BerryDunn

Endowments & Their Purpose

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Agenda & Goal

TO GAIN A DEEPER UNDERSTANDING OF ENDOWMENTS

- **What They Are**
- **Benefits**
- **Threats**
- **Complexity**
- **Accounting**
- **Reporting**

What Are Endowments

An endowment represents a compact between a donor and an organization. Endowments are assets (usually cash accounts that are invested in equities, bonds, and/or other investment vehicles) set aside so that the original assets (known as the "corpus") grow over time as a result of income earned from the underlying invested funds. The corpus may also be added to over time.

Endowments link past, current and future generations.

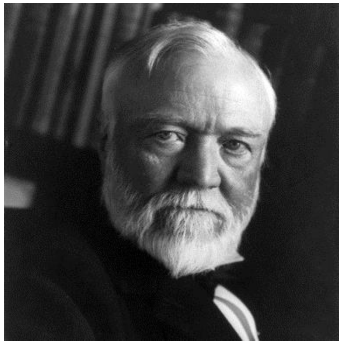
History of Endowments

Concept was founded in the 15th and 16th centuries in England

1638 John Harvard leaves his library collection and half of his estate to a newly formed college

1715 Elihu Yale gave a large gift to the Collegiate School of Connecticut

1889 Andrew Carnegie wrote an article called “The Gospel of Wealth”



“The man who dies rich, dies disgraced.”
- ANDREW CARNEGIE

Benefits of Endowments

BENEFITS OF ENDOWMENTS

- Provide stability
- Encourage innovation and flexibility
- Allows for a longer time horizon
- Leverage other sources of revenue
- Reduces dependency on annual campaigns, special events and other traditional fundraising
- Most endowment investment earnings are exempt from taxation

Threats to Endowments

MISUNDERSTANDING ENDOWMENTS

- Hoarding a pile of money (aka all endowments are huge)
- Single fund
- Limited understanding of annual fund purpose
- Comparisons of payout rates to rates of return
- Lack budget and planning
- UPMIFA
- The public does not benefit from endowments

http://ideas.time.com/2012/02/09/college-endowments-why-even-harvard-isnt-as-rich-as-you-think/

Threats to Endowments

Threats to Endowments

Why Do We Care?

- In October 2008, IRS sends compliance questionnaires to approximately 400 C&U's
- Questions focused on
    - Unrelated business income (UBIT)
    - Endowments
    - Executive compensation
- Questionnaire comes out at the same time as the 2008 stock market crash.
- However, report is published in May 2010
- In February 2016, two congressional committees sent letters to the 56 private institutions whose endowments exceeded $1 billion as of fiscal year 2014.

Threats to Endowments

Congress of the United States
Washington, DC 20515

February 8, 2016

[redacted]

Dear President [redacted]

In the United States Congress, the Senate Committee on Finance and House Committee on Ways and Means have exclusive jurisdiction over federal revenue measures. Under Senate and House rules, the committees have corresponding authority to conduct oversight of activities within their jurisdiction. As chairmen of these committees and the Ways and Means Oversight Subcommittee, we are conducting an inquiry into the activities of colleges and universities related to the numerous tax preferences they enjoy under the Internal Revenue Code. We write to request information regarding the operations of [redacted] University and status of the university's endowment.

The National Association of College and University Business Officers reports that 56 private universities and colleges have endowments of more than $1 billion.[1] This study showed endowments had an average return on investment of 15.5 percent and an average payout rate of 4.4 percent during the 2014 fiscal year. Despite these large and growing endowments, many colleges and universities have raised tuition far in excess of inflation.[2]

Threats to Endowments

- Questions asked or information requested included:
  - What is your endowment size
  - What has been the endowment return
  - How do you determine spending each year
  - What is the breakout between UR, TR, and PR
  - What are the uses for each restricted asset
  - Have you ever spent endowment principal
  - Do you grant naming rights based on donation levels
  - What conflict of interest policies address financial interest in endowment investments

Threats to Endowments

November 2, 2017

House GOP leaders release proposed "Tax Cuts and Job Act".

