Statement of Financial Accounting Standards No. 124

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FAS124 Summary

Accounting for Certain Investments Held by Not-for-Profit Organizations

November 1995

Financial Accounting Standards Board
of the Financial Accounting Foundation
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Statement of Financial Accounting Standards No. 124

Accounting for Certain Investments Held by Not-for-Profit Organizations

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FAS 124: Accounting for Certain Investments Held by Not-for-Profit Organizations

FAS124 Summary

This Statement establishes standards for accounting for certain investments held by not-for-profit organizations. It requires that investments in equity securities with readily determinable fair values and all investments in debt securities be reported at fair value with gains and losses included in a statement of activities. This Statement requires certain disclosures about investments held by not-for-profit organizations and the return on those investments.

This Statement also establishes standards for reporting losses on investments held because of a donor's stipulation to invest a gift in perpetuity or for a specified term.

This Statement is effective for annual financial statements issued for fiscal years beginning after December 15, 1995. Earlier application is encouraged. This Statement is applied either by restating the financial statements of all prior years presented or by recognizing the cumulative effect of the change in the year of the change. The expiration of restrictions on previously unrecognized net gains may be recognized prospectively.

INTRODUCTION

1. This Statement establishes standards of financial accounting and reporting for certain investments in **securities** [1] and establishes disclosure requirements for most investments held by not-for-profit organizations.

2. Guidance for accounting for and reporting of investments held by not-for-profit organizations is currently provided primarily by the AICPA Guides listed in paragraph 22. This Statement is part of a broader FASB agenda project that considers several inconsistencies in that guidance. In addition, this Statement considers many of the same concerns that were examined for business enterprises in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities.* Because this Statement establishes standards for certain investments, provisions in the AICPA Guides that are inconsistent with this Statement are no longer acceptable *specialized* [2] accounting and reporting principles and practices.

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STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Scope

3. The measurement standards of paragraph 7 apply to investments in **equity securities** that have readily determinable fair values, except those described in paragraph 5, and to all investments in **debt securities**. For purposes of this Statement, the **fair value** of an equity security is readily determinable if one of the following three criteria is met:

a. Sales prices or bid-and-asked quotations for the security are currently available on a securities exchange registered with the Securities and Exchange Commission (SEC) or in the over-the-counter market, provided that those prices or quotations for the over-the-counter market are publicly reported by the National Association of Securities Dealers Automated Quotations systems or by the National Quotation Bureau. Restricted stock [3] does not meet that definition.
b. For an equity security traded only in a foreign market, that foreign market is of a breadth and scope comparable to one of the U.S. markets referred to above.
c. For an investment in a mutual fund, the fair value per share (unit) is determined and published and is the basis for current transactions.

4. The reporting standards of paragraphs 8-16 apply to all investments held by not-for-profit organizations, except those described in paragraph 5.

5. This Statement does not apply to investments in equity securities that are accounted for under the equity method or to investments in consolidated subsidiaries.

6. Generally accepted accounting principles other than those discussed in this Statement also apply to investments held by not-for-profit organizations. For example, not-for-profit organizations must disclose information required by FASB Statements No. 105, *Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk*, No. 107, *Disclosures about Fair Value of Financial Instruments*, and No. 119, *Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments.*

Accounting for Investments in Debt Securities and Certain Equity Securities

7. Investments in equity securities with readily determinable fair values and all investments in debt securities shall be measured at fair value in the statement of financial position.

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Reporting Investment Gains, Losses, and Income

8. Pursuant to paragraph 22 of FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations,* gains and losses on investments shall be reported in the statement of activities as increases or decreases in unrestricted net assets unless their use is temporarily or permanently restricted by explicit donor stipulations or by law.

9. Pursuant to paragraph 20 of Statement 117, dividend, interest, and other investment income shall be reported in the period earned as increases in unrestricted net assets unless the use of the assets received is limited by donor-imposed restrictions. Donor-restricted investment income is reported as an increase in temporarily restricted net assets or permanently restricted net assets, depending on the type of restriction. This Statement does not specify methods to be used for measuring the amount of dividend and interest income.

10. Gains and investment income that are limited to specific uses by donor-imposed restrictions may be reported as increases in unrestricted net assets if the restrictions are met in the same reporting period as the gains and income are recognized, provided that the organization has a similar policy for reporting contributions received, reports consistently from period to period, and discloses its accounting policy.

Donor-Restricted Endowment Funds

11. A donor's stipulation that requires a gift to be invested in perpetuity or for a specified term creates a **donor-restricted endowment fund**. Unless gains and losses are temporarily or permanently restricted by a donor's explicit stipulation or by a law that extends a donor's restriction to them, gains and losses on investments of a donor-restricted endowment fund are changes in unrestricted net assets. For example, if a donor states that a specific investment security must be held in perpetuity, the gains and losses on that security are subject to that same permanent restriction unless the donor specifies otherwise. However, if a donor allows the organization to choose suitable investments, the gains are not permanently restricted unless the donor or the law requires that an amount be retained permanently. Instead, those gains are unrestricted if the investment income is unrestricted or are temporarily restricted if the investment income is temporarily restricted by the donor.

12. In the absence of donor stipulations or law to the contrary, losses on the investments of a donor-restricted endowment fund shall reduce temporarily restricted net assets to the extent that donor-imposed temporary restrictions on net appreciation of the fund have not been met before the loss occurs. Any remaining loss shall reduce unrestricted net assets.

13. If losses reduce the assets of a donor-restricted endowment fund below the level required by the donor stipulations or law, [4] gains that restore the fair value of the assets of the endowment fund to the required level shall be classified as increases in unrestricted net assets.

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Disclosures

14. For each period for which a statement of activities is presented, a not-for-profit organization shall disclose:

a. The composition of investment return including, at a minimum, investment income, net realized gains or losses on investments reported at other than fair value, and net gains or losses on investments reported at fair value
b. A reconciliation of investment return to amounts reported in the statement of activities if investment return is separated into operating and nonoperating amounts, together with a description of the policy used to determine the amount that is included in the measure of operations and a discussion of circumstances leading to a change, if any, in that policy.

15. For each period for which a statement of financial position is presented, a not-for-profit organization shall disclose:

a. The aggregate carrying amount of investments by major types, for example, equity securities, U.S. Treasury securities, corporate debt securities, mortgage-backed securities, oil and gas properties, and real estate
b. The basis for determining the carrying amount for investments other than equity securities with readily determinable fair values and all debt securities
c. The method(s) and significant assumptions used to estimate the fair values of investments other than financial instruments [5] if those other investments are reported at fair value
d. The aggregate amount of the deficiencies for all donor-restricted endowment funds for which the fair value of the assets at the reporting date is less than the level required by donor stipulations or law.

16. For the most recent period for which a statement of financial position is presented, a not-for-profit organization shall disclose the nature of and carrying amount for each individual investment or group of investments that represents a significant concentration of market risk.[6]

Effective Date and Transition

17. This Statement shall be effective for fiscal years beginning after December 15, 1995, and interim periods within those fiscal years. Earlier application is encouraged.

18. Unless this Statement is applied retroactively under the provisions of paragraph 19, the effect of initially applying this Statement shall be reported as the effect of a change in accounting principle in a manner similar to the cumulative effect of a change in accounting principle (APB Opinion No. 20, *Accounting Changes,* paragraph 19). The amount of the cumulative effect shall be based on a retroactive computation, except that the expiration of restrictions on previously unrecognized gains and losses may be recognized prospectively. [7] A not-for-profit organization

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shall report the cumulative effect of a change in accounting on each class of net assets in the statement of activities between the captions "extraordinary items," if any, and "change in unrestricted net assets," "change in temporarily restricted net assets," and "change in permanently restricted net assets."

19. This Statement may be applied retroactively by restating the beginning net assets for the earliest year presented or, if no prior years are presented, for the year this Statement is first applied. The expiration of restrictions on previously unrecognized gains and losses may be recognized prospectively. In the period that this Statement is first applied, a not-for-profit organization shall disclose the nature of any restatement and its effect on the change in net assets and on each class of net assets for each period presented.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the affirmative votes of five members of the Financial Accounting Standards Board. Messrs. Beresford and Northcutt dissented.

Mr. Beresford disagrees with the standard in paragraph 7 that requires all investments in debt securities to be measured at fair value. Mr. Beresford believes this Statement should require a two-category approach. Under that approach, debt securities that an organization has the positive intent and ability to hold to maturity would be reported at amortized cost. Other debt securities and equity securities with readily determinable fair values would be reported at fair value. If a debt security is held to maturity, interim changes in that security's market value do not affect either the amount or timing of net cash flows to the entity. Consequently, Mr. Beresford agrees with the Board's conclusion in paragraph 58 of Statement 115 that "amortized cost is most likely to be relevant for those debt securities that will be held to maturity," and he believes that different accounting treatment is warranted for those debt securities. He believes that not-for-profit organizations should have the same ability as business enterprises to measure those securities at amortized cost.

Mr. Beresford also believes that more restrictive display requirements are necessary when amounts computed under a spending-rate or other budgetary method are included within an organization's measure of operations. He believes that users of financial statements might be misled if the amount reported within an operating measure is greater than the actual return for the period. He would limit the amount reported within the operating measure to actual gains and losses for the period—those amounts are based on the nature of the underlying transactions rather than on spending-rate or budgetary designations.

