



**American
Friends Service
Committee**

Guide to the AFSC Audit

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With additional note on expenses March 2024

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Introduction¹

This Guide to reading the AFSC Audit is offered as a contribution towards the goal of clear and understandable financial reporting. The Guide walks through each of the main audit tables, focusing on the largest items or those that feature prominently in the other reports Board advisory committees receive. The balance sheet and income and expense statement receive the deepest attention. Along the way, the Guide points to relevant information in the Notes, including the new liquidity analysis.

This year's audit and others back to 2006 are available at <https://www.afsc.org/financial-information>, along with the big picture of AFSC finances and a link to the Annual Report for further information.

Windows into AFSC Finances

The audit provides quite a different view into AFSC finances than two other reports that receive regular attention: the budget and the investment portfolios.

The AFSC Board approves the AFSC budget and takes other policy-level financial decisions. It receives reports and recommendations on financial matters from an advisory committee, the Stewardship Committee, and the Stewardship Committee's Investment Subcommittee. Quarterly, AFSC's Chief Financial Officer gives the Stewardship Committee a financial briefing and the Board is invited to attend.

The Stewardship Committee vets the income side of the budget for the Board, asking questions such as: How much income shall we budget for the coming fiscal year and where will it come from? This Committee does not do any resource allocation; that is left to the General Secretary and staff. Once the budget is finished, the Stewardship Committee examines it to make sure that planned spending is in line with income and that the budget is fiscally sound; the Committee reports its opinion on those matters to the Board. To do this work, the Stewardship Committee focuses attention in particular on the four main AFSC income streams: contributions (gifts), bequests, matured planned gifts, and the allocation from the endowment. The actual amounts of income that come in through these streams can be found in the audit, but not easily.

The Investment Subcommittee sees AFSC finances through quite a different window, namely, the four big pools of investments: endowments, formal and informal retirement plans, and annuities. These can also be found in the audit, but not in one place. The main job of the Investment Subcommittee is to make sure the investments follow socially responsible principles and grow more than the expenses that are paid from them, so that they keep supporting AFSC's work. The Investment Subcommittee never sees the annual budget in the course of its regular work.

The audit is a comprehensive look at AFSC's finances: assets, income, and expenses. The Board accepts it, on recommendation from its Audit Committee. It is the only financial information document the AFSC Corporation or the world outside AFSC sees on a regular basis. For those who want a more detailed view than the Annual Report provides, it is therefore worth investing some time in understanding it.

¹ I thank Joe Njoroge and James Spengler of the Finance Department for their patience in answering my many questions and for giving this document a detailed, careful read.

Audits and Fiscal Years

Each audit refers to an AFSC “fiscal year” (FY) that runs from October 1 to the following September 30. The most recently completed fiscal year is FY2019, so the most recent audit refers to that year as well.

“Full” audited financial statements, the kind AFSC commissions, are prepared by people who are not employees of the organization being audited and whose accreditation as professionals depends on following standards set by an external body. Our current audit firm is Tait Weller.

The auditors organize an organization’s financial information according to standard categories, so that the information can be compared across organizations. The standards used are called GAAP – Generally Accepted Accounting Principles. The GAAP principles are established by the Financial Accounting Standards Board (FASB). They evolve; one year’s standards may change in the next. Often, GAAP requires the auditors to look at our finances in somewhat different ways than we look at them for management purposes.

Some questions the audit can answer: Is AFSC living within its means? How much does it spend on management and fundraising? Is AFSC following standard accounting practices? Some questions the audit cannot answer: What income does AFSC count on to budget each year? Has income grown over the last decade? How much is available for special one-time expenses?

Parts of the Audit

The FY19 report from the auditors starts with a general letter to the Board giving their overall judgment of the information they reviewed. A “clean audit” says that the auditors found that the information “fairly presents the financial position” of the organization and that there are no departures from accounting standards; that’s what we want.

Four tables follow. I will give their formal names below, but use the nicknames balance sheet, income and expense statement (I&E), cash flow report, and spending report.

