



Frequently Asked Questions: Agency Endowment Funds Held at Montana Community Foundation

Introduction

Nonprofits place their endowment funds with Montana Community Foundation, Inc. (MCF) to allow them to stay mission focused. The administrative burden to manage an endowed fund can be significant from both a labor and financial standpoint. Entrusting MCF with your endowed fund gives you peace of mind, knowing we have more than 30 years of experience successfully managing endowments for nonprofit organizations. While we focus on prudently manage your thoughtful investment in your organization's future, you stay focused on your mission.

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

AGENCY ENDOWMENT BASICS*

What is an agency endowment?

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

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

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

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

In June 1999, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No. 136, Transfers of Assets to a Not-for-Profit Organization or Charitable Trust that Raises or Holds Contributions for Others, also known as FAS 136. This has now been codified within FASB ASC 958-605 principally in sections 15 and 25. FASB ASC 958-605-55-2-110 provides guidance for accounting in the case where a "resource provider" (nonprofit entity) transfers assets to a community foundation, but specifies itself or its affiliate as the beneficiary of the assets. The transaction is deemed to be reciprocal because at the time of the transfer, the nonprofit entity expects to receive future distributions because it specifies itself as a beneficiary, and by acceptance of the transfer, the community foundation agrees to make distributions to the nonprofit entity.

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

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

The nonprofit receives an annual endowment payout from the agency endowment at MCF. Can the nonprofit force an additional distribution of the agency endowment back to itself?

No. An agency endowment at Montana Community Foundation is subject to the legal control of the Foundation. Allowing the nonprofit to reserve the right to force a distribution would be contrary to MCF's legal ownership of the fund. For this reason, the reservation of the power to unilaterally withdraw the fund in full or in part creates several potential results which are often

undesirable. First, reservation of such power raises the question of whether a completed gift has been made by the agency to the community foundation. Second, an incomplete gift may lead to the conclusion that the community foundation is managing someone else's fund. Third, reservation of the right to unilaterally withdraw the funds may be considered a material restriction calling into question whether the fund is a component fund. Finally, a contribution to MCF is subject to the legal control of MCF. Allowing the nonprofit to reserve the right to force a distribution would be contrary to MCF's legal ownership of the fund.

ACCOUNTING FOR AGENCY ENDOWMENTS¹

Creation of the Fund:

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

DEBIT Beneficial Interest in Assets Held by MCF (Permanently Restricted Net Assets)	\$ XX	
CREDIT Cash (Permanently Restricted Net Assets)		\$ XX

Source of Nonprofit Funds:

If the net assets transferred are from the nonprofit's operating surplus (Unrestricted Net Assets), then the net assets will need to be transferred to Permanently Restricted Net Assets on the nonprofit's books. The nonprofit would show a reclassification of net assets from Unrestricted to Permanently Restricted on the Statement of Activities. If the net assets transferred are derived from donor-restricted endowment funds contributed to the nonprofit, the nonprofit should first ensure that the transfer of the net assets will not violate the contract between the nonprofit and the donor. If the transfer will not violate such contract, then no reclassification of net assets will be necessary as the net assets should already be classified as permanently restricted on the nonprofit's books. Less guidance is given on the proper treatment of changes in value and distributions from the assets held at the community foundation to the nonprofit throughout the life of the fund agreement.

DEBIT Reclassification of Net Assets (Unrestricted Net Assets)	\$ XX	
CREDIT Cash (Unrestricted Net Assets)		\$ XX
DEBIT Cash (Permanently Restricted Net Assets)	\$ XX	
CREDIT Reclassification of Net Assets (Permanently Restricted Net Assets)		\$ XX

Financial Activity of Fund:

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

1. Periodic Endowment Valuation Changes:

Changes in value of the agency endowment fund at the MCF would be captured on the nonprofit's books as follows:

DEBIT Beneficial Interest in Assets Held by MCF (Permanently Restricted Net Assets)	\$ XX	
CREDIT Investment Gain or Loss (Permanently Restricted Net Assets)		\$ XX

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

2. Annual Endowment Payout Distribution:

As Montana Community Foundation makes distributions of income back to the nonprofit organization, the following entries are made on the nonprofit's books.

DEBIT Cash (Unrestricted Net Assets)	\$ XX	
CREDIT Investment Income (Unrestricted Net Assets)		\$ XX

¹ Sources include Council on Foundations, <http://www.cof.org/content/accounting-agency-endowment-funds-held-communityfoundations#sthash.oVesO-POd.dpuf> and <http://www.cof.org/content/agency-endowment-funds-frequently-askedquestions#sthash.tvJlqM1t.dpuf> and FASB ASC 958-605



Presentation and Disclosure:

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

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

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

1. The identity of MCF,
2. The terms under which MCF will distribute amounts to the nonprofit (which is annual endowment distributions subject to the payout policy approved by the MCF Board of Directors),
3. A statement that variance power was granted to MCF and a description of the terms of the variance power
 - a. Example wording could be "The MCF Board has the power to modify any restriction or condition on the distribution of funds for any specified charitable purpose or to any specified organization if, in the sole judgment of the governing body, such restriction or condition becomes, in effect, unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community or area served" or "The MCF Board has full authority to vary the terms of the endowment as appropriate",
4. The aggregate amount reported in the statement of financial position and how that amount is described (i.e. Beneficial Interest in Assets Held by MCF).

FORM 990 REPORT OF AGENCY ENDOWMENTS¹

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

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

Part VIII Statement of Revenue:

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

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

Part X Balance Sheet:

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

Schedule A – Public Charity Status and Public Support:

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

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

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

¹ Tax guidance described is derived from Council on Foundations publications, IRS Form 990 instructions, with technical review and counsel from Moss Adams LLP, audit and tax advisors of Montana Community Foundation.

that is the beneficiary of an agency endowment at MCF does not “hold” the assets, it does not report them in question #1. It is important to remember that endowments held at MCF are legally transferred assets; according to the IRS, the nonprofit agency that transferred the assets does not have any ownership claim to them.

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

The nonprofit can choose to answer question #4 and describe in Part XIII that it is the beneficiary of an agency endowment at MCF and it annually receives an endowment distribution used to support its operations.

Schedule 1 – Grants:

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

No distributions are made until the fund reaches the fund minimum.

*The information in this publication is not intended as legal or tax advice. For legal or tax advice, please consult your attorney and/or tax professional.

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