Mr. Northcutt disagrees with the standards in paragraphs 11-13, which prescribe the accounting for losses on the investments of donor-restricted endowment funds. Mr. Northcutt believes this Statement should require the method described in paragraphs 78 and 79, in which losses on investments of permanently restricted endowment funds reduce the net asset classes in which unappropriated net appreciation of the fund is reported and any additional losses reduce

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permanently restricted net assets. In Mr. Northcutt's view, the method required by paragraphs 11-13 has three main problems.

First, Mr. Northcutt believes that the method required by this Statement fails to acknowledge that not-for-profit organizations identify the assets of each endowment fund and the investment income earned by those assets because they have fiduciary responsibilities and must be able to demonstrate that they are complying with the donors' stipulations and applicable laws. Because the assets of an endowment fund are known, classification of the net assets related to those assets is straightforward. First, the portion of the net assets that may never be spent because of donor or legal restrictions should be classified as permanently restricted net assets. Next, net appreciation for which restrictions on expenditure have not yet been met should be classified as temporarily restricted net assets. Finally, the remaining portion of net appreciation should be classified as unrestricted net assets. If a loss reduces the value of the assets of an endowment fund, the classification of the net assets related to the remaining assets follows the same procedure. If a loss reduces the assets of an endowment fund below the amount that must be maintained in perpetuity (historic dollar value), those assets are entirely unexpendable and all the net assets of that endowment fund should be classified as permanently restricted.

Mr. Northcutt acknowledges that the method he prefers must either define the assets of the fund or tolerate the effects of differing definitions. A definition requires a method for identifying when assets are removed from the fund for spending and thus are no longer present to absorb losses. Mr. Northcutt accepts the method provided in the Uniform Management of Institutional Funds Act for removing net appreciation—appropriation. He would define the assets of an endowment fund using appropriation because he believes the effects of management's discretion on classification of net assets are limited. An appropriation for expenditure does not change the class of net assets in which the appropriated amount is reported. An appropriation does not change when restrictions on net appreciation expire. When a loss occurs, only one classification of net assets is possible because an appropriation either was made or was not made prior to the loss. An appropriation can be made only when the fund has available net appreciation, and amounts appropriated may not be returned to the fund. The appropriation determines only the amount of net appreciation of a donor-restricted endowment fund that is available to absorb a future loss.

Mr. Northcutt recognizes that attributing significance to the act of appropriation for purposes of classifying losses on endowment funds may be viewed as inconsistent with the Board's decisions in Statements 116 and 117. He would be willing to amend Statement 117 to allow an exception only for this case.

Second, Mr. Northcutt believes that the method of accounting for losses described in this Statement can result in the classification of permanently restricted net assets and unrestricted net assets in a manner that is inconsistent with the definitions of those classes of net assets. That method can result in an overstatement of permanently restricted net assets, which could lead users to believe that there are more assets generating income for support of the organization than there actually are. That method also can result in an understatement of the net resources that an organization as a whole has available to meet current operating needs.

Third, Mr. Northcutt believes that the method described in paragraphs 11-13 of this

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Statement misclassifies the gains that restore the fair value of the assets of the endowment fund to the level required by donor stipulations or law. That method would report future gains as increases in unrestricted net assets, even though the amount of net resources that are expendable for current operating needs is unchanged. In effect, gains that must be retained in perpetuity because of a donor-imposed restriction will be reported as increases in unrestricted net assets, which makes sense only because it corrects the erroneous reporting of the year of the loss.

Members of the Financial Accounting Standards Board:

Dennis R. Beresford, *Chairman*
Joseph V. Anania
Anthony T. Cope
John M. Foster
James J. Leisenring
Robert H. Northcutt
Robert J. Swieringa

Appendix A: BACKGROUND INFORMATION

20. In March 1986, the Board added a project to its agenda to resolve certain inconsistent accounting practices of not-for-profit organizations. The Board identified five areas of inconsistency that persist, in part, because the specialized accounting principles and practices in the AICPA Guides for not-for-profit organizations contain inconsistent requirements. Accounting for investments, one of the five areas, was initially included in the financial instruments project, which was added to the Board's agenda in May 1986.

21. FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* issued in May 1993, specifically excluded not-for-profit organizations from its scope. The Board decided to consider the issues about investments held by not-for-profit organizations after it resolved its agenda projects on accounting for contributions and financial statement display by those organizations. FASB Statements No. 116, *Accounting for Contributions Received and Contributions Made,* and No. 117, *Financial Statements of Not-for-Profit Organizations,* were issued in June 1993. In February 1994, the Board began deliberations to establish standards for reporting investments held by not-for-profit organizations.

22. Current guidance for accounting for and reporting of investments held by not-for-profit organizations is provided by the following four AICPA Guides:

a. *Audits of Colleges and Universities*
b. *Audits of Voluntary Health and Welfare Organizations*
c. *Audits of Providers of Health Care Services*

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d. *Audits of Certain Nonprofit Organizations.*

The requirements in those Guides are similar in some respects. In other respects they differ from each other and from generally accepted accounting principles applicable to other entities. The inconsistencies lead to differences in accounting practices and, hence, to comparability and understandability problems. Further, three of the Guides permit accounting alternatives that lead to further inconsistencies within the subsector they cover.

23. In addition to the inconsistencies in the Guides, the Board identified other problems that this project should attempt to resolve:

a. *Greater relevance of fair value information.* Some believe that fair value information about investments is a more relevant measure of the ability of the organization's assets to support operations than cost-based information.
b. *LOCOM is not evenhanded.* The lower-of-cost-or-market method, which is required by one Guide and permitted by another, is not evenhanded because it recognizes the net diminution in value but not the net appreciation in the value of investments.
c. *Managing change in net assets.* Cost-based measures create situations in which decisions to sell certain securities may be based on the sale's effect on the change in net assets. Organizations may choose to sell appreciated securities to recognize the unrealized gains while choosing to retain other securities with unrealized losses. Similarly, organizations may choose to sell securities with unrealized losses while choosing to retain appreciated securities to reduce the change in net assets.
d. *Accounting based on intent.* Accounting standards based on the intent of management make the accounting treatment depend on the plans of management rather than the economic characteristics of an asset. Intent-based accounting impairs comparability.

24. The Board discussed the resolution of those problems at a number of public Board meetings. In March 1995, the Board issued the Exposure Draft, *Accounting for Certain Investments Held by Not-for-Profit Organizations.* The Board and staff analyzed the 86 comment letters received and obtained additional information from a field test of the proposed requirements for classification of losses on investments of endowment funds and from a meeting with rating agency analysts, officers of grant-making foundations, and others who use the financial statements of not-for-profit organizations. The concerns raised by respondents, field test participants, and users of financial statements were considered by the Board at additional public Board meetings. Throughout the project, the Board and staff consulted with the members of the FASB Task Force on Accounting Issues for Not-for-Profit Organizations, including discussing the Board's tentative decisions at a June 1994 public meeting. The Board decided that it could reach an informed decision without holding a public hearing.

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Appendix B

BASIS FOR CONCLUSIONS

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Appendix B: BASIS FOR CONCLUSIONS

Introduction

25. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this Statement. It includes reasons for accepting certain views and rejecting others. Individual Board members gave greater weight to some factors than to others.

Benefits and Costs

26. The mission of the Board is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information. In fulfilling that mission, the Board strives to determine that a proposed standard will fill a significant need and that the costs imposed to meet that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. Present and potential donors, creditors, members, and others all benefit from improvements in financial reporting; however, the costs to implement a new standard may not be borne evenly by all parties. Further, the costs of not issuing a standard are impossible to quantify. Because there is no common gauge by which to judge objectively the costs to implement a standard against the need to improve information in financial statements, the Board's assessment of the costs and benefits of issuing an accounting standard is unavoidably subjective.

27. The benefits of reporting debt and certain equity securities at fair value are discussed in paragraphs 33-40. In addition to those benefits, fair value measurement resolves for those investments each of the problems discussed in paragraph 23 of Appendix A. This Statement enhances comparability by eliminating the inconsistencies in the current guidance for reporting carrying amounts of equity securities with readily determinable fair values and all debt securities. For those securities, this Statement also removes the bias implicit in LOCOM accounting, precludes opportunities for managing change in net assets through selective sale of securities, and eliminates the subjectivity of accounting based on management's intent.

28. The Board concluded that the overall benefits of the information provided by applying this Statement justify the costs that this Statement may impose. Because the AICPA Guides and FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments,* require that not-for-profit organizations disclose fair value information for investments reported at cost, organizations generally have the information systems that are needed to meet the requirements of this Statement. Although there will be transitional costs as not-for-profit organizations apply the requirements, the Board believes that the ongoing costs of applying this Statement should not be

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significantly greater than for existing requirements. The Board also believes that some of the costs this Statement imposes have been reduced in various ways: by limiting the scope of the measurement standards to equity securities whose fair values are readily determinable and to debt securities, by providing broad guidance and allowing some latitude in how information is reported in financial statements, and by eliminating requirements to disclose cost-based information for investments reported at fair value.

Scope

29. This Statement provides measurement standards for most investments held by not-for-profit organizations. Some not-for-profit organizations have more complex investment portfolios that include investments that are outside the scope of this Statement. A broader scope would have included investments such as interests in trusts, joint-venture agreements, oil and gas properties, real estate, and investments in closely held companies and partnerships. Those investments could have raised significant valuation issues that might not have been resolved in time to coordinate the implementation of this Statement with the implementation of Statements 116 and 117.

