CENTRAL FLORIDA FOUNDATION

FREQUENTLY ASKED QUESTIONS
Nonprofit Endowment Funds Held at Central Florida Foundation

INTRODUCTION

Nonprofits place their endowment funds with Central Florida Foundation (CFF), a community foundation, for a variety of reasons, including investment expertise, efficiencies, and access to planned giving advice and services. As nonprofits seek to place their assets and partner with CFF, questions arise as to the appropriate accounting for this relationship and legal ownership of the assets.

The purpose of this document is to provide nonprofits with answers to common questions about nonprofit endowments held with CFF and offer a possible solution for accounting for their interest in those endowment funds. As is always the case, each nonprofit organization should consult with its own professional advisors in determining the best solution for its needs. It should be noted that this document speaks only to the accounting for endowment funds created at a community foundation by a nonprofit organization with its own endowment dollars. Donor designated funds held by a community foundation, which come directly to the community foundation from a donor and not through the nonprofit, are not covered.

NONPROFIT ENDOWMENT BASICS[i]

What is a nonprofit endowment?

A nonprofit endowment is a type of fund established by a nonprofit at a community foundation for the nonprofit's own benefit or the benefit of a related entity. That is, the donor or resource provider and the beneficiary or recipient organization is the same entity. For example, an art museum transfers funds to a community foundation to establish a fund that will provide annual grants to the art museum for its own use. The instrument of transfer used to establish a nonprofit endowment references the variance power and transfers legal ownership over the assets to the community foundation.

What types of organizations can establish a nonprofit endowment at a community foundation?

A public charity under Section 509(a)(1), 509(a)(2), or 509(a)(3) may establish a nonprofit endowment at a community foundation. This may include an endowment created by a government unit.

What is the accounting rule that establishes the standards for transactions involving nonprofit endowments at a community foundation?

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*, also known as FAS 136. This has now been codified within FASB ASC 958-605 principally in sections 15 and 25. FASB ASC 958-605-55-

110 provides guidance for accounting in the case where a “resource provider” (nonprofit entity) transfers assets to a community foundation, but specifies itself or its affiliate as the beneficiary of the assets. The transaction is deemed to be reciprocal because at the time of the transfer, the nonprofit entity expects to receive future grants because it specifies itself as a beneficiary, and by acceptance of the transfer, the community foundation agrees to make grants to the nonprofit entity.

When a public charity establishes a nonprofit endowment at a community foundation, which organization owns the contributed funds?

Central Florida Foundation has legal ownership of funds contributed to a nonprofit endowment. As such, CFF’s board has fiduciary responsibility over the funds. The legal ownership of the funds is a frequent source of confusion between nonprofits and community foundations. Therefore, the ownership is clearly identified in the fund agreement at the start of the relationship. The confusion arises, in part, because FAS 136 requires that a nonprofit recognize a beneficial interest in assets held by a community foundation as an asset on the nonprofit’s books. This leads some nonprofits and their advisors to believe they maintain legal ownership over the funds. However, FAS 136 only affects the accounting treatment of the funds, not the legal ownership.

Since the nonprofit is releasing legal ownership of the transferred assets, how can the nonprofit’s board agree to the transfer of assets to establish a nonprofit endowment without violating its fiduciary duties?

The nonprofit’s board must make the decision regarding whether transferring legal ownership of the funds to establish a nonprofit endowment is consistent with its fiduciary duties. A nonprofit’s board may decide that such a transfer is prudent and consistent with its fiduciary responsibility to the organization because of the benefits provided as a result of the relationship with the community foundation. For example, the nonprofit may benefit from the expertise of the community foundation in long-term management of assets, the flexibility the community foundation may provide by accepting types of non-cash contributions not accepted by the nonprofit, or the protection that the transfer will provide by establishing an endowment at a separate organization.

The nonprofit receives an annual endowment payout from the nonprofit endowment at Central Florida Foundation. Can the nonprofit force an additional grant of the nonprofit endowment back to itself?

No. A nonprofit endowment at Central Florida Foundation is subject to the legal control of the Foundation. Allowing the nonprofit to reserve the right to force a grant would be contrary to CFF’s legal ownership of the fund. For this reason, the reservation of the power to unilaterally withdraw the fund in full or in part creates several potential results which are often undesirable. First, reservation of such power raises the question of whether a completed gift has been made by the nonprofit to the community foundation. Second, an incomplete gift may lead to the conclusion that the community foundation is managing someone else’s fund. Third, reservation of the right to unilaterally withdraw the funds may be considered a material restriction calling into question whether the fund is a component fund. Finally, a contribution to the Central Florida Foundation is subject to the legal control of the Foundation. Allowing the nonprofit to reserve the right to force a grant would be contrary to the Foundation’s legal ownership of the fund.

