditional since the donor could change the beneficiary at any time.

How is the gift valued?

If the policy is fully paid up the gift is recorded at its fair market value, which is the cash surrender value (CSV) of the policy. The contribution is offset by recording the CSV as an investment or other asset. The CSV should be adjusted each year with the offset going to an other income or expense account.

If the community foundation is the owner of the policy and policy premiums are still to be paid, the most common arrangement is for the donor to make a cash gift to the community foundation and for the community foundation to use the gift to pay the insurance premium keeping the policy in force. In such instances the gift should be recorded as contribution revenue when the cash is received. As insurance premiums are paid, a portion of the premium increases the CSV and a portion is recorded as insurance expense. As a practical matter, an estimate may be made as to the breakdown of the premium and an adjustment made annually to reflect the actual CSV when a statement is received from the insurance company. When the insured dies and the foundation receives the insurance proceeds, the amount received in excess of the CSV should be recorded as “other income”.

VIII. Real Estate

Gifts of real estate should be recorded as a contribution using the fair market value.

When is a gift of real estate completed?
If a community foundation receives a gift of real estate, the gift is completed and should be recorded when the community foundation receives clear title to the property.

How is the gift valued?
A gift of real estate should be recorded at its fair market value of the date of gift. In most instances, a donor will need a qualified appraisal to take a tax deduction for a gift of real estate. The community foundation can value the gift using the same appraisal. If the appraisal is not complete as of the date of the gift, a reasonable estimate should be used. If the community foundation sells the real estate within two years of the gift, Form 8282, "Donee Information Return" is to be filed with the IRS. The "amount received upon disposition" (box III e) is the gross sales price received by the foundation. For more information on the details of this filing requirement please see "Filing Requirements Form 8282 and Form 8283" provided as a separate document by the Accounting Practices Committee in the Fall 2003 FAOG newsletter.

November 6, 2003

Accounting Practices Committee:

Ray Biddiscombe	**Columbus Foundation**
Kit Conroy	**The New York Community Trust**
Carol Crenshaw	**The Chicago Community Trust**
Leslie Griffith	**Oklahoma City Community Foundation, Inc**
Kathy Hebert	**The Greater New Orleans Foundation**
Mandy Hess	**Greater Milwaukee Foundation**
Carroll Lavalleur	**Lincoln Community Foundation, Inc**
Susan Nicholson	**The Community Foundation of Louisville, Inc.**
Pat Quick	**Stark Community Foundation**
Juan J. Reyes	**Puerto Rico Community Foundation**
Brenda VanKanegan	**The Oregon Community Foundation**
Lisa Williams	**Community Foundation for Greater Atlanta**
Mary Wilson	**The Pittsburgh Foundation**
Herb Folpe	**Technical Advisor, Retired Partner, KPMG**

This paper was prepared by the Accounting Practices Committee, which consists of accounting professionals working in the community foundation field. The guidance presented is based on their extensive review of authoritative accounting and/or tax literature available as of the date of this paper. Questions about the guidance given in this paper may be directed to members of the Committee, whose names are listed at the end of this paper.

Please consult with your accounting and/or tax advisors for specific advice tailored to your community foundation's particular circumstances.

Sarbanes-Oxley Act

The Sarbanes-Oxley Act was signed into law on July 30, 2002. This Act sets new standards for corporate governance and applies to public companies. Although this legislation currently does not apply to not-for-profit organizations, many feel that the not-for-profit sector will one day be governed by similar regulations. It may be in our best interest to voluntarily adopt pertinent aspects of Sarbanes-Oxley before we are mandated to do so.

Reasons to consider adopting some of the changes include:

- Increased accountability will strengthen donor confidence in not-for-profits
- There is a belief that the IRS will add corporate governance concepts in the Form 990
- Non-profit audit committee members frequently come from the corporate world and operate with these more stringent rules
- Some states are currently looking into adopting similar legislation for not-for-profits.