Then there are Notes – a lot of them. For better or for worse, we can’t understand the audit without reading them. A key one for many readers is Note 2, which defines a lot of the terms used. If you are looking at an accounting term in one of the tables and wondering, “what is this?”, there is a good chance that Note 2 answers the question.

The General Secretary and the Board also receive a “management advisory letter” and a “professional standards” letter from the auditors, which identify any accounting deficiencies and big-picture financial issues the auditors see in the numbers based on their experience with other organizations and GAAP standards. The management and professional standards letters are not posted publicly.

Balance sheet (“Statements of Financial Position”)

The balance sheet presents information on everything AFSC owns (“assets”) and any restrictions on how we may use what we own. Note that the balance sheet does not include the assets or liabilities of the formal retirement plan. AFSC manages those resources on behalf of the plan participants and does not actually own them. Information on the assets of the formal retirement plan appear in Note 6.

Assets

The top section of the balance sheet lists the assets themselves, based on where they are held. The largest amounts are in the “Investments” section. The discussion here starts with them then turns back to the smaller categories.

Investments

AFSC’s Investment Subcommittee monitors our investments (except Friends Center) and recommends investment policies to the Board. The Subcommittee includes investment professionals who share AFSC’s values and donate their time to our mission. The Subcommittee is advised by a professional investment advising firm, currently Concord Advisory Group. A key feature of AFSC’s investments is that they are invested in socially responsible ways (see <https://www.afsc.org/document/afsc-investment-policy-statement>). This kind of investment is known as ESG, because it uses environmental, social, and governance criteria to reflect AFSC’s values in its assets. The Investment Subcommittee and investment advisor are continually seeking ways to use AFSC investments for positive social impact, in addition to the funds they generate for AFSC operations.

Details on the kinds of investments AFSC holds appear in Note 3, such as common stocks, mutual funds, and bonds. All the portfolios are balanced, with no more than 70% stocks in each. Within the best balance of risk and return the Committee can identify, the Consolidated Fund is invested for maximum growth the annuities portfolio for stability, and the retirement funds with a strategy that falls somewhere between.

The audit groups the investments into three categories.

- **Planned giving.** In this category, the balance sheet includes the funds that were donated via planned gifts. There are three kinds of .planned gifts: charitable gift annuities (CGAs), pooled life income funds, and charitable remainder trusts (annuity trusts or unitrusts).² Donors have already given us these funds and we have promised to pay the donors (or someone else they designate) a regular income from them while they live. The planned giving investment portfolios produce that income. AFSC uses what is left when they die as unrestricted income in the year it arrives or, in the rate case where the donor requested this, as an addition to endowment.
- **Other long-term investments.** In this category, the balance sheet includes two other large investment pools: the consolidated fund (where the endowments and charitable gift funds reside) and the assets of the informal retirement plan, which is currently used primarily to pay for post-retirement medical insurance premiums, plus a few smaller items. AFSC has dozens of specific endowments, each with its own specific terms. Some are permanent, some are “term” (spending down on a specific schedule), and some are “Funds Functioning as Endowment” (FFAE), which have more flexible arrangements for how the principal may be used. AFSC’s [Investment Policy Statement](#) sets the rate of spending from the endowments. The rate is set as a percentage of the market value of the permanent endowments, term endowments, and FFAE combined at the end of the fiscal year, averaged over the past three years. The rate is currently being moved down gradually towards 4.5% in order to maintain the buying power of the

² See <http://legacyofpeace.afsc.org/charitable-gift-annuities> and <http://legacyofpeace.afsc.org/charitable-remainder-trusts> for details. Pooled life income funds have a similar structure to charitable remainder trusts but accept smaller initial amounts.

income. The gap between the spending rate and the expected rate of appreciation in the assets needs to be at least at the level of inflation, or the buying power of the income erodes over time. Since some endowments carry instructions to use them for specific purposes, some of the funds spent from the endowment are used for those purposes; the rest is unrestricted.