ACCOUNTING FOR NONPROFIT ENDOWMENTS[1]

Creation of the Fund:

FASB ASC 958-605-55 Example #10 demonstrates that upon the transfer of assets to a community foundation, the nonprofit organization would recognize an asset on its books as a beneficial interest in assets held by the community foundation. Therefore, the following entry would be made upon transfer:

DEBIT	Beneficial Interest in Assets Held by Central Florida Foundation (Net Assets with Donor Restriction)	$ XX	
CREDIT	Cash (Net Assets with Donor Restriction)		$ XX

Source of Nonprofit Funds:

If the net assets transferred are from the nonprofit's operating surplus (Net Assets without Donor Restriction), then the net assets will need to be transferred to Net Assets with Donor Restriction on the nonprofit's books. The nonprofit would show a reclassification of net assets from Unrestricted to with donor restriction on the Statement of Activities. If the net assets transferred are derived from donor-restricted endowment funds contributed to the nonprofit, the nonprofit should first ensure that the transfer of the net assets will not violate the contract between the nonprofit and the donor. If the transfer will not violate such a contract, then no reclassification of net assets will be necessary as the net assets should already be classified as with donor restriction on the nonprofit's books. Less guidance is given on the proper treatment of changes in value and grants from the assets held at the community foundation to the nonprofit throughout the life of the fund agreement.

DEBIT	Reclassification of Net Assets (Net Assets without Donor Restriction	$ XX	
CREDIT	Cash (Net Assets without Donor Restriction)		$ XX
DEBIT	Cash (Net Assets with Donor Restriction)	$ XX	
CREDIT	Reclassification of Net Assets (Net Assets with Donor Restriction)		$ XX

Financial Activity of Fund:

The nonprofit's interest in the endowment fund at Central Florida Foundation is similar in nature to an interest in a perpetual trust, in that the nonprofit organization has an interest in a future income stream from the trust. As with a perpetual trust, the nonprofit organization does not have access to the principal value of the assets held in the CFF nonprofit endowment fund under the terms of the fund agreement. Based on the premise that a nonprofit endowment fund is like a perpetual trust, the following accounting entries would be made throughout the life of the fund to account for the changes in value and grants from the assets held at the Central Florida Foundation:

1. Periodic Endowment Valuation Changes:

Changes in value of the nonprofit endowment fund at the Central Florida Foundation would be captured on the nonprofit's books as follows:

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[1] Sources include Council on Foundations, http://www.cof.org/content/accounting-agency-endowment-funds-held-community-foundations#sthash.oWesOPOd.dpuf and http://www.cof.org/content/agency-endowment-funds-frequently-asked-questions#sthash.tVjlqM1t.dpuf and FASB ASC 958-605

DEBIT	Beneficial Interest in Assets Held by Central Florida Foundation (Net Assets with Donor Restriction)	$ XX	
CREDIT	Investment Gain or Loss (Net Assets with Donor Restriction)		$ XX

(To adjust for changes in present value of expected cash flows – debit and credit could be reversed.)

2. Annual Endowment Grant:

As Central Florida Foundation makes grants of income back to the nonprofit organization, the following entries are made on the nonprofit's books.

DEBIT	Cash (Net Assets without Donor Restriction)	$ XX	
CREDIT	Investment Income (Net Assets without Donor Restriction)		$ XX

Presentation and Disclosure:

As shown above in the accounting entries, the nonprofit would show an asset on its balance sheet equal to the interest in the fund held at the community foundation. Because the fund agreement limits the nonprofit's access to the endowment assets at the community foundation, the net assets related to the interest in the fund would be classified as with donor restriction.

Interest in assets held at the community foundation is carried at fair value, which requires the nonprofit to include information in its fair value disclosure in accordance with FASB ASC 820, *Fair Value Measurements and Disclosures.* GAAP addresses the categorization of this type of investment at FASB ASC 820-10-35-58 *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent).* There it instructs that if a reporting entity (nonprofit) will never have the ability to redeem its investment (nonprofit endowment) with the investee (CFF) at the net asset value per share, the fair value measurement of the investment shall be categorized as a Level 3 fair value measurement.