The Accounting Practices Committee has made an effort to gather information related to the Sarbanes-Oxley Act to assist community foundations in determining the level of implementation that is best suited for their foundation. The APC also hopes to provide resources to facilitate this process. You can find a summary of Sarbanes-Oxley Act of 2002 at http://www.aicpa.org/info/sarbanes_oxley_summary.htm or a copy of the complete document at http://www.sarbanes-oxley.com/pcaob.php?level=1&pub_id=SEC-Rules

Janne G. Gallagher, Deputy General Counsel of the Council on Foundations prepared a paper titled "Recent Reforms in Corporate Governance – Should Foundations Change Too?" This paper contains a summary of reforms that could be adopted by not-for-profits and a list of nine steps that the Coalition for Nonprofit Health Care has recommended to its members to take voluntarily. (A copy of Janne Gallagher's paper is attached as Exhibit 1.)

Below are a couple of areas of the Sarbanes-Oxley Act that community foundations may want to consider. The areas discussed below seem to be the recurring topics in not-for-profit communications and publications related to Sarbanes-Oxley. However, we suggest that members of your foundation become familiar with the Act in order to decide which areas are applicable to your organization. In addition, we suggest that you educate your board and upper management and discuss the appropriate level of implementation with your auditors. (Attached as Exhibit II, is a sample of how to document your implementation efforts.)

Services Outside the Scope of Practice of Auditors

The audit committee must approve all audit and non-audit services. Sarbanes-Oxley prohibits public companies from engaging their auditors to conduct certain non-audit related services contemporaneously with the audit.

Audit Partner Rotation
The lead audit or coordinating partner and the reviewing partner must rotate off the audit every five to seven years.

Auditor Reports to Audit Committees
The accounting firm must report all critical accounting policies and practices and all alternative accounting treatments to the audit committee.

Conflicts of Interest
The CEO, Controller, CFO, Chief Accounting Officer or person of equivalent position cannot have been employed by the company's audit firm during the 1 year period proceeding the audit.

In addition, Sarbanes-Oxley requires companies to adopt a code of ethics for senior financial officers, applicable to its principal financial officer, comptroller or principal accounting officer, or persons performing similar functions.

Independent Audit Committees
Each member of the audit committee must be independent.

Audit Committee Financial Expert
At least 1 member of the audit committee should be a "financial expert".

WhistleBlower Protection
"Whistleblower Protection" is extended to employees and would prohibit employers from taking certain actions against employees who lawfully disclose private employer information to parties in a judicial proceeding involving a fraud claim. You can find additional information regarding this topic at http://www.ethicspoint.com/files/news/whistleblower_system.pdf

Record Retention
Organizations should review their record retention policies.

Sarbanes-Oxley places significant emphasis on the roles and responsibility of the audit committee. There are many questions that need to be answered as it relates to the audit committee. Does your Foundation need to form a separate audit committee? If so, who should be on that committee? What are the roles and responsibilities of the committee? Many Foundations will need to answer these types of questions as part of their review of Sarbanes-

Oxley. To assist you in this process, a sample audit committee charter from the AICPA can be found at http://www.aicpa.org/pubs/jofa/jan1999/beanexh4.htm

Exhibits:

Exhibit 1 – A paper titled "*Recent Reforms in Corporate Governance- Should Foundations Change Too?*" written on October 10, 2002 by Janne G. Gallagher, Deputy General Counsel for the Council of Foundations

Exhibit 2 – An example of a Community Foundation's review and documentation of compliance with the Sarbanes-Oxley Act of 2002

In addition, there will be a session titled "The Sarbanes-Oxley Act and its Implication on the Nonprofit Sector" at the annual conference on Monday, October 27 from 2:00-3:30 P.M.

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EXHIBIT 1

Recent Reforms in Corporate Governance

Should Foundations Change Too?

Janne G. Gallagher
Deputy General Counsel
October 10, 2002

The Sarbanes-Oxley Act of 2002[1] makes sweeping changes in the governance of public companies, including requirements with respect to the independence of auditors, the role of the audit committee, minimum standards for directors to be considered independent, and a host of other law changes designed to protect investors and the public. By its terms Sarbanes-Oxley applies only to public companies – businesses that issue publicly-traded stock. However, although Sarbanes-Oxley does not apply to them, some charities are asking whether they should adopt similar rules voluntarily to bolster public confidence in their financial integrity.