30. Most respondents to the Exposure Draft agreed with the Board's decision to limit the scope of this Statement. A few of those respondents said that the Board should consider carefully any requests to expand the scope to include investments that are not readily marketable. They were troubled by the subjectivity that may be necessary in estimating fair values. The Board understands that reliability is an important factor in financial reporting and, therefore, limited the scope for equity securities to those that have readily determinable fair values. The scope of this Statement includes all debt instruments that are securities because the Board believes that sufficiently reliable estimates of fair value can be made for those instruments.

31. A few other respondents indicated that the scope should be expanded to include either all investments or all financial instruments. Provisions of the AICPA Guides remain in effect for measuring investments that are not within the scope of this Statement, including impairment of investments reported using cost-based measures. Where permitted by the relevant AICPA Guide, the Board does not discourage not-for-profit organizations from using fair value to measure investments that are outside the scope of this Statement; the Board limited the scope for practical reasons.

32. The Board decided to use the definitions of *security, equity security, debt security,* and *readily determinable fair value* that were developed in Statement 115 to ensure that this Statement and Statement 115 apply to the same investments. In the future, the Board expects to consider the accounting for other financial instruments held by business enterprises and not-for-profit organizations within the financial instruments project that is currently on its technical agenda.

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Accounting for Certain Investments in Debt and Equity Securities

Relevance of Fair Values of Investments in Securities

33. The Board concluded that measuring investments in debt and equity securities at fair value in the financial statements provides information that is relevant and useful to present and potential donors, creditors, and others in making rational decisions about the allocation of resources to not-for-profit organizations—the first objective of financial reporting discussed in FASB Concepts Statement No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations*.

34. Measuring those investments at fair value also serves to achieve the second objective of financial reporting—providing information that is useful in assessing the ability of the organization to provide services. Fair value more accurately measures the resources available to provide mission-related services because it portrays the market's estimate of the net future cash flows of those securities, discounted to reflect both time value and risk. "The assessment of cash flow potential is important because it relates directly to the organization's ability to provide the goods and services for which it exists" (Concepts Statement 4, paragraph 45).

35. Fair value information assists users in assessing management's stewardship and performance—thus helping to meet the third objective of financial reporting discussed in Concepts Statement 4. Management must continually decide whether to hold an investment or to sell the investment and redirect resources to other investments or other uses. Fair value reports information useful in evaluating the performance of management in dynamic market conditions.

36. Many respondents to the Exposure Draft agreed with the Board about the relevance of fair value information. Creditors, rating agencies, regulators, and others that use the financial statements of not-for-profit organizations said fair value measures provide information that is useful to them in comparing and evaluating organizations and their managements. Because the goal of investing is to maximize returns commensurate with the risks undertaken, the only way to evaluate performance is to compare returns, adjusted for risk, to that of other entities or to common market indicators. Those financial statement users said that comparisons are reasonable only when securities and their returns are measured using fair value measures.

37. The ability to make meaningful comparisons between organizations is enhanced when securities are measured at fair value. Cost-based measures of the same security can vary significantly from organization to organization; fair value measures vary little, if at all. The value of securities, and all financial instruments, comes from the ability to convert them to their promised cash flows and to use the resulting cash to purchase the services, goods, and long-lived assets that the organization needs to conduct its activities. The cash flows associated with the securities do not depend on which organization owns them; thus, the measures of securities

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should not vary from organization to organization.

38. Some respondents were concerned primarily about reporting unrealized changes in fair value in their financial statements. Some that supported fair value measures said that changes in the fair values of securities should not be reported in the statement of activities until realized. They argued that the volatility that results from reporting unrealized gains and losses in change in net assets is unrepresentative of the results of operations of the organization and presents a false picture of the organization's stewardship abilities. Other respondents that favored cost-based measures said that not-for-profit organizations invest for long-term returns that support program activities and that temporary fluctuations in market values are irrelevant to managing the organization or its investment portfolio. They argued that fair value measures ignore those considerations. In their view, fair value measures focus on the effects of transactions and events that do not involve the organization and report opportunity gains and losses that should not be recognized until realized.

39. The Board concluded that to delay recognition of gains and losses until they are realized omits relevant information from the financial statements of not-for-profit organizations. To ignore fluctuations that actually occur fails to represent faithfully the risks inherent in investing activities, and to fail to report increases and decreases in value in periods when market conditions change impairs the credibility of financial statements. Recognizing only realized gains and losses in financial statements does not eliminate volatility in the change in net assets; instead, it provides opportunities to use selective sales of securities to manage that volatility. This Statement attempts to reduce opportunities to manage the reported change in net assets by selective sales of securities.

40. The requirement to report investments in equity securities with readily determinable fair values and all debt securities at fair value builds on current and evolving practices and requirements. Three of the four AICPA Guides permit organizations to report investments at fair value, and all four Guides require disclosure of fair value if investments are reported using a cost-based measure. FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans,* requires that all plan investments be reported at fair value because that reporting provides the most relevant information about the resources of a plan and its present and future ability to pay benefits when due. Statements 107, 115, and 119 also require that entities report fair value information about their financial instruments because that information is relevant to users of financial statements.

Consideration of Whether to Amend Statement 115

41. The Board considered amending Statement 115 to include not-for-profit organizations within its scope. In addition to not-for-profit organizations, Statement 115 excludes from its scope enterprises whose specialized accounting practices include accounting for substantially all investments in debt and equity securities at market or fair value, with changes in value recognized in earnings (income) or in change in net assets. Those enterprises (principally

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brokers and dealers in securities, defined benefit pension plans, and investment companies) are excluded because the Board believes that their current accounting practices provide more relevant information for users of their financial statements. The specialized accounting practices of most not-for-profit organizations permit reporting investments at fair value with changes in fair value recognized in change in net assets, and a significant number of not-for-profit organizations presently do so. Accordingly, the Board considered whether an approach similar to those specialized accounting practices or the approach used in Statement 115 would result in more relevant information for the users of the financial statements of not-for-profit organizations.

42. Statement 115 identifies three categories of investments into which an enterprise classifies its investments. The accounting and reporting differ by category. Investments in debt securities that the enterprise has the positive intent and ability to hold to maturity are classified as *held-to-maturity securities* and are reported at amortized cost. Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified *as trading securities* and reported at fair value, with unrealized holding gains and losses included in earnings. [8] Debt and equity securities not classified as either held-to-maturity securities or trading securities are classified as *available-for-sale securities* and reported at fair value, with unrealized holding gains and losses excluded from earnings and reported in a separate component of shareholders' equity.

43. The approach in Statement 115 resulted from a need to accommodate situations that are largely nonexistent in not-for-profit organizations. Some enterprises affected by Statement 115 (principally banks, thrifts, credit unions, and insurance companies) manage their interest rate risk by coordinating the maturity and repricing characteristics of their investments and their liabilities. Reporting unrealized holding gains and losses on only the investments, and not the related liabilities, could cause volatility in earnings that is not representative of how financial institutions are affected by economic events. The Board concluded that accommodations similar to those in Statement 115 were unnecessary for not-for-profit organizations because (a) the purposes for which not-for-profit organizations hold investments generally do not relate investments to liabilities and (b) the change in net assets is not a performance measure comparable to earnings of a business enterprise.

44. Respondents to the Exposure Draft and task force members helped the Board identify the purposes for which not-for-profit organizations hold investments. Three of the primary purposes identified were endowment, funded depreciation, and short-term investment of operating cash surpluses. Organizations usually do not relate investment assets to liabilities when investing for those purposes. However, organizations may relate investment assets to specific liabilities when investing for other purposes. For many of those other purposes, the related liability is measured and periodically remeasured at the present value of estimated future cash flows using a discount rate commensurate with the risks involved. For example, the obligation to the beneficiary of an annuity agreement is measured at the present value of the payments to be made, the obligation to employees covered by a funded postretirement benefit plan is measured at the actuarial present

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value of the expected benefits attributed to periods of employee service, and the obligation to provide future service in continuing care retirement communities is measured at the present value of future net cash flows. This Statements requirement to measure investment securities at fair value will eliminate situations where the adjustment of the liability is included in the change in net assets, but the change in the value of related investments is not.

45. In other identified relationships, such as many debt service funds, this Statement requires that the investments be measured at fair value, although the related liability is reported at historical proceeds. However, most respondents that supported a Statement 115 approach or its held-to-maturity category indicated that they did not coordinate maturities of the investments with the related liabilities. The Board concluded that the possibility for volatility that is not representative of how not-for-profit organizations are affected by economic events is limited, both in the number of not-for-profit organizations potentially affected and in the amounts of investments and liabilities involved.

46. The Board also noted that the distinctions between the three categories of investments of Statement 115 are less relevant for not-for-profit organizations because the change in net assets is not a performance measure equivalent to earnings of a business enterprise. "[Not-for-profit] organizations generally have no single indicator of performance comparable to a business enterprise's profit" (Concepts Statement 4, paragraph 9). Although the magnitude of profits is generally indicative of how successfully a business enterprise performed, the same relationship is not true of a not-for-profit organization. The magnitude of change in net assets does not indicate how successfully a not-for-profit organization performed in providing goods and services. Further, because donor-imposed restrictions affect the types and levels of service a not-for-profit organization can provide, the change in each class of net assets may be more significant than the change in net assets for the organization as a whole (FASB Concepts Statement No. 6, *Elements of Financial Statements,* paragraph 106).

