

PRIME Advisory Review



PRIME Asset Consulting

Foundation: Recent Trends in Foundation Giving

The information in this article was based on a study conducted in 2004 by The Foundation Center, a leading authority on philanthropy, on initial figures from large and mid-size, grantmaking US Foundations. The foundations included are independent, corporate and community foundations that respond to The Foundation Center's "Foundation Giving Forecast Survey." Survey responses are combined with year-end fiscal reports.

According to the study, overall giving by grantmaking foundations fell in 2003 by 2.5%, down to \$29.7 billion from \$30.4 billion in 2002. The decline of only 2.5% compares favorably to negative market performance over the past several years, which helped lead foundation assets down over 10% between 2000 and 2002.

The fact that many foundations continued to maintain giving levels or limit

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Pension: Valuation Numbers: Not Always What You Think

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Valuation numbers are critical for a variety of reasons. Without them, effectively allocating assets, re-balancing positions and hedging financial risk is virtually impossible. Yet even when valuation numbers

are readily available, they can be misleading, misunderstood, incomplete or too old to be useful. A solid understanding of what valuation estimates do — and do not — represents a first step in avoiding costly mistakes. This is especially true for securities that do not trade in public markets or trade infrequently, such as investments in private equity, hedge funds or closely-held companies.

Building Block Concepts

Interpreting valuation numbers

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Recent Trends in Foundation Giving (continued)

reductions to giving despite the difficult economic environment and significant cutbacks in government funding was rather remarkable. While foundations experienced a fall in the real (inflation-adjusted) value of giving for only the second time since 1994, moderate levels of inflation over the past several years were helpful in minimizing the decline. Inflation-adjusted giving in 2003 fell 4.7%, compared to 1.8% in 2002.

The study also analyzed changes in giving by the type of foundation.

Community foundations were the only group to show an increase in giving, with an increase of 1.5% in 2003. When adjusted for inflation, real giving was down only 0.7% from the prior year. Gifts to community foundations actually remained fairly steady in 2002, which likely helped 2003 giving levels, as budgets for grant appropriations are typically based on the value of assets over the previous two or more years.

Independent foundations (including family foundations) showed the largest decline in giving in 2003, falling 3.3%. Unfortunately, independent foundations are also typically the largest in overall giving and

comprise the majority of overall foundations.

Giving from corporate foundations fell 2% in 2003, marking the first decline since The Foundation Center started tracking the information on corporate foundations in 1987. Overall corporate foundation grantmaking equaled \$3.4 billion, down \$68.3 million from 2002.

The stock market and the economy improved significantly in the second half of 2003, which may have provided a boost for foundation assets. That could be positive news for giving levels in 2004. Almost half

(45.4%) of foundations surveyed indicated that they expected giving to increase in 2004, and only 18% expected giving to decline in 2004. However, after three years of maintaining giving levels in the face of reduced resources and falling assets, foundations will likely need to see their assets recover significantly before noticeable increases in giving begin.

Source: The Foundation Center's 2004 Foundations Today Series, Foundation Growth and Giving Estimates. For more information visit their website at www.fdncenter.org.

401(K)orner: 401(k) and Profit Sharing Eligibility

The Profit Sharing/401(k) Council of America (PSCA) recently released results from its latest review of participant eligibility data on 401(k) and Profit Sharing Plans. The PSCA collected data from 271 companies over an assorted range of size, industry and location. Two hundred of the companies surveyed (slightly over 73%) offered both a 401(k) and a Profit Sharing plan.

The statistics over the past six years indicate that while both 401(k) plans and Profit Sharing plans have reduced the overall waiting period for new employees to become eligible to participate, profit sharing plans generally continue to have a longer initial waiting period than 401(k) plans.

A full 37% of all 401(k) plans surveyed had immediate eligibility while 15% of all Profit Sharing plans offered immediate eligibility, up from 24% and 9%, respectively, in 1998. 401(k) plans with a waiting period of three months or less

rose to 51% in 2003 from 32% in 1998, while Profit Sharing plans rose to 22% from 12% in 1998.