The Coalition for Nonprofit Health Care ("CNHC"), an umbrella organization for nonprofit hospitals, believes that it is only a matter of time until some of these corporate reforms are applied to nonprofit organizations. A July report by the coalition[2] cites statements by several state assistant attorneys general that their nonprofit oversight will include corporate governance. In addition, the IRS has just announced that it is considering adding a series of questions to Form 990 addressing accounting practices and the veracity of information provided to the public. Possible questions include:

- Whether the organization has a conflict of interest policy
- Whether the organization has an independent audit committee

[1] Public Law No. 107-204 (July 30, 2002).

[2] Coalition for Nonprofit Health Care, White Paper: "'Corporate Responsibility Proposals' That Could Be Extended to Nonprofit Health Care Organizations" (July 18, 2002), http://www.cnhc.org/pdf/Corporate%20Responsibility.pdf(v1).PDF.

The IRS also is asking whether there should be additional disclosure, beyond the considerable detail already required, for transactions between the organization and its substantial contributors, officers, directors, trustees, and key employees.

The balance of this memorandum is a list and brief discussion of Sarbanes-Oxley reforms that could be adopted voluntarily by charitable nonprofit organizations. Not all of these reforms will be appropriate for all charities. However, as the current "gold standard" for corporate responsibility, charity executives and boards would be well-advised to consider whether some reforms are appropriate for voluntary adoption. Attached at the end of this memorandum are the nine steps that the Coalition for Nonprofit Health Care has recommended its members take voluntarily.

Auditor Committees and Outside Auditors

Audit Committees

The Sarbanes-Oxley reforms substantially strengthen the independence of corporate audit committees. Measures that charitable nonprofits could adopt voluntarily include:

- Establishing an audit committee if the organization does not already have one;
- Requiring that audit committee members be independent. That is, members of the audit committee could not be employed by the charity, or any organization affiliated with the charity, and could not accept compensation from the charity for providing services other than as a board member;
- Making the audit committee directly responsible for hiring, compensating, and overseeing the work of the foundation's outside auditor;
- Disclosing whether the audit committee has at least one member who is a financial expert; and
- Providing for "whistleblower" access to the committee.

Obtaining Consulting or Other Services from a Charity's Outside Auditor

Sarbanes-Oxley bars companies from purchasing the following services from the company's outside auditor:

- Bookkeeping and other services related to the accounting records or financial statements;
- Design and implementation of financial systems;
- Appraisal or valuation services, fairness opinions, and contribution-in-kind reports;
- Actuarial services;
- Internal audit outsourcing services;
- Management functions or human resources;
- Broker or dealer, investment adviser, or investment banking services; and
- Legal services and expert services unrelated to the audit.

The legislation authorizes the SEC to add to this list and also provides that the company's audit committee must approve, in advance, the provision of any other non-audit services by the company's outside auditor. Charities could consider whether they should voluntarily refrain from purchasing similar services from their outside auditor.

Audit Partner Rotation

Sarbanes-Oxley requires the outside auditor to designate a new lead audit partner and a new audit review partner at least every five years. Charities could weigh the desirability of a similar rotation against the increased audit cost that may result.

Code of Ethics for Senior Financial Officers

Sarbanes-Oxley requires companies to disclose whether or not they have adopted a code of ethics for their senior financial officials that is applicable to its principal financial officer, its comptroller, and its principal accounting officers (or persons performing similar functions). If the company has not adopted such a code, it must explain why it has not. The code of ethics is to include those standards reasonably necessary to promote:

- Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
- Full, fair, accurate timely, and understandable disclosures in the company's periodic reports; and
- Compliance with applicable governmental rules and regulations.

Charities could weigh whether to adopt a similar code of ethics for their principal financial officers.