47. Because change in net assets is not a performance measure, the distinction between trading securities and available-for-sale securities is less relevant for not-for-profit organizations in reporting changes in fair value than that distinction is for business enterprises. Business enterprises distinguish between components of comprehensive income, [9] reporting certain changes in equity (net assets) in an income statement and other changes in net assets in a separate component of equity. The trading and available-for-sale categories are used to make those differentiations. In contrast, the statement of activities of a not-for-profit organization is like a statement of comprehensive income; it reports all changes in net assets. Reporting in a manner similar to Statement 115 introduces unnecessary complications by introducing separate components of equity within the three classes of net assets.

48. The Board concluded that fair value is more relevant to donors and other users of a not-for-profit organization's financial statements than the approach used in Statement 115. The Board decided that use of the three categories of investments prescribed in Statement 115 would add complexity without returning sufficient benefits for measurement or reporting purposes of

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not-for-profit organizations.

49. Some respondents, primarily health care organizations and their auditors, said that because Statement 115 requires business enterprises to report changes in fair value of available-for-sale securities in a separate category of equity and to report held-to-maturity securities at amortized cost, users would be unable to make meaningful comparisons when not-for-profit organizations and business enterprises are engaged in the same industry. This Statement allows an organization with those comparability concerns to report in a manner similar to business enterprises by identifying securities as available-for-sale or held-to-maturity and excluding the unrealized gains and losses on those securities from an operating measure within the statement of activities.

Debt Securities Held to Maturity

50. In addition to the three-category approach used in Statement 115, the Board considered a two-category approach. Under that approach, debt securities that the organization has the positive intent and ability to hold to maturity would be reported at amortized cost. Other debt securities and equity securities with readily determinable fair values would be reported at fair value. Two of the AICPA Guides permit the use of amortized cost for debt securities if a not-for-profit organization has the intent and ability to hold those securities to maturity. The Board considered whether that practice should continue and decided that amortized cost should not be permitted.

51. Respondents to the Exposure Draft that favored a two-category approach said that fair value information is less relevant for debt securities that are being held to maturity. They said that amortized cost provides relevant information because it focuses on the decision to acquire the asset, the earning effects of that decision that will be realized over time, and the ultimate recoverable value of the asset. If a debt security is held to maturity, the face value of the security will be realized, unless the issuer defaults, and all interim unrealized gains and losses will be reversed. In their view, increases and decreases in the fair value of the debt security are not true gains and losses in investment value because the organization's cash flows are "locked in" at purchase.

52. Other respondents said that fair value information is as relevant for debt securities that are being held to maturity as it is for other investments. Increases or decreases in fair value reflect the success or failure of the strategy of purchasing and holding a longer-term rather than a shorter-term debt security in an environment of changing interest rates. For example, if an organization invests in a fixed-rate debt security and interest rates rise, the organization generally will receive less cash than if it had invested in a variable-rate security. That success (or failure) in maximizing the return on the organization's resources is relevant and should be reflected in the financial statements in the period the event (that is, the change in interest rates) occurs. In addition, fair value also reflects the risk that the cash flows will not be received as expected.

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53. Some respondents that favored fair value measures mentioned that effective management of financial activities often requires a flexible investment strategy that is inconsistent with a held-to-maturity notion. They said that although many investment policies are based on long-term strategies, market fluctuations impact decisions to buy or sell specific instruments in order to achieve the organization's overall objectives. The Board believes that if an organization would sell a debt security to achieve its investment objectives, the organization does not have the positive intent to hold the security to maturity.

54. Other respondents that favored a two-category approach said they use a buy-and-hold strategy or "ladder" the maturities of their debt securities so that the organization can hold debt securities to maturity. Many of those respondents were concerned about volatility in the change in net assets, which would result if debt securities could not be reported at amortized cost when market interest rates changed. However, respondents that expressed that concern indicated that debt securities being held to maturity represent only a small portion of their portfolios. The Board noted that unless a portfolio was composed completely of debt securities being held to maturity, a two-category approach would not resolve concerns about volatility in change in net assets.

55. Respondents also said that not-for-profit organizations should have the same ability as business enterprises to report debt securities classified as held-to-maturity securities at amortized cost. Measuring an investment at (a) amortized cost if the organization has the positive intent and ability to hold it to maturity or (b) fair value if the organization does not have that intent bases the measurement on the intent of management rather than on the economic characteristics of the asset. Measurement based on the intent of management is one of the problems that this Statement attempts to resolve.

56. Statement 115 did not resolve the problem of accounting by intent. As discussed in paragraphs 43-48 of this Statement, the approach in Statement 115 resulted from a need to accommodate situations that are largely nonexistent in not-for-profit organizations. Thus, the Board concluded that allowing a not-for-profit organization to account for investments based on management's intent is unwarranted and that investments in equity securities with readily determinable fair values and all debt securities should be reported at fair value.

Determining Fair Values

57. The Board decided to use the term *fair value* in this Statement to avoid confusion between the terms *fair value* and *market value;* some constituents associate the term *market value* only with items that are traded on active secondary markets (such as exchange and dealer markets). However, the Board does not make that distinction and intends the term to be applicable whether the market for an item is active or inactive, primary or secondary.

58. The fair value of an asset is the amount at which the asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Quoted market prices in active markets are the best evidence of fair value and should be used as

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the basis for measurement, if available. Quoted market prices are easy to obtain and are reliable and verifiable. They are used and relied upon regularly and are well understood by donors, creditors, and other users of financial information.

59. Although quoted market prices are not available for all debt securities, the Board believes that a reasonable estimate of fair value can be made or obtained for the remaining debt securities required to be reported at fair value by this Statement. For debt securities that do not trade regularly or that trade only in principal-to-principal markets, the estimate of fair value should be based on the best information available in the circumstances. The estimate of fair value should consider market prices for similar debt securities and the results of valuation techniques to the extent available in the circumstances. Examples of valuation techniques include the present value of estimated expected future cash flows using a discount rate commensurate with the risks involved, option-pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis. The Board realizes that estimating fair value may require judgment but notes that a considerable degree of judgment also is needed when complying with other long-standing accounting and reporting requirements.

Financial Statement Presentation

Reporting Investment Gains, Losses, and Income

60. This Statement provides requirements for reporting changes in the fair value of investments in securities. The total change in fair value consists of both the change in the unpaid interest income on a debt security (or the unpaid accrued dividends on an equity security until the ex-dividend date) and the change in fair value that results from holding a security—the gain or loss, which can be either realized or unrealized. Gains and losses are recognized as changes in net assets in the periods in which they occur, and investment income is recognized as revenue in the period earned. Delaying recognition of restricted gains, losses, and income until the restrictions are met is inappropriate. The requirements of this Statement clarify, but do not change, the requirements of Statement 117.

61. Statement 117 establishes broad standards directed at critical display issues and allows organizations latitude to present information in a form that management believes is most meaningful to financial statement users. The Board decided that display guidance in this Statement also should focus on critical information that is essential in meeting the financial reporting objectives for all not-for-profit organizations.

62. The Board concluded that the most critical information—investment gains, losses, and investment income—should be recognized and reported in the statement of activities. Other critical information about the types of investments, their risks, and their returns should be disclosed, but organizations can decide whether that information is disclosed on the face of the statements or in the notes to financial statements.

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63. The Board considered whether more restrictive display requirements were necessary for realized gains and losses, unrealized gains and losses, investment return, or the amounts computed under a spending-rate or other budgetary method for reporting endowment returns. By not prescribing specific standards in this Statement, the Board recognizes that differing financial statement display practices are probable. Statement 117 is not yet in effect for most organizations, and they are just beginning to explore reporting that complies with its requirements and responds to its flexibility. The Board believes that it is premature to conclude that reporting differences will be undesirable and that at this time it is best to allow latitude so that financial reporting practices may continue to evolve.

64. Most respondents supported the reporting flexibility that this Statement permits. However, several respondents said that users of financial statements might be misled if organizations use a spending-rate or total return policy [10] that reports in an operating measure an amount that exceeds the total investment return for the year. The Board noted that those respondents were not similarly concerned about reporting less than the total investment return in an operating measure, nor were they concerned about reporting net realized gains in an operating measure and net unrealized losses outside that measure, although the reporting in that latter case also may result in including an amount in an operating measure that exceeds the total investment return for the year. A few respondents said that distinctions between realized and unrealized amounts are acceptable because those distinctions are based on the underlying nature of the transaction, but spending-rate and total return amounts are computed using formulas. In general, the Board agrees that amounts reported in an organization's financial statements should be based on the nature of the underlying transactions rather than on budgetary designations—to report otherwise suggests the reported operating measure is being managed. In this case only, the Board agreed that amounts based on budgetary designations may be displayed because the necessary constraints are provided by the disclosures required by paragraph 14 of this Statement and paragraph 23 of Statement 117 (including its requirement that an operating measure, if reported, must appear in a financial statement that, at a minimum, reports the change in unrestricted net assets for the period).