Included is a proposed excise tax of 1.4% on certain endowments

- **PRIVATE** universities only
- At least 500 students
- Endowment assets of more than $100,000 per student

Threats to Endowments

Want to know more?

NACUBO is holding a 2 hour webinar this Thursday at 3:00 ET

Make Your Voice Heard: Tax Reform Hits Higher Education Hard

Focused on the newly released tax reform legislation

http://www.nacubo.org/Distance_Learning/Make_Your_Voice_Heard_Tax_Reform_Hits_Higher_Education_Hard.html?utm_source=MagnetMail&utm_medium=email&utm_term=rbishop@berrydunn.com&utm_content=Upcoming%20Events%20November%202017&utm_campaign=Upcoming%20Events%20and%20Webcasts

Endowment Statistics

ENDOWMENT STATISTICS

- At the end of fiscal 2014, market value of funds of colleges and universities was $535 billion
- Represents an increase of 15% compared to the beginning of the fiscal year, which was $466 billion
- Top 5 endowments at the end of 2014 (represents approx. 24% of total value):
  - Harvard University - $36 billion
  - University of Texas System - $25 billion
  - Yale University - $24 billion
  - Stanford University - $21 billion
  - Princeton University - $21 billion
- Top 120 colleges account for approx. 75% of total

Source: U.S. Department of Education, National Center for Education Statistics. (2016). *Digest of Education Statistics, 2015* (NCES 2016-014), Chapter 3

Introduction to Endowments

ENDOWMENT STATISTICS

Investment returns on endowments for institutions participated in 2016 NACUBO-Commonfund Study of Endowments for periods ended June 30, 2016

SIZE	1 YEAR (792)	3 YEAR (744)	5 YEAR (721)	10 YEAR (598)
Over $1 Billion	(1.9)	6.0	6.1	5.7
$501 million to $1 Billion	(2.2)	5.4	5.7	5.3
$101 million to $500 million	(2.4)	4.9	5.1	4.8
$51 million to $100 million	(1.8)	5.1	5.1	4.7
$25 million to $50 million	(1.6)	5.2	5.3	4.7
Under $25 million	(1.0)	5.5	5.8	5.0

Introduction to Endowments

Average Annual Spending Rates for institutions participated in 2016 NACUBO-Commonfund Study of Endowments for periods ended June 30, 2016

SIZE	2016	2015	2014	2013
Over $1 Billion	4.4	4.3	4.6	4.8
$501 million to $1 Billion	4.3	4.1	4.3	4.6
$101 million to $500 million	4.3	4.1	4.3	4.4
$51 million to $100 million	4.4	4.4	4.4	4.4
$25 million to $50 million	4.1	4.0	4.2	4.3
Under $25 million	3.8	4.5	4.6	4.1

Introduction to Endowments

Asset Allocations for institutions that participated in 2016 NACUBO-Commonfund Study of Endowments as of June 30, 2016

SIZE	US EQUITY	FIXED INCOME	NON-US EQUITY	ALTERNATIVE	S-TERM/ CASH
Over $1 Billion	13	7	19	58	3
$501 million to $1 Billion	20	9	18	45	8
$101 million to $500 million	26	13	20	35	6
$51 million to $100 million	33	17	19	24	7
$25 million to $50 million	38	20	17	17	8
Under $25 million	44	24	15	10	7

Introduction to Endowments

ENDOWMENT CREATION

Usually supported by a guiding document such as a will, trust instrument or donor letter

Donor restricts use of gift using certain terms or phrases:

- Endowed fund
- In perpetuity
- Income to be used…
- Corpus to be maintained

Introduction to Endowments

THREE PRINCIPAL CATEGORIES:

- True Endowments
- Term Endowments
- Funds Functioning as Endowments (aka "Quasi-Endowment" or "Board Designated")

WHAT IS NOT AN ENDOWMENT:

- Board Designated Net Assets NOT Functioning as Endowments
- Reserve funds
- Collection of Trusts
- Invested Funds

Introduction to Endowments

QUESTIONS RELATED TO ENDOWMENTS

- What is the right investment mix to generate sufficient returns for the spending policy while protecting the purchasing power?
- What portion of investment returns should be used currently vs. reinvested for growth?
- What expenses are appropriate to charge to the endowment?
- Can spending continue if there aren’t sufficient accumulated investment returns?
- Should there be a minimum level at which an endowment fund is created? If so, what amount? Does it vary by purpose?