Disclosures and Certifications

Financial Statement Certification

Sarbanes-Oxley requires a company's CEO <u>and</u> its CFO to sign quarterly and annual reports required to be filed with the Securities and Exchange Commission. The signature of the two officers attests that:

- The officer has reviewed the report;
- To the officer's knowledge, the report does not contain any untrue statements or omit any material facts;
- To the officer's knowledge, all financial information fairly represents the company's financial condition for the period covered by the report;

- The officers have designed and are maintaining internal controls that ensure that material information about the company and its consolidated subsidiaries is made known to the officers. In addition, the officers must:
    - Evaluate the effectiveness of the internal controls within 90 days of the date the report is filed; and
    - Disclose in the report their conclusions about the controls' effectiveness;
- The officers have disclosed to the company's auditors and to its audit committee:
    - All significant deficiencies in the design or operation of internal controls that could adversely affect the company's ability to process and report financial data, including the identification to the auditors of any material weaknesses in the internal controls; and
    - Any fraud, whether or not material, on the part of management or other employees with a significant role in the internal audit process.

The charity equivalent would be for the CEO or CFO to sign the charity's Form 990 or Form 990-PF (the IRS permits any officer to sign these documents). Charities also could consider adopting internal control systems similar to those required for public companies and issuing an annual statement evaluating the effectiveness of those controls.

Related Party and Off-books Relationships

Sarbanes-Oxley requires companies to disclose all material transactions not included in the company's balance sheet and all relationships with unconsolidated entities or other persons that may materially affect the company's current or future financial condition, liquidity, capital resources, and so forth. Complex corporate and financial structures are far less prevalent among charities;[3] however, those charities that do have transactions or relationships that fall within the spirit of this rule may want to consider disclosures analogous to those required of regulated companies.

Compensation Issues

Loans to Executives and Board Members

Sarbanes-Oxley prohibits personal loans or other extensions of credit to company directors or executive officers. Existing loans are grandfathered. Adopting a blanket rule like this voluntarily is likely to be controversial since some charities include mortgage loans, loan guarantees, or similar extensions of credit as part of a package to induce executives to relocate

[3] They are not unknown, however. The Arizona Baptist Foundation, an Arizona charity, with the assistance of its outside auditor, Arthur Anderson, made use of some 60 subsidiary companies to hide its lack of assets from investors. Following Arizona Baptist's collapse, Arthur Andersen agreed to a $217 million settlement.

and such loans are legally permissible as long as the economic benefit of any below-market loan, when added to the individual's other compensation, does not render the total unreasonable. Nonetheless, the inclusion of this provision in Sarbanes-Oxley suggests that charities may want to revisit their policies on loans to executives and consider whether other forms of compensation may be more appropriate or less controversial.

Executive Compensation

Sarbanes-Oxley did not include provisions addressing the disclosure of executive compensation. However, President Bush has challenged CEOs to describe in plain English in their annual reports every detail of their compensation packages and to explain how that package is in the best interests of the company's shareholders. Executive compensation must be reported annually to the SEC, but the President believes that the information is frequently buried in proxy statements and infrequently reviewed by shareholders. Charity CEO compensation is disclosed in Form 990 or Form 990-PF. Charities could consider whether to adopt additional disclosures in the spirit of the President's challenge to business executives.

Coalition for Nonprofit Health Care Recommended

Action Steps for Nonprofit Health Care Organizations

A July 18, 2002 White Paper prepared by the Coalition includes the following nine steps that nonprofit health care organizations can take immediately, in anticipation of the adoption of formal reforms applicable to nonprofit organizations generally:

- Adopt internal accounting controls and accounting practices that will facilitate the ability of CEOs and CFOs to personally vouch for the organization's financial statements;
- Understand and be prepared to disclose or defend any related party transactions or off-balance sheet transactions engaged in by the organization;
- Assess the independence of directors, outside auditors, and outside advisors carefully and, if necessary, take measures to reduce conflicts of interest;
- Evaluate the use of independent audit firms for other services;
- Establish or assess the independence of dedicated audit committees, nominating committees, and compensation committees;
- Adopt clear record-retention policies;
- Understand and compose a detailed description of executive compensation packages, including a clear explanation of why the packages are in the best interest of the nonprofit health care organization;
- Evaluate governance policies and procedures in light of the Subcommittee's report on the Enron board and strengthen board understanding of fiduciary duties; and

Review the financial condition, accounting practices, and financial statements of for-profit subsidiaries, and considering the extent to which the above items may affect the activities of and disclosures made with respect to for-profit subsidiaries.