Reporting Losses on Endowment Funds

65. Statement 117 requires that gains and losses be classified based on the existence or absence of donor-imposed restrictions or law that limits their use. Paragraph 129 of that Statement explains the application of that requirement to the net appreciation of endowment funds:

> . . . the Board concluded that if the law of the relevant jurisdiction, as interpreted by an organization's governing board, places permanent restrictions on some part of the net appreciation, that amount should be reported as permanently restricted net assets in the organization's financial statements. In the absence of such a law or a donor's explicit or clear implicit permanent restriction, net appreciation should be reported as unrestricted if the endowment's income is unrestricted or

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temporarily restricted if the endowment's income is temporarily restricted by the donor.

Some respondents to the Exposure Draft of Statement 117 raised questions about reporting losses on investments of endowments. The Board deferred consideration of those issues to this Statement.

66. The Board limited its consideration to losses on investments of endowment funds that are created by donor stipulations requiring that the gifts be invested in perpetuity or for a specified term. The classification of losses on investments of an endowment fund created by a board designation of unrestricted funds is straightforward; the losses are classified as reductions in unrestricted net assets because all sources of that endowment fund—original amount, gains and losses, and interest and dividends—are free of donor restrictions.

67. The classification of losses on investments of an endowment fund created by a donor also is straightforward if the donor explicitly states in the gift agreement what is to occur in the event of a loss; the losses are classified in accordance with the donor stipulations. Similarly, a donor's explicit requirement that an organization hold a specific donated asset in perpetuity implies that the enhancements and diminishments of that asset (gains and losses) are subject to the same permanent restriction. In the absence of donor stipulations or law to the contrary, the Board concluded that losses on investments of a donor-restricted endowment fund should reduce temporarily restricted net assets to the extent that donor-imposed temporary restrictions on net appreciation of the fund have not been met before the loss occurs and that any remaining loss should reduce unrestricted net assets.

Fundamental Conclusions about the Classification of Losses

68. In determining the method to be used to classify losses in the absence of explicit donor stipulations or law, the Board considered the Uniform Management of Institutional Funds Act (Uniform Act), which has been adopted in varying forms in at least 38 states and the District of Columbia. It says:

> The governing board may appropriate for expenditure for the uses and purposes for which an endowment fund [11] is established so much of the net appreciation, realized and unrealized, in the fair value of the assets of an endowment fund over the historic dollar value [12] of the fund as is prudent. . . .
>
> Unrealized gains and losses must be combined with realized gains and losses to insure that the historic dollar value is not impaired. [Section 2 and the comment to that section, footnotes added.]

Although the Uniform Act indicates that losses should be netted against gains and that realized and unrealized amounts should be considered equally in applying its provisions, the Act is silent about an organization's responsibility to restore a decrease in the value of the assets of an

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endowment fund. The Board concluded that a method for classifying losses of a donor-restricted endowment fund should not define an organization's fiduciary responsibilities to maintain the assets of the fund; each organization should determine its responsibilities in accordance with donor-imposed restrictions and law.

69. The Board also considered different interpretations of "the assets of an endowment fund," in part because the Uniform Act does not define that phrase. Different interpretations result in different determinations of which investment losses are losses of a donor-restricted endowment fund and how much of prior periods' appreciation can be netted with losses of the fund in the current period. Respondents' interpretations of the phrase differed. For example, some organizations that participated in the field test of the Exposure Draft interpreted the phrase to mean that assets purchased with a gift and assets purchased with its net appreciation are part of the endowment fund until a portion of the assets is removed by an appropriation for expenditure. Other participants said that in addition to those assets, assets purchased with investment income are part of the fund. Another participant said that assets purchased with net appreciation are not part of the fund at all. Without case law to help interpret the Uniform Act, the Board has no basis to adopt one interpretation and reject all others. The Board concluded that a method for classifying losses should accommodate different interpretations of "the assets of an endowment fund" but minimize the effects of differing interpretations on the classification of net assets.

70. The Board considered whether the ability to "appropriate for expenditure" granted by the Uniform Act should influence the classification of losses. Attributing significance to an act of appropriation would allow management's intent to influence the classification of net assets and is inconsistent with the Board's conclusions in Statements 116 and 117. Statement 116 requires that a restriction on temporarily restricted net appreciation expire when an expense is incurred for the restricted purpose, regardless of whether an amount is appropriated. In Statement 117, the Board concluded that decisions about when to appropriate resources should not influence their classification—net gains are reported in unrestricted or temporarily restricted net assets unless permanently restricted by the donor or law. The Board concluded that appropriation of a portion of net appreciation should not change the classification of a loss on an endowment fund.

71. The Board believes that inconsistent classification of net assets would result if it did not specify a method for classifying losses on investments of donor-restricted endowment funds. Donors generally are silent about losses on the investments of the funds they establish, and the Uniform Act is unclear about an organization's responsibilities when a loss occurs. Without explicit donor stipulations or law to determine the classification of losses on investments of endowment funds, organizations could arrive at different answers in similar circumstances.

72. The Board considered the three methods for classifying losses on investments of donor-restricted endowment funds that are discussed in paragraphs 73-82, as well as variations of those methods. All of the methods considered had some drawbacks. The Board believes that the method in this Statement for classifying losses is simple to apply and will result in greater comparability and consistency in classification of net assets so that users of financial statements

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may make better-informed decisions.

Method Used in This Statement for Classifying Losses

73. The Board concluded that, in the absence of donor stipulations or law to the contrary, losses on the investments of a donor-restricted endowment fund reduce temporarily restricted or unrestricted net assets. The Board concluded that if a donor requires an endowment fund to be invested in perpetuity, permanently restricted net assets should equal the historic dollar value of the fund. The Uniform Act says, "Accounting entries recording realization of gains or losses to the fund have no effect upon historic dollar value. No increase or decrease in historic dollar value of the fund results from the sale of an asset held by the fund and the reinvestment of the proceeds in another asset" (comment to Section 1(5)). Unless historic dollar value changes, such as when a donor directs that gains be accumulated in the fund, neither gains nor losses affect permanently restricted net assets.

74. Whether a loss reduces temporarily restricted net assets, unrestricted net assets, or both depends on where the net appreciation of the fund is classified at the time the loss occurs. First, to the extent that donor-imposed temporary restrictions on net appreciation have not been met prior to the loss, the loss reduces temporarily restricted net assets. The remaining loss reduces unrestricted net assets, which can be viewed as reducing any net appreciation classified in that net asset class and then reducing unrestricted net assets for any excess loss (that is, the amount by which the fair value of the assets of the fund is less than the historic dollar value). In other words, when losses exceed the net appreciation classified in temporarily restricted and unrestricted net assets, the excess loss reduces unrestricted net assets.

75. The Board concluded that the method used in this Statement is most consistent with the fundamental conclusions described in paragraphs 68-72. Under that method, different interpretations of "the assets of an endowment fund," especially differences in how and when net appreciation is removed from the fund, have a lesser effect on the classification of net assets. A loss that reduces the fair value of the assets of the endowment fund to historic dollar value and a loss that reduces the fair value below historic dollar value reduce the same net asset class, unrestricted net assets, unless restrictions on net appreciation have not been met prior to the loss. The effects of appropriation are minimized because the amounts appropriated for expenditure also are classified in unrestricted net assets (or will be reclassified to that net asset class shortly because the donor-imposed restrictions will be met when the amounts are spent).

76. A drawback of that method is that excess losses decrease unrestricted net assets even if the organization is not required by a donor-imposed restriction or law to use its unrestricted resources to restore immediately the value of the endowment fund to the level required by donor stipulations or law. Some respondents said that that drawback could be mitigated by requiring organizations to disclose the amount of the deficiency when the fair value of the assets of a donor-restricted endowment fund is less than the level required by the donor's restriction or law. The Board agreed and added that requirement. However, the field test results indicated that,

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except in the early years of an endowment fund, incidences of excess losses will be few because organizations generally accumulate net appreciation through policies that preserve and grow their endowment funds.

77. Because unrestricted net assets are reduced for the excess loss when the fair value of the assets of the endowment fund falls below the fund's historic dollar value, this Statement requires that unrestricted net assets be restored from future gains for that reduction. Some respondents said that that classification was confusing and that they would expect those gains to be classified as increases in permanently restricted net assets because they cannot be appropriated for expenditure. However, because the prior loss did not reduce permanently restricted net assets, the classification suggested by respondents would increase the amount of permanently restricted net assets beyond the level required by donor restrictions or law. Thus, gains that restore the fair value of the assets of the endowment fund to the fund's required level (historic dollar value) should be classified as increases to the same class of net assets that was previously reduced for the excess loss—unrestricted net assets. After the fair value of the assets of the endowment fund equals the required level, gains are again available for expenditure, and those gains that are restricted by the donor are classified as increases in temporarily restricted net assets.

Other Methods Considered

78. The Board also considered a method in which losses would reduce temporarily restricted and unrestricted net assets to the extent that unappropriated net appreciation is classified in those net asset classes, but the excess loss would reduce permanently restricted net assets if the donor required the fund to be invested in perpetuity or would reduce temporarily restricted net assets if the donor required the fund to be invested for a specified term. Most respondents that commented on the endowment loss provisions preferred that method.