- **Friends Center.** AFSC owns Friends Center jointly with Central Philadelphia Monthly Meeting and Philadelphia Yearly Meeting. Our portion of the value of the building is included on the balance sheet as an investment. (See basic information on the partnership in Note 2 and details of the asset calculation in Note 4.)

Other assets

- *Cash and cash equivalents*, which refers to money held in savings accounts, checking accounts, or money market funds. These do not count as “invested.”
- *Accounts and notes receivable – net*, a category that includes what we are owed from local and international grants; what employees owe for personal credit card use; and amounts due from retirees for their part of retiree insurance premiums.
- *Income receivable and prepaid expenses.* The largest component of this is the endowment spend from the fourth quarter, which has not been transferred to operations by the end of September.
- *Land, building, equipment.* Note 2 defines the category and Note 5 gives the details, including the reduction in value that accounts for depreciation. Following these procedures, the audit may end up with different numbers than commonsense would recognize.
- *Other assets* include the Adaptive Budgeting software and royalty interests.
- *Agency fund assets* are those that AFSC holds but disburses at the instruction of the donor (see the definition in Note 2). The largest ones for AFSC are among the charitable remainder trusts, where another organization may be designated to receive some of the proceeds at maturity or where the donor elects to be able to change the terms of the trust.

Liabilities and Net Assets

Having identified all the assets, the balance sheet then adds up AFSC’s “liabilities” (legally binding purposes for which the assets are being held) and “Net Assets” (assets with other kinds of expectations or promises attached, either by donors or AFSC policies, practices, or decisions). Subtracting those items from total assets yields the amount that AFSC can use any way it wants (“reserved for current and future operations”).

Liabilities

The largest single item in the “liabilities” category is “annuities and unitrusts payable.” This represents the combined liabilities of the **planned giving program**. When a planned gift is set up, a portion of the funds is designated as liability; the portion varies with the type of fund and age of donor. The liabilities of the charitable gift annuities are calculated annually by an external actuary (see the calculation at the very end of Note 3).

The second largest number is the “liabilities for post-retirement benefits.” This number refers to the **obligations of the informal retirement plan**, which as noted earlier is used primarily to fund retiree medical insurance premiums. At the end of each fiscal year, an external actuary calculates those obligations based on current information and the total is indicated here. The calculations at the end of

FY19 appear in Note 6. Since AFSC owns the assets of this plan, the whole amount of this benefit is treated as a liability, just as all the funds in it are AFSC assets.

In addition, the liabilities list includes an item called “liability for pension benefits.” This appears if the **assets of the formal retirement plan** (a defined benefit pension plan) are not enough to meet the obligations of that plan, according to the actuary’s calculations. The calculations used to determine the underfunding appear in Note 6, along with information on the kinds of investments the formal retirement plan holds. Recall that AFSC manages the assets of that plan on behalf of the retirees but does not own them.

Other liabilities are:

- **Accounts payable and accrued liabilities.** These include, for example, separation costs and the vacation pay that AFSC employees have earned, which we have promised to pay them if they leave.
- **Deferred income.** This is money we have already received from grant funders and that remains to be spent.
- **Interest-free loans.** Some people have loaned AFSC money and allowed AFSC to use the interest on that money for unrestricted purposes. At any time, the lender can ask for the loaned money back, so these appears on the books as liabilities.

Net Assets

The Net Assets list indicates parts of the assets that AFSC has promised or elected to set aside for specific purposes, leaving a portion that can be used at the organization’s discretion. The discretionary amount appears on the first line of the section (“designated for current and future operations”), but with a twist to be described further on.

The rest of the table sorts the remaining asset amounts into two buckets: “with donor restrictions” and “without donor restrictions.” The following discussion moves from the bottom of that list to the top, as appropriate for working towards finding out how much we have at our discretion and why not the rest.