Introduction to Endowments

POOLING OF INVESTMENTS

- Many organizations combine the assets of multiple endowments and other funds (including operating) into one investment pool
- Investment policy dictates the investment decisions for the entire pool
- Benefits to pooling:
  - Spreading the total risk across funds and making them equal for all pooled funds
  - Better investment performance compared to smaller individual funds
  - Potential for reducing management fees

POOLING OF INVESTMENTS

- Specific investment assets are not attributable to specific endowment funds
- Must develop a methodology to allocate investment earnings (losses) for the entire pool to the individual components of the pool
- Investment pools exclude pledges receivable since the funds have not been received to invest
- Only the assets in the investment pool should be considered for the allocation of investment return, applying spending formulas or assessing fees
- Spending decisions need to be made at the individual fund level

Introduction to Endowments

OTHER KEY TERMS

- Spending/Appropriation
- Release from Restriction
- Endowment Draw
- Total Return vs. Income

Investment Policy Statement

COMPONENTS OF THE INVESTMENT POLICY STATEMENT

- Introduction
- Spending Policy
- Investment Objectives
- Asset Allocation Policy
- Endowment Portfolio Reporting and Maintenance

Financial Reporting

Endowment Reporting

BY INDEPENDENT INSTITUTIONS

REPORTED WITHIN 3 NET ASSET CLASSIFICATIONS:

- Permanently Restricted
- Temporarily Restricted
- Unrestricted Restricted

Classification is based on existence or absence of donor-imposed restrictions

Endowment Reporting

BY INDEPENDENT INSTITUTIONS

CLASSIFICATION OF COMPONENTS OF TRUE ENDOWMENTS:

COMPONENT	CLASSIFICATION
Original gift, additional gifts, and donor-directed reinvestment of return	Subject to interpretation as to what must be retained: Retained permanently = PRNA Not required to be retained permanently = TRNA
Accumulated earnings before appropriation	Temporarily Restricted
Donor restrictions on the appropriated earnings	Temporarily Restricted until used for the purpose specified by the donor
Donor doesn’t restrict the use of appropriated earnings	Released immediately to unrestricted net assets
Underwater endowments	Unrestricted net assets

Endowment Reporting

BY INDEPENDENT INSTITUTIONS

TERM ENDOWMENTS:

- Term endowments are recorded within Temporarily Restricted Net Assets
- Released to unrestricted net assets after the stated period of time expires or upon the occurrence of a certain event

QUASI-ENDOWMENTS:

- Quasi-endowments are reflected as a component of unrestricted net assets

Endowment Reporting

BY INDEPENDENT INSTITUTIONS

UNDERLYING RECORDS SHOULD:

- Track the portion of an endowment that must be retained permanently
- Quantify the investment return available for appropriation for each fund
- Account for the change in each endowment's balance from beginning to end of year for each type of activity required for disclosure
- Identify the donor-restricted endowments where market value has dropped below the amount to be retained permanently
- Differentiate the components of Temp Restricted Net Assets
    - Amount that can be released through the satisfaction of the donor's intent
    - Amount that must be retained (investment return not yet appropriated by the Board)

Endowment Reporting

BY INDEPENDENT INSTITUTIONS

EXAMPLE PRIVATE UNIVERSITY
STATEMENT OF FINANCIAL POSITION
JUNE 30, 2017

Cash and cash equivalents	$	4,299,416
Student tuition receivables, net		627,188
Other receivables		2,226,134
Prepaid expenses		958,178
Contributions receivable, net		4,388,759
Investments		14,768,585
Notes receivable from students, net		4,012,152
Investments held in trusts by others		278,729
Property, plant and equipment, net		32,259,890
Total assets	$	63,819,027
Liabilities:		
Accounts payable and accrued expenses	$	1,436,357
Advance deposits and deferred revenue		2,430,018
Long-term debt, net		22,323,762
Refundable advances		2,936,808
Total liabilities		29,126,945
Net assets:		
Unrestricted		17,051,129
Temporarily restricted		9,246,849
Permanently restricted		8,394,105
Total net assets		34,692,083
Total liabilities and net assets	$	63,819,027