79. That method would result in the same classification of net assets as this Statement except when the fair value of the assets of the endowment fund is less than historic dollar value. However, it cannot accommodate differing interpretations of "the assets of an endowment fund." Unless all organizations interpret the phrase in the same way, the calculation of the excess loss could differ, resulting in different classifications of net assets in similar circumstances. In addition, how and when an organization removes net appreciation from the fund also can affect classification of net assets. If an organization determines that appropriated amounts are unavailable to absorb losses on the investments of an endowment fund, an action of the governing board to appropriate an amount forces a larger reduction in permanently restricted net assets than would have occurred if that amount had not been appropriated. The Board concluded that it is unacceptable to have differing classifications of net assets result from an action of the governing board. The Board rejected that method after evaluating it in light of the fundamental conclusions in paragraphs 68-72.

80. The Board also considered a second method that would allocate income, gains, and losses between the classes of net assets based on the proportionate interests of those classes in the

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investment pool—or the investments of each fund if investments were not pooled. Each time the fair value of the units related to permanently restricted net assets increased beyond historic dollar value, units with a value equal to the net appreciation would be transferred to temporarily restricted net assets (or unrestricted net assets if the donor did not restrict the use of income from the endowment). Each time a restriction expired, units with a value equal to the expired amount would be transferred from temporarily restricted net assets to unrestricted net assets. Income and gains on the units related to permanently restricted net assets would be classified as increases in temporarily restricted net assets if restricted by the donor to a specific use; otherwise, they would increase unrestricted net assets in accordance with paragraphs 8 and 9 of this Statement. Losses on those units would decrease permanently restricted net assets. Income, gains, and losses on the units related to unrestricted and temporarily restricted net assets would increase or decrease those net asset classes.

81. That second method results in similar classifications of net assets regardless of the interpretation of "the assets of an endowment fund" or whether amounts were appropriated. Further, it is the only method considered by the Board that does not reduce unrestricted net assets for a loss on investments of permanently restricted net assets. The method in this Statement and the other methods considered by the Board result in restriction of previously unrestricted gains when a loss occurs.

82. However, because that method allocates gains, losses, and income based on the proportionate interests of each net asset class, it can be inconsistent with some organizations' interpretations of their fiduciary responsibilities to maintain the assets of the endowment fund and to use the income earned by those assets in accordance with the donors' stipulations. That method's classification of losses is most consistent with an interpretation that an organization's fiduciary responsibilities do not extend to net appreciation of previous periods; that is, net appreciation is not included in "the assets of an endowment fund." The Board rejected the second method after evaluating it in light of the fundamental conclusions in paragraphs 68-72.

Disclosures

83. Using an approach of broad standards for basic information similar to that used in Statement 117, the Board determined the information that is required to be disclosed without prescribing whether it should be disclosed on the face of the statements or in the notes. That approach allows an organization's management to report the information in a manner that is most useful to users of its financial statements. The disclosure requirements are not intended to limit the amount of detail or the manner of providing information; additional classifications and subclassifications may be useful.

84. The Board developed the disclosure requirements after consulting with its task force and with users of financial statements of not-for-profit organizations. It also considered existing disclosure requirements for investments reported at fair value, especially those found in Statements 35 and 115. The Board believes that the required disclosures provide information

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that is useful in assessing management's stewardship and the organization's liquidity and exposure to risk.

85. Some respondents questioned the need for the information about the composition of investment return or the reconciliation required if investment return is separated into operating and nonoperating amounts. Disclosures required for investment return reinforce the requirements of Statement 117 to (a) report information about revenues, gains, and losses by aggregating items into relatively homogeneous groups and (b) disclose information about the nature of a reported measure of operations if the definition of operations is not apparent from the face of the statement of activities. Users of financial information indicated that the disclosures required by paragraph 14 were especially useful in their work. The Board retained those requirements.

86. A few respondents suggested that additional guidance should be provided for the disclosure about "significant concentration of market risk or risk of physical loss" that was proposed in the Exposure Draft. Others suggested that the Board should quantify *significant.* The Board believes that management's judgment about concentrations and significance is in itself useful information. Therefore, the Board chose not to define further those terms. The Board concluded that an entity should review its portfolio of investments to determine if any significant concentrations of market risk result from the nature of the investments or from a lack of diversity of industry, currency, or geographic location. The Board decided to delete the requirement to disclose information about the risk of physical loss.

87. The Board concluded that disclosure of realized gains and losses is necessary when investments that are reported at measures other than fair value are sold. Without that disclosure, information about total investment return may be misleading to donors, creditors, and other users of financial statements because the realized gains or losses reported will represent the activity of more than a single period; that is, the organization's change in net assets will include unrealized gains and losses accumulated in previous periods but not recognized until the year of sale.

88. However, the Board is not convinced that information about realized gains and losses or about the historical cost of investments is relevant and useful for investments reported at fair value when the changes in their fair values are reported in a statement of activities. Most respondents agreed. Both realized and unrealized net gains on endowment funds may be prudently spent in accordance with the Uniform Act. Thus, distinguishing between them does not enhance a user's assessment of an organization's ability to provide mission-related services and to pay debtors. Both realized and unrealized gains and losses are included in a statement of activities, and opportunities for managing change in net assets through selective sale of securities are greatly reduced by the requirements of this Statement. A user, therefore, does not need information about realized and unrealized gains and losses and about the historical cost of investments to determine if selective sales are occurring. Further, a user does not need the information to determine the potential tax consequences of management's decisions to sell or hold investments; realization of gains and losses has no tax consequences for most not-for-profit

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organizations.

89. The Board recognizes that information about realized and unrealized gains and losses and about historical costs of investments may be useful in some circumstances. For example, if a state adopted a modified form of the Uniform Act that allows a not-for-profit organization to spend only realized gains or if an organization pays taxes on realized gains and losses, information that distinguishes between realized and unrealized amounts may be useful. Thus, this Statement does not preclude disclosing that information.

90. The Exposure Draft would have required that organizations disclose information about their investment objectives and about the contractual maturities of debt securities. Many respondents, including users of financial statements, asked the Board not to require those disclosures. Some said that information about investment objectives should not be required of not-for-profit organizations because Statement 115 does not require business enterprises to make that disclosure. Others said that organizations may have different objectives for different investment portfolios and that, as an organization's policies become more complex, investment objectives become more difficult to summarize. Still others said that the resulting disclosures might be "boilerplate" or would be meaningless without an accompanying disclosure of investment performance. A number of respondents said that information about contractual maturities was unnecessary when debt securities are reported at fair value. The Board decided that the information need not be disclosed.

Effective Date and Transition Method

91. The Board concluded that this Statement should be effective for fiscal years beginning after December 15, 1995. That effective date corresponds to the later effective date of Statements 116 and 117, which are effective for fiscal years beginning after December 15, 1995, for organizations with less than $5 million in total assets and $1 million in revenues. It was not possible to require the implementation of this Statement for the earlier effective date of Statements 116 and 117 (fiscal years beginning after December 15, 1994).

92. A few respondents said that smaller organizations might have difficulty implementing this Statement by its effective date. Because the AICPA Guides and Statement 107 require disclosure of the fair value of investments, organizations already have the necessary information systems in place. In addition, many not-for-profit organizations already report investments at fair value. Thus, the Board concluded that there is adequate time to develop the information required by this Statement. The Statement should not be difficult to implement, except perhaps for the release of restrictions on investment appreciation.

93. The Board decided to allow prospective treatment for the release of restrictions on previously unrecognized gains and losses. Determining the expiration of restrictions may be difficult or impossible if an organization no longer has the necessary records or if past procedures did not require those records. The Board permits similar treatment for expiration of

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restrictions on contributions in Statement 116.

94. Early application of this Statement is encouraged whenever practicable. Some respondents said that applying this Statement early may result in some loss of comparability of reporting between organizations during the transition period; however, the Board concluded that the benefits of early application outweigh its disadvantages. In addition, allowing early implementation will allow organizations that must implement Statements 116 and 117 on the earlier effective date to implement this Statement in the same fiscal year.

Appendix C: ILLUSTRATIVE EXAMPLES

Example of Classification of an Endowment Fund Loss

95. This example illustrates the classification prescribed by this Statement of a loss on investments of a donor-restricted endowment fund. Paragraph 12 of this Statement requires that in the absence of donor stipulations or law to the contrary, losses on the investments of a donor-restricted endowment fund reduce temporarily restricted net assets to the extent that donor-imposed temporary restrictions on net appreciation of the fund have not been met before the loss occurs. Any remaining loss reduces unrestricted net assets. Paragraph 13 requires that if losses reduce the assets of a donor-restricted endowment fund below the level required by donor stipulations or law, gains that restore the fair value of the assets of the endowment fund to the required level are classified as increases in unrestricted net assets.

Year 1

96. At the beginning of year 1, NFP Organization received a gift of $1,000,000. The donor specified that the gift be used to create an endowment fund that will be invested in perpetuity with income to be used for the support of Program A. The investments purchased with the gift earned $30,000 of investment income. NFP Organization spent that income plus an additional $20,000 of unrestricted resources on Program A during the year. At the end of the year, the fair value of the investments was $1,047,000.