With donor restrictions

- **Endowments net assets required to be held in perpetuity.** This number represents what the endowment donors gave us originally.
- **Accumulated gains on endowment assets.** This is the appreciation on the permanent endowment; our investment choices have increased the endowment by this amount above and beyond the endowment spend.
- **Purpose restricted.** These are funds that we raised for specific purposes that are being carried over to be spent in future years. The places to which they are restricted are identified in Note 7.
- **Time restricted.** This number includes (1) the assets of the term endowments and (2) what is in the planned giving portfolios over and above the liabilities that appear in the liability section of the table, with an exception. The exception is the amount in the charitable gift annuity accounts that is over and above the basic liabilities of the CGAs. That number appears in the list of “net assets without donor restrictions,” and is therefore discussed in the next section of this Guide.

Without Donor Restrictions

The “without donor restrictions” total is assets minus the liabilities and the net assets with donor restrictions. Another way of putting this is that if the assets are neither liabilities, nor permanently or temporarily restricted, then by accountant definition they are unrestricted. The audit treats quite a lot of assets as unrestricted that AFSC would not consider using for operations except in case of emergency.

- **Land, buildings, and equipment.** Same as indicated in the Assets section.
- **Investment in Friends Center.** Same as indicated in the Assets section.
- **Funded status of pension and informal retirement benefit plans.** The calculations underlying this number appear in Note 6. The totals for the formal and informal plan are added together. In FY19, for example, \$1.4 million in excess funding in the informal plan offset part of the \$9.9 million underfunding in the formal plan.
- **Funds designated for payment of charitable gift annuities.** This is the third piece of the annuity portfolio, mentioned above. The calculation of this number appears at the end of Note 3. Starting from the total value of the investments in the CGA accounts, Note 3 subtracts the basic legally established liabilities. The difference between the two appears on this line in the audit as something AFSC has opted to hold for CGA purposes, in the eyes of the auditors. Part of the amount is required by various state laws, as Note 3 shows.
- **Funds Functioning as Endowment.** These were also mentioned earlier. This is a set of funds established at different times with different designated purposes. Because the Board designated some of those purposes, these are also referred to as “Board-designated” endowments. Legally, the Board could designate them differently, but the donors who provided them would probably be very unhappy with that decision. The Stewardship Committee has always strongly opposed treating them any differently than the permanent endowments.

Finally, we come to the top figure in the unrestricted net assets listing, called “**designated for current and future operations.**” This number includes two items, although one is “invisible”. The “invisible” one is the assets of any charitable gift funds AFSC is holding in its investments; as mentioned earlier, the market value of those assets is part of the other long-term investments line. These are funds that donors give us but ask us to pass part of them on to other organizations. According to GAAP, such funds should be treated as “without donor restrictions,” but of course AFSC would follow donor instructions, as in the case of Funds Functioning as Endowment. In FY19, for example, the CGF number was \$1,653,233; unfortunately, that number is not specifically mentioned anywhere in the audit. Subtracting that amount from “designated for current and future operations,” we have a total of \$843,020 that constitute AFSC’s reserves according to Board policy.

Income and Expense Statement (“Statement of Activities and Changes in Net Assets”)

The income and expense (I&E) statement summarizes the flows of funds into and out of AFSC during the fiscal year in question, along with funds that we raised earlier and used for operations in that year. It includes funds that we received during the year as assets for endowments and annuities.

Because the income and expense statement looks a lot like the organization’s budget, it is tempting to confuse it with a report on budget performance. But there are key differences; some things are counted as revenues here that AFSC would never spend in the annual budget (e.g., endowment) and some key

income streams are included but not broken out (in particular, matured planned gifts, which are buried in the “net assets released from restrictions”).³

Operating Revenues/ Income

Public Support

Contributions

The row labeled “Contributions for Current Program Work” consolidates unrestricted and restricted contributions; each category appears in its own column. Gifts received in fulfillment of Campaign pledges are included here as restricted gifts. The total is net of credit card fees and other expenses associated with income.

Grants

The audit report separates “grants from foundations” from “government grants.” The first appear under “public support.” In both cases, the amount under operating revenues shows what was actually used from those sources to cover expenses in the fiscal year in question. When AFSC receives grant funds that are carried over to be spent in future years, they are reflected in the balance sheet in the audit; this is the “deferred income” we discussed above under liabilities.