In accordance with FASB ASC 958-605-55 Example #10, the nonprofit should disclose the following in its financial statements:

1. The fact that Central Florida Foundation holds the nonprofit's endowment,
2. The terms under which Central Florida Foundation will distribute amounts to the nonprofit (which is annual endowment grants subject to the spending policy approved by the CFF Board of Directors),
3. A statement that variance power was granted to Central Florida Foundation and a description of the terms of the variance power. Example wording could be
    a. "The Board of Directors of the Central Florida Foundation, Inc. shall have the power to modify or eliminate any restriction, limitation, or condition on the distribution of funds, including their use for any specified purposes or their distribution to specific organizations, if the Board of Directors determines that such restriction, limitation or condition becomes by material and significant change of circumstances in effect unnecessary, incapable of fulfillment, or inconsistent with the proper charitable, religious, scientific, literary, cultural or educational uses and purposes of the Central Florida area." or
    b. "The CFF Board has full authority to vary the terms of the endowment as appropriate",
4. The aggregate amount reported in the statement of financial position and how that amount is described (i.e. Beneficial Interest in Assets Held by Central Florida Foundation).

FORM 990 REPORTING OF NONPROFIT ENDOWMENTS[2]

The accounting treatment mandated by FASB ASC 958-605 (FAS 136) only impacts financial statements prepared in accordance with generally accepted accounting principles; it does not affect the legal, and therefore IRS, treatment of contributions to and grants from nonprofit endowments.

A guide to reporting a nonprofit endowment in relevant sections of the nonprofit's Form 990 is described below.

Part VIII Statement of Revenue:

A book to tax difference exists between revenue and expenses reported in the audited financial statements subject to FAS 136 and the Form 990 Statement of Revenue. When a nonprofit makes a contribution to a nonprofit endowment at Central Florida Foundation and grants variance power to the Foundation, the nonprofit should report this as a grant in the Form 990 and for tax purposes no additional activity of that money is reported.

The revenue and expense entries reported for GAAP purposes in the audited financial statements (*Periodic Endowment Valuation Changes* and *Annual Endowment Grants)* should be shown as reconciling items in Schedule D – Supplemental Financial Statements Part XI and Part XII of the 990. The grant recorded in the 990 Statement of Revenue to reflect the transfer of assets to CFF to invest in the nonprofit endowment will also be a reconciling item in Part XII between the expenses per the audited financial statements and expenses per the return.

Part X Balance Sheet:

Although a book to tax difference exists between revenue and expenses reported in the audited financial statements and the 990, the balance sheet is presented consistent with the audited financial statement presentation. Therefore, the nonprofit should present the "Beneficial Interest in Assets Held by Central Florida Foundation" as an asset in its balance sheet reported in Part X of its Form 990.

Schedule A – Public Charity Status and Public Support:

Nonprofits that receive unrestricted contributions that are later granted to the community foundation to be invested in a nonprofit endowment should report these original donor gifts as public support in Schedule A.

Schedule D – Supplemental Financial Statements, Part V Endowment Funds:

Nonprofits that are the beneficiary of a nonprofit endowment fund held by Central Florida Foundation should not report them as endowments in Schedule D, Part V, question #1 or #2. Form 990 Schedule D Part V: Endowment Funds instructs an organization (such as the nonprofit) to complete "Part V – Endowment Funds" only if the filing organization answered yes to the Part IV, line 10 question "Did the organization, directly or through a related

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[2] Tax guidance described is derived from Council on Foundations publications and IRS Form 990 instructions

organization, hold assets in term, permanent, or quasi-endowments?" Since the non-profit that is the beneficiary of a nonprofit endowment at CFF does not "hold" the assets, it does not report them in question #1. It is important to remember that endowments held at Central Florida Foundation are legally transferred assets; according to the IRS, the nonprofit that transferred the assets does not have any ownership claim to them.

In question #3a, "Are there endowment funds not in the possession of the organization that are held and administered for the organization by: (i) unrelated organizations, or (ii) related organizations", the nonprofit can answer yes to question 3a (i).

The nonprofit can choose to answer question #4 and describe in Part XIII that it is the beneficiary of a nonprofit endowment at Central Florida Foundation and it annually receives an endowment grant used to support its operations.

Schedule I – Grants:

In the nonprofit's Form 990 Statement of Revenue, a grant expense is recorded to reflect the transfer of assets to CFF to invest in the nonprofit endowment. This grant can be included in the detail of grants listed in the Schedule I, Part II.

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[i] This information is not a substitute for expert legal, tax or other professional advice and we strongly encourage nonprofits to work with their advisors and counsel to determine the application of the law to their particular situations. This information may not be relied upon for the purposes of avoiding any penalties that may be imposed under the Internal Revenue Code.