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Transactions for year 1 are classified as increases or decreases in permanently restricted net assets, temporarily restricted net assets, or unrestricted net assets as follows:

	Net Assets			
Transactions	**Unrestricted**	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Activity of Program A				
Board-designated resources[a]	$ 20,000			$ 20,000
Investment income		$ 30,000		30,000
Expenses	(50,000)			(50,000)
Release restriction[b]	30,000	(30,000)		
Subtotal	0	0		0
Investments				
Gift			$1,000,000	1,000,000
Gains[c]		47,000		47,000
Release restriction[b]	20,000	(20,000)		
Subtotal	20,000	27,000	1,000,000	1,047,000
End of year	$ 20,000	$ 27,000	$1,000,000	$1,047,000

a. The governing board designates $20,000 of unrestricted resources of the organization to be spent in support of Program A.
b. When $50,000 is spent in support of Program A, restrictions are released on the $30,000 of income and $20,000 of temporarily restricted gains according to the provisions of Statement 116. The restrictions on the gains expire even though the governing board chose to use unrestricted resources rather than sell some investments and use the proceeds for Program A.
c. The $47,000 gain is restricted to the same purpose as the income in accordance with the Uniform Act.

Year 2

97. On January 1, in accordance with its spending policy, the governing board of NFP Organization sold some investments for $25,000 and spent the proceeds on Program A. The remaining investments earned $30,000 of investment income, which NFP Organization also spent on Program A. At the end of the year, the fair value of the investments was $1,097,000.

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Transactions for year 2 are classified as follows:

	Net Assets			
Transactions	**Unrestricted**	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Activity of Program A				
Spending Policy[d]		$ 25,000		$ 25,000
Investment income		30,000		30,000
Expenses	$ (55,000)			(55,000)
Release restriction	55,000	(55,000)		0
Subtotal	0	0		0
Investments				
Spending Policy[d]		(25,000)		(25,000)
Gains		75,000		75,000
Beginning of year	20,000	27,000	$1,000,000	$1,047,000
End of year	$ 20,000	$ 77,000	$1,000,000	$1,097,000

d. When the governing board sells investments and uses the proceeds for the donor's specified purpose, the historic dollar value of the endowment fund does not change. Neither the decision by the governing board to appropriate net appreciation nor the sale of the investments changes the class of net assets in which the appropriated amount is reported. The $25,000 is classified as temporarily restricted net assets until the restriction is met by spending on Program A.

Year 3

98. On January 1, in accordance with its spending policy, the governing board of NFP Organization sold some investments for $28,000 and spent the proceeds on Program A. The remaining investments earned $30,000 of investment income, which NFP Organization also spent on Program A. At the end of the year, the fair value of the investments was $975,000.

Transactions for year 3 are classified as follows:

	Net Assets			
Transactions	**Unrestricted**	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Activity of Program A				
Spending Policy		$ 28,000		$ 28,000
Investment income		30,000		30,000
Expenses	$ (58,000)			(58,000)

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Release restriction	58,000	(58,000)		0
Subtotal	0	0		0
Investments				
Spending Policy		(28,000)		(28,000)
Losses[e]	(45,000)	(49,000)		(94,000)
Beginning of year	20,000	77,000	$1,000,000	1,097,000
End of year[f]	$(25,000)	$ 0	$1,000,000	$ 975,000

e. According to the provisions of paragraph 12, the decline in the fair value of the assets of the endowment fund reduces temporarily restricted net assets by $49,000. The remaining loss reduces unrestricted net assets.

f. According to the provisions of paragraph 15(d), NFP Organization would disclose the $25,000 deficiency between the fair value of the investments of the endowment fund at the end of the year and the level required by donor stipulations or law. If NFP Organization had other donor-restricted endowment funds in deficit positions, it would disclose the aggregate amount of the deficiencies.

Year 4

99. On January 1, the governing board of NFP Organization could not apply its spending policy because the fair value of the investments was less than the historic dollar value of the fund; thus, no appreciation was available for expenditure. The investments earned income of $27,000, which NFP Organization spent on Program A. At the end of the year, the fair value of the investments was $1,005,000.

Transactions for year 4 are classified as follows:

	Net Assets			
Transactions	**Unrestricted**	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Activity of Program A				
Investment income		$ 27,000		$ 27,000
Expenses	$ (27,000)			(27,000)
Release restriction	27,000	(27,000)		0
Subtotal	0	0		0
Investments				
Gains[g]	25,000	5,000		30,000
Beginning of year	(25,000)	0	$1,000,000	975,000
End of year[f]	$ 0	$ 5,000	$1,000,000	$1,005,000

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g. According to the provisions of paragraph 13 of this Statement, because losses have reduced the assets of a donor-restricted endowment fund below the level required by donor stipulations or law ($1,000,000), the gains ($25,000) that restore the fair value of the assets of the endowment fund to the required level are classified as increases in unrestricted net assets. The remaining gains ($5,000) are available to be spent on Program A.

Example of an Organization That Separates Investment Return into Operating and Nonoperating Amounts

100. This example illustrates the disclosures required by paragraph 14 and a statement of activities that reports a portion of investment return within a measure of operations. Paragraph 14(a) requires an organization to disclose the composition of investment return including, at a minimum, investment income, net realized gains or losses on investments reported at other than fair value, and net gains or losses on investments reported at fair value. Paragraph 14(b) requires a reconciliation of investment return to amounts reported in the statement of activities if investment return is separated into operating and nonoperating amounts, together with a description of the policy used to determine the amount that is included in the measure of operations and a discussion of circumstances leading to a change, if any, in that policy. The reconciliation need not be provided if an organization includes all investment return in its measure of operations or excludes it from that measure entirely.

101. Statement 117 neither encourages nor discourages organizations from classifying items of revenues, expenses, and other changes in net assets as operating and nonoperating, but it requires that if an organization reports an intermediate measure of operations, it must do so within a financial statement that, at a minimum, reports the change in unrestricted net assets for the period. Statement 117 also specifies that if an organization's use of the term *operations* is not apparent from the details provided on the face of the statement of activities, a note to financial statements should describe the nature of the reported measure of operations or the items excluded from operations.

102. This example is illustrative only; it does not indicate a preferred method of reporting investment return or defining operations. Organizations may separate investment return into operating and nonoperating amounts in ways that they believe will provide meaningful information to users of their financial statements. Distinctions may be based on:

a. The nature of the underlying transactions, such as classifying realized amounts as operating and unrealized amounts as nonoperating
b. Budgetary designations, such as classifying amounts computed under a spending-rate or total return policy as operating and the remainder of investment return as nonoperating
c. The reporting requirements for categories of investments used in Statement 115, such as classifying investment income, realized gains and losses, unrealized gains and losses on trading securities, and other-than-temporary impairment losses on securities (that is, all items included in net income of a business enterprise) as operating and classifying the

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remainder of investment return as nonoperating

d. Other characteristics that provide information that is relevant and understandable to donors, creditors, and other users of financial statements.

103. A statement of activities of Not-for-Profit Organization is illustrated below. Not-for-Profit Organization invests cash in excess of daily requirements in short-term investments; during the year, those investments earned $1,275. Most long-term investments of Not-for-Profit Organization's endowments are held in an investment pool, which earned income of $11,270 and had net gains of $15,450. Certain endowments are separately invested because of donors' requirements. The investments of those endowments earned income of $1,000 and increased in value by $1,500. One donor required that the net gains be added to the original endowment gift; that endowment's investment in the pool increased in value by $180.

Not-for-Profit Organization
Statement of Activities
Year Ended June 30, 19X1

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Operating revenues, gains, and other support:				
Contributions	$ x,xxx	$ x,xxx		$xx,xxx
Fees	x,xxx			x,xxx
Investment return designated for current operations	11,025	4,500		15,525
Other	xxx			xxx
Net assets released from restrictions	xx,xxx	(xx,xxx)		
Total operating revenues, gains, and other support	xx,xxx	(x,xxx)		xx,xxx
Operating expenses and losses:				
Program A	xx,xxx			xx,xxx
Program B	x,xxx			x,xxx
Program C	x,xxx			x,xxx
Management and general	x,xxx			x,xxx
Fund raising	x,xxx			x,xxx
Total operating expenses	xx,xxx			xx,xxx
Change in net assets from operations	x,xxx	(x,xxx)		x,xxx
Other changes:				

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Investment return in excess of amounts esignated for current operations	10,992	3,798	$ 180	14,970
[Other items considered to be nonoperating]	x,xxx xxx	x,xxx xxx	 xxx	x,xxx xxx
Change in net assets	$ xx,xxx	$ x,xxx	$ xxx	$xx,xxx

104. Not-for-Profit Organization would add the following illustrative text to its note to the financial statements that describes the measure of operations:

> The board of trustees designates only a portion of the Organization's cumulative investment return for support of current operations; the remainder is retained to support operations of future years and to offset potential market declines. The amount computed under the endowment spending policy of the investment pool and all investment income earned by investing cash in excess of daily requirements are used to support current operations.

105. The following illustrative text and schedule would be added to a note to the financial statements about investments to provide the information about the composition of return and the reconciliation of investment return required by paragraph 14:

> State law allows the board to appropriate so much of the net appreciation as is prudent considering the Organization's long- and short-term needs, present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions. Under the Organization's endowment spending policy, 5 percent of the average of the fair value at the end of the previous 3 years is appropriated to support current operations. The following schedule summarizes the investment return and its classification in the statement of activities:

	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Dividends, interest, and rents (net of expenses of $565)	$ 8,400	$ 3,870		$12,270
Net realized and unrealized gains	12,342	4,428	$180	16,950
Return on long-term investments	20,742	8,298	180	29,220

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Interest on short-term investments	1,275			1,275
Total return on investments	22,017	8,298	180	30,495
Investment return designated for current operations	(11,025)	(4,500)		(15,525)
Investment return in excess of amounts designated for current operations	$ 10,992	$ 3,798	$180	$14,970

106. Often, as in the example above, the amount of investment return designated for current operations is less than the total return on investments for the year. An organization may be able to designate an amount for the support of operations even if the total investment return for the year is less than the amount computed under a spending-rate policy; for example, when the organization designates part of its cumulative investment return from prior years to support its current operations. In that case, the operating and nonoperating amounts should be labeled to faithfully represent their natures. For example, the amount excluded from operations, which is negative, might be labeled "Investment return reduced by the portion of cumulative net appreciation designated for current operations."