EXHIBIT 2

SARBANES-OXLEY ACT OF 2002

Last year – in the wake of extraordinary revelations of corporate fraud – Congress passed the "American Competitiveness and Corporate Accountability Act of 2002", commonly referred to as the Sarbanes-Oxley Act (SOX) after its key Congressional supporters. SOX is perceived to be setting new standards for corporate governance and is primarily directed at ensuring more independent voices in corporate boardrooms of publicly-listed companies.

With very few exceptions, Sarbanes-Oxley does not apply to nonprofit organizations. However, staff met with outside legal counsel and the auditors to ensure that The Foundation's current practices would comply with SOX if it were applied to nonprofits.

Three themes run throughout Sarbanes-Oxley, and we reviewed Foundation practices against them. They are: 1) the independence of directors, 2) an independent audit committee, and 3) independent auditors.

Independence of Directors (SOX defined "independent" as not receiving compensation for services from the company.)

The Foundation is a not-for-profit corporation. By statute and practice, a not-for-profit operates to benefit the public, not its directors. The Foundation's Resolution and Declaration of Trust and Corporate By-Laws prescribes outside nominating authorities to ensure that Distribution Committee members are independent and broadly represent the public. Directors receive no compensation for their services. We review annually with our outside auditors compliance with the IRS rules against self-dealing (intermediate sanctions). The Foundation has a conflict of interest policy, and each year all board and outside committee members as well as senior staff sign conflict of interest statements that are reviewed by general counsel. Potential conflicts are noted and board members recuse themselves from voting on these matters.

Independent Audit Committee

Sarbanes-Oxley requires publicly-held companies to establish an audit committee – comprised of independent members – to appoint, compensate, and oversee the independent auditor. The Foundation's Finance and Audit Committee currently follows these "best practices." They meet with the auditors before the audit to discuss the audit approach and determine areas requiring special attention and then after to review the findings. The audit fee is approved as part of the annual administrative budget process. And, the board appoints the outside audit firm on the recommendation of the Finance and Audit Committee.

Independent Auditors

SOX bars public companies from purchasing consulting and outsourcing services from their audit firm. The Foundation does not currently purchase any consulting services from our auditor. Other than the annual audit, we use ABC CPA Firm to review various tax and trust filings (e.g., Form 990, Form 5500, UBIT) related to our audit.

The legislation also requires the outside auditor of public companies to designate a new lead partner and a new audit review partner at least every five years. We do not plan to request such a change because we can see no particular benefit. Given the complexity of our business, and the dearth of audit partners who are experienced in our work, we are concerned that a change in both the reviewing partner and the engagement partner would be more harmful than helpful. We do have a regular change of the engagement manager who is responsible for supervising the fieldwork. This gives us the benefit of "fresh eyes" reviewing our business every few years. We have also requested a change in reviewing partner.

Sarbanes-Oxley contains a few criminal provisions that apply to any company that may be investigated or reviewed by a federal agency. As a nonprofit The Foundation is subject to audit by the IRS and so these criminal provisions may apply to us. The first deals with document destruction. When prosecuting Arthur Andersen, the government was forced to rely on statutes dealing with obstruction of justice. SOX has broadened this to include a range of circumstances in which the government may prosecute document destruction. Jane Doe is working on a document retention policy that we plan to have in place by year end. SOX also provides new protections for whistleblowers against retaliation in terms of employment. Mr. Smith is drafting a new personnel policy that encourages employees to report problems regarding financial irregularities to the Vice President for Administration, the General Counsel, the President, or the Chairman of the Finance & Audit Committee.