Endowment Reporting

BY INDEPENDENT INSTITUTIONS

EXAMPLE PRIVATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017

Note 8 - Temporarily Restricted Net Assets		
Purpose restrictions		
Instruction	$	1,222,158
Student aid		1,354,314
Contributions receivable for building		20,015
Other purpose restrictions		898,809
Time restrictions		
Unspent appreciation on endowment for which the income is unrestricted		876,650
Unrestricted contributions receivable		4,596,176
Contributions - remainder unitrusts		278,729
	$	9,246,849

Note 9 - Permanently Restricted Net Assets		
Endowment funds for which the income is restricted:		
Instruction	$	772,712
Student aid		5,291,463
Other endowment funds		1,013,250
Endowment funds for which the income is unrestricted		1,316,681
	$	8,394,105

Endowment Reporting

BY INDEPENDENT INSTITUTIONS

EXAMPLE PRIVATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017

Note 10 - Endowment Composition

Endowment funds were held as follows:

Cash and cash equivalents	$ 170,436
Investments	14,714,447
	$ 14,884,883

Endowment net asset composition by fund:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted	$ (1,043)	$ 2,779,563	$ 8,312,081	$ 11,090,601
Board designated	3,794,282	-	-	3,794,282
	$ 3,793,239	$ 2,779,563	$ 8,312,081	$ 14,884,883

Changes in endowment net assets during the year:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Beginning of year	$ 3,620,021	$ 2,203,076	$ 8,313,467	$ 14,136,563
Investment income	380,969	1,110,677	-	1,491,645
Other changes	-	-	(1,386)	(1,386)
Reclassification of restrictions	16,187	(16,187)	-	-
Appropriation of endowment assets for expenditure	(223,937)	(518,003)	-	(741,939)
	$ 3,793,239	$ 2,779,563	$ 8,312,081	$ 14,884,883

Endowment Reporting

BY PUBLIC INSTITUTIONS

REPORTED WITHIN 3 NET ASSET CLASSIFICATIONS:

- Restricted Nonexpendable
- Restricted Expendable
- Unrestricted

Restricted net assets are subject to externally-imposed constraints on their use

Endowment Reporting

BY PUBLIC INSTITUTIONS

CLASSIFICATION OF COMPONENTS OF TRUE ENDOWMENTS:

COMPONENT	CLASSIFICATION
Original gift, additional gifts, and donor-directed reinvestment of return	Restricted nonexpendable
Accumulated earnings before appropriation	Restricted expendable
Spending on endowments below the amount that must be retained permanently	Transfer from restricted expendable to unrestricted
Underwater endowments	Restricted nonexpendable

Endowment vs. Investments

RECONCILIATION OF THE ENDOWMENT:

- Generally, all endowments are composed of investments
- Total investments may include amounts other than endowed funds
- Endowments can include a cash component related to gifts received from donors that haven’t been invested as of year-end
- Financial statements are required to include a disclosure of the composition of the endowment as of year-end and a rollforward from the beginning of year to the end of year

RECONCILIATION OF THE ENDOWMENT:

- If endowment includes assets other than investments, recommend including a schedule for the composition of the endowment
- If investments include nonendowed funds, need to first allocate investment income between endowed and nonendowed funds
- The investment income allocated to the endowed funds will then be proportionately allocated to the individual funds within the endowment
- Funds appropriated and released, but not drawn increase the amount of nonendowed funds included in investments

Common Challenges & Questions

Common Challenges & Questions

- Allocation of earnings with commingled investment pools
- When to classify and report an endowment fund as permanently restricted, temporarily restricted or unrestricted
- When to release the temporary restriction on endowment funds
- When to consider permanently restricted pledges receivable as endowment
- Are assets or investments held for split-interest agreements considered endowments?

Questions

Interested in More?

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