Appendix D: AMENDMENTS TO EXISTING PRONOUNCEMENTS

107 FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises,* as amended by FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* is amended as follows:

a. The following sentence is added at the end of paragraph 45:

> A not-for-profit organization that conducts insurance activities should account for those investments in accordance with FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*.

b. Paragraph 46 is replaced by the following:

> Investments in equity securities that are not addressed by Statement 115 or Statement 124 because they do not have "readily determinable fair values" as defined by those Statements shall be reported at fair value. A business enterprise shall recognize changes in fair value as unrealized gains and losses reported, net of applicable income taxes, in a separate component of equity. A not-for-profit organization shall recognize the change

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in fair value in its statement of activities.

108. The following sentence is added at the end of paragraph 4 of FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities,* as amended by Statement 115:

> Mortgage-backed securities held by not-for-profit organizations shall be reported at fair value in accordance with the provisions of FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*.

109. In paragraph 3 of FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases,* as amended by Statement 115, *of a business enterprise or change in net assets of a not-for-profit organization* is added at the end of the last sentence.

110. The last sentence of paragraph 4 of Statement 115 is replaced by the following:

> This Statement applies to cooperatives and mutual enterprises, including credit unions and mutual insurance companies, but does not apply to not-for-profit organizations. FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations,* establishes standards for not-for-profit organizations.

111. In paragraph 168 of FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations,* the definition of *endowment fund* is replaced by the following:

> An established fund of cash, securities, or other assets to provide income for the maintenance of a not-for-profit organization. The use of the assets of the fund may be permanently restricted, temporarily restricted, or unrestricted. Endowment funds generally are established by donor-restricted gifts and bequests to provide a permanent endowment, which is to provide a permanent source of income, or a term endowment, which is to provide income for a specified period. The portion of a permanent endowment that must be maintained permanently—not used up, expended, or otherwise exhausted—is classified as permanently restricted net assets. The portion of a term endowment that must be maintained for a specified term is classified as temporarily restricted net assets. An organization's governing board may earmark a portion of its unrestricted net assets as a board-designated endowment (sometimes called funds functioning as endowment or quasi-endowment funds) to be invested to provide income for a long but unspecified period. A board-designated endowment, which results from an internal designation, is not donor restricted and is classified as unrestricted net assets.

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Appendix E: GLOSSARY

112. This appendix contains definitions of terms or phrases as used in this Statement.

Debt security

Any security representing a creditor relationship with an enterprise. It also includes (a) preferred stock that by its terms either must be redeemed by the issuing enterprise or is redeemable at the option of the investor and (b) a collateralized mortgage obligation (CMO) (or other instrument) that is issued in equity form but is required to be accounted for as a nonequity instrument regardless of how that instrument is classified (that is, whether equity or debt) in the issuer's statement of financial position. However, it excludes option contracts, financial futures contracts, forward contracts, lease contracts, and swap contracts.

- Thus, the term *debt security* includes, among other items, U.S. Treasury securities, U.S. government agency securities, municipal securities, corporate bonds, convertible debt, commercial paper, all securitized debt instruments, such as CMOs and real estate mortgage investment conduits (REMICs), and interest-only and principal-only strips.
- Trade accounts receivable arising from sales on credit and loans receivable arising from consumer, commercial, and real estate lending activities of financial institutions and not-for-profit organizations are examples of receivables that do not meet the definition of *security;* thus, those receivables are not debt securities (unless they have been securitized, in which case they would meet the definition).

Donor-restricted endowment fund

An endowment fund that is created by a donor stipulation requiring investment of the gift in perpetuity or for a specified term. Also refer to **Endowment fund.**

Endowment fund

An established fund of cash, securities, or other assets to provide income for the maintenance of a not-for-profit organization. The use of the assets of the fund may be permanently restricted, temporarily restricted, or unrestricted. Endowment funds generally are established by donor-restricted gifts and bequests to provide a permanent endowment, which is to provide a permanent source of income, or a term endowment, which is to provide income for a specified period. The portion of a permanent endowment that must be maintained permanently—not used up, expended, or otherwise exhausted—is classified as permanently restricted net assets. The portion of a term endowment that must be maintained for a specified term is classified as temporarily restricted net assets. An organization's governing board may earmark a portion of its unrestricted net assets as a board-designated endowment (sometimes called funds functioning as endowment or quasi-endowment funds) to be invested to provide income

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for a long but unspecified period. A board-designated endowment, which results from an internal designation, is not donor restricted and is classified as unrestricted net assets.

Equity security

Any security representing an ownership interest in an enterprise (for example, common, preferred, or other capital stock) or the right to acquire (for example, warrants, rights, and call options) or dispose of (for example, put options) an ownership interest in an enterprise at fixed or determinable prices. However, the term does not include convertible debt or preferred stock that by its terms either must be redeemed by the issuing enterprise or is redeemable at the option of the investor.

Fair value

The amount at which an asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. If a quoted market price is available for a financial instrument, the fair value to be used in applying this Statement is the product of the number of trading units of the instrument times the market price per unit.

Security

A share, participation, or other interest in property or in an enterprise of the issuer or an obligation of the issuer that (a) either is represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer, (b) is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment, and (c) either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

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Footnotes

FAS124, Footnote 1--Words that appear in the glossary are set in **boldface type** the first time they appear.

FAS124, Footnote 2--The term *specialized* is used to refer to the current accounting and reporting principles and practices in the existing AICPA Guides and Statements of Position that are neither superseded by nor contained in Accounting Research Bulletins, APB Opinions, FASB Statements, or FASB Interpretations.

FAS124, Footnote 3--For the purpose of this Statement, *restricted stock* means equity securities for which sale is restricted at acquisition by governmental or contractual requirement (other than in connection with being pledged as collateral) except if that requirement terminates within one year or if the holder has the power by contract or otherwise to cause the requirement to be met within one year. Any portion of the security that can be reasonably expected to qualify for sale within one year, such as may be the case under Rule 144 or similar rules of the SEC, is not considered restricted.

FAS124, Footnote 4--Donors that create endowment funds can require that their gifts be invested in perpetuity or for a specified term. Some donors may require that a portion of income, gains, or both be added to the gift and invested subject to similar restrictions. It is generally understood that at least the amount of the original gift(s) and any required accumulations is not expendable, although the value of the investments purchased may occasionally fall below that amount. Future appreciation of the investments generally restores the value to the required level. In states that have enacted its provisions, the Uniform Management of Institutional Funds Act describes "historic dollar value" as the amount that is not expendable.

FAS124, Footnote 5--Paragraph 10 of Statement 107 requires organizations to disclose the method(s) and significant assumptions used to estimate the fair value of *financial instruments.*

FAS124, Footnote 6--Paragraph 20 of Statement 105 requires organizations to disclose all significant concentrations of *credit risk* arising from financial instruments, whether from an individual counterparty or groups of counterparties.

FAS124, Footnote 7--Paragraph 17 of FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made,* establishes standards for recognizing the expiration of donor-imposed restrictions. Those standards also apply to the expiration of donor-imposed restrictions on investment income, gains, and losses. A similar provision permitting prospective recognition of the expirations of restrictions is included in paragraphs 29 and 30 of Statement 116.

FAS124, Appendix B, Footnote 8--In addition to securities that are acquired with the purpose of selling them in the near term, Statement 115 also permits an enterprise to classify securities that

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it plans to hold for a longer period *as trading securities.* However, the decision to classify a security as trading should occur at acquisition; transfers into or out of the trading category should be rare.

FAS124, Appendix B, Footnote 9--Comprehensive income includes all changes in equity during a period except those resulting from investments by owners and distributions to owners (Concepts Statement 6, paragraph 70).

FAS124, Appendix B, Footnote 10--In managing their endowment funds, some organizations use a spending-rate or total return policy. Those policies consider total investment return--investment income (interest, dividends, rents, and so forth) plus net realized and unrealized gains (or minus net losses). Typically, spending-rate or total return policies emphasize (a) the use of prudence and a rational and systematic formula to determine the portion of cumulative investment return that can be used to support operations of the current period and (b) the protection of endowment gifts from a loss of purchasing power as a consideration in determining the formula to be used.

FAS124, Appendix B, Footnote 11--The Uniform Act uses the term *endowment fund* to describe a fund with characteristics of a donor-restricted endowment fund, as defined in this Statement. Section 1(3) of the Uniform Act defines an endowment fund as:

...an institutional fund, or any part therof, not wholly expendable by the institution on a current basis under the terms of the applicable gift instrument.

FAS124, Appendix B, Footnote 12--The Uniform Act defines *historic dollar value* in Section 1(5) as:

...the aggregate fair value in dollars of (i) an endowment fund at the time it became an endowment fund, (ii) each subsequent donation to the fund at the time it is made, and (iii) each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the fund.

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