The Foundation has always held itself to the highest standards of corporate governance. This review confirms that we operate well within the spirit of Sarbanes-Oxley.

Charity Navigator And Why Community Foundations Should Know What's Being Reported About Them

BACKGROUND:

Charity Navigator (*www.charitynavigator.org*), which claims to be "your guide to intelligent giving", began its evaluation of America's 2,500 largest charities, including community foundations, in 2001. Utilizing financial information from a charity's annual Form 990, Charity Navigator rates a charity utilizing a zero to four-star rating system, which is based upon an evaluation of "two broad areas of financial health, their organization efficiency and their organizational capacity."

While there has been some attempt in their evaluation process to distinguish between the many different types of not-for-profit organizations, e.g., direct services providers versus fund raising/endowment entities such as community foundations, it is limited in scope. In addition, its evaluation of community foundations has been limited, for the most part, to the largest ninety or so.

Several community foundations have had discussions with Charity Navigator concerning its evaluation process and it appears unlikely to change their method. Consequently, the Accounting Practices Committee believes it important to inform the field of this rating organization's practices, identify what it believes to be reporting deficiencies and provide points of rebuttal should a community foundation receive a sub-par rating. As this organization matures and expands its database, their evaluation of community foundations is not likely to be limited to just the largest.

ISSUES:

1. Charity Navigator is limited by the number of years of Form 990 information they have available to them.

2. Because of the relative newness of this organization, it appears that many/most of the trend ratings are based upon only two year's information.

3. Charity Navigator's calculation of Fundraising Efficiency does not take into account trends, only a year at a time. Community Foundation's with development staffs are not only soliciting current gifts, but are also cultivating deferred gifts, which will not mature for many years. Consequently, bequests and large unexpected gifts will make a community foundation look good one year and bad in another, absent these types gifts.

4. Charity Navigator's evaluation of "primary revenue growth" does not account for the differences in mature and emerging community foundations. A mature community foundation, for example, having flat year-to-year of primary earnings of say $100 million

each year, is not rated as high as a community foundation that for example doubled its year-to-year primary earnings from, say $1 million to $2 million.

5. The issue identified in # 4 above is also true of “program expenses growth”. A mature community foundation with substantial grantmaking each year, but with little or no year-to-year increase, it not as highly rated as would an emerging community foundation that has substantial percentage increases, but not necessarily substantial dollar increases.

6. Charity Navigator because it uses only the community foundation’s “primary” Form 990, does not adjust its ratings for those community foundations that have supporting foundations (which file separate Form 990’s) and have substantial “primary revenue growth” and “program expense growth”. Development efforts by a community foundation may not result in a new component fund, but in the creation of a new supporting foundation. The consequences of this are that the expenses are retained by the community foundation and the revenue growth is not.

CONCLUSIONS & RECOMMENDATIONS:

1. Visit the Charity Navigator website and determine if your community foundation is one of the foundations being rated.

2. If your community foundation is being rated, you should provide as much history (prior year’s Form 990’s) for Charity Navigator to effectively rate the criteria that evaluate trends.

3. Community foundations should be particularly careful in allocating their operating expenses to program services, management & general and fundraising on their Form 990.

4. Urge Charity Navigator to include all of the community foundation’s supporting organization’s activity in their rating process.

5. If you think your foundation has been incorrectly rated, contact Charity Navigator and tell them so. Also, contact one of the members of the Accounting Practices Committee so that we can keep a tally of these conversations and/or contacts.

AICPA Publishes Guidance for Audit Committees

The American Institute of Certified Public Accountants (AICPA) has released an Audit Committee Toolkit for Not-for-Profit Organizations. The Toolkit provides sample documents of best practices to assist audit committees in carrying out their duties. Topics include an audit committee charter matrix, a Request For Proposal (RFP) for CPA services, the basics of internal controls and other valuable resources! The toolkit is available to download at no cost at http://www.aicpa.org/Audcommctr/toolkitsnpo/homepage.htm.

A hardcopy of the Toolkit will be available for purchase in the Fall of 2005.