As might be anticipated, plans with over 1,000 employees generally had the shortest eligibility wait period among both 401(k) and Profit Sharing plans. What was notable, however, is that companies offering a Profit Sharing plan with a short (less than 3 months) waiting period remained fairly steady (around 25%) for all companies with over 500 employees. However, among companies offering a 401(k), 71.8% of companies with 1,000 – 9,999 employees had a short (less than 3 months) wait time, while companies in the 500-999 and >9,999 employees range dipped back down to near 60%.

Source: The Profit Sharing/401(k) Council of America (PSCA) Eligibility Survey for 2003. For more information or for a complete copy of the report, visit their website at www.psc.org.

Valuation Numbers: Not Always What You Think (continued)

requires first knowing the underlying standard of value. Fair market value is a frequently used standard and assumes the existence of a rational, informed and willing buyer and seller. In contrast, investment value looks at the advantages of ownership for a particular organization and reflects perceived synergies. Other standards of value include liquidation value, intrinsic value, book value, and fair value. The interpretation and use of an estimate of value is ill-advised without knowing the assumed standard of value. A related assumption, the premise of value, looks at whether a company is likely to stay in business or will instead be forced to close its doors in short order.

Valuation date is another consideration. Reported numbers, regardless of source and motivation, reflect value at a particular point in time. In a fast changing market, this could spell trouble. A company may experience unexpected and substantial changes in its financial fortunes after the report date. New regulation, retirement of a key executive or technological innovation each has the effect of quickly rendering previously published numbers obsolete.

Reporting requirements are yet another factor. Valuation numbers are often produced for regulatory compliance reasons, in which case the user must understand the nature of underlying rules. For example, some valuation numbers reflect a gain or loss that is smoothed out over a long period of time. In other situations, a valuation number could reflect a particular methodology,

making it hard to compare investment values generated from alternative approaches.

Data is another issue altogether. Format, calendar period, frequency of collection and source all have the potential to affect valuation outcomes, sometimes in rather dramatic ways.

Hidden Risk

Some valuation numbers are problematic because input information used to compute them is hard to interpret or is simply not available. Hedge funds are a case in point. Proponents laud their diversification benefits while critics cite the lack of transparency about how they invest and the extent to which leverage is employed. With closely-held companies, it may be easier to hide assets or minimize expenses, resulting in valuation estimates that are far removed from economic reality.

Modeling

Not all models are created equal. A model may be inappropriate, inaccurate, inconsistent or all of the above. Model risk, a term used to capture the essence of these problems, is surfacing more often as various regulators take a new look at bank capital adequacy and mutual fund operations.¹ Besides the obvious, reasonable people can disagree about computational methodologies, necessitating a discussion as to when model risk is likely to occur.

Prescription for Better Numbers

Anyone using valuation numbers must ask hard questions about their source, method of computation, related rules and what they do — and do not — represent. A recent article for the Institute of Internal Auditors provides an investigative checklist about models, starting with an assessment of its stated purpose.²

Failing to do the requisite homework regarding valuation estimates can be costly. Knowing where to begin can be a problem, especially if the investment committee or board members specialize in areas outside of investing. Ask vendors who put together valuation reports to explain their work in “plain English.” Identify the worst thing that can happen and work backwards to evaluate what information is needed to track trigger points. Be vigilant and remember that published information can be a help or a hindrance, depending on its completeness and accuracy.

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¹ Mangiero, Susan M. “Model Risk and Valuation”, *Valuation Strategies*, 6 VS 34 (Mar/Apr 2003)

² Mangiero, Susan M. “Asset Valuation: Not a Trivial Pursuit”, *FSA Times*, First Quarter, 2004

PRIME News

Welcome New Clients*

Rhode Island Blood Center
Bissell Foundation
Town of Monroe, CT Board of Education

Golf Tournaments a Success

The Seventh Annual PRIME Asset Consulting Charity Golf Tournaments to Benefit VNA Healthcare, Inc. Hospice Program raised approximately \$16,000 for the cause. Thank you to all of our sponsors and clients who gave to this worthy cause. We are already looking forward to next year!

* These are names of clients who have given permission to list their names as representative clients who receive a variety of advisory services at UBS Financial Services Inc. This is not meant to be a complete list. These clients have not indicated whether or not they endorse the advisory services provided by UBS Financial Services Inc.

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