Bequests

Unrestricted bequest income appears in the audit in the “without donor restrictions” column and restricted bequest income in the “with donor restrictions” column. These are funds that donors left to AFSC in their wills. The total that arrives in any given year goes up and down a lot.

Planned Gifts

The planned gift area is one where the budget and the audit I&E include completely different things. Both numbers relate to the fundraising strategy of gift annuities, but one reflects funds put into that portfolio of investments and the other reflects the amounts received from it for operations.

The I&E, under the category “Contributions to planned giving program,” reports a portion of the amounts that donors placed into new annuity funds during the fiscal year of the report (the rest is treated as a liability, to account for the payments that will be made). Because the funds are not available to spend on operations until “maturity,” that is, when the donor or beneficiary dies, this amount is never included in the budget nor reported in the management report on current spending. As discussed above under assets, the contributed funds are used to pay the promised annuities to these individuals and are allowed to appreciate until “maturity” in order to maximize the amount freed up to spend at that time. When they reach maturity, they are included in the I&E statement as part of “net assets released from restrictions.”

³ In June 2019, the Board received a detailed analysis comparing the income and expense statement in the FY2018 audit with the reports the Board receives on budget performance. If you are interested in the details, you may want to request that report (Board Supporting Paper 1906N).

Contributions to Endowment Funds

As with the contributions to the annuities program, the audit shows new amounts that went into the endowment during the fiscal year, whether the source was a direct contribution or a bequest that was designated for endowment. Since these funds are not available for current spending, they do not appear in the budget.

Other Operating Revenues

Investment Income

The full name for this item in the I&E is “Investment Income net of fees, appropriated (Note 3).” It refers to the amount the Board has authorized to be spent from endowment for operating costs in any given year (that is what “appropriated” means here). The Board policy on endowment spending appears in the [Investment Policy Statement](#). As mentioned above, AFSC is currently gradually moving the spending rate down to 4.5% of the average investment value over the previous three years.

Other Income

The audit report includes “program service income” and “miscellaneous interest and other income.” The first category, for example, includes funds raised by selling AFSC branded items.

Net assets released from restrictions

This is another area where the audited financials do something completely different from the way AFSC budgets and reports on income and spending. On this row of the table, the auditors add up all the restricted funds that were used to meet expenses in the fiscal year in question, whether that income was received in that fiscal year or earlier. The restrictions could relate to timing or purpose. Note 7 provides a breakout. Funds raised for program under the Campaign appear here when they are used, as do other funds donated for programs; all of that spending would appear in the budget. Planned gifts that matured during the year are also included on this row, since they went from time-restricted to unrestricted status. The “time restrictions met” row in Note 7 indicates the planned gifts that matured.

Operating Expenses

Program Services and Program Support

These areas are familiar territory in the AFSC budget: U.S. and International Programs, Fundraising, and Management. The twist, for those who know the budget, is that some items that appear in the Central Office budget are included in different categories here. This Guide returns to why and how AFSC maps the budget to these categories in the section on the Spending Report.

Changes in net assets from operations

An accountant would refer to this line as AFSC’s “deficit.” Because of the differences we have just indicated, however, it is not the same as a budget deficit. That is because contributions TO the planned giving program and contributions TO endowment funds are included, even though we do not use them to support operations in a given year. A more budget-related statement of the operating surplus or deficit would subtract those two numbers and add the matured planned gifts released to operations (from the Cash Flow Report).

Nonoperating Changes in Net Assets

In addition to the ways the assets were built up or used in operations during the fiscal year, there are other dynamics that affect the level. This section of the I&E statement captures them.

Investment gains not appropriated

The calculation of this number appears just before the CGA calculations towards the end of Note 3. First it adds up dividends and interest and the overall gains on the investments, including in Friends Center. Then it subtracts the fees paid to the investment managers. Finally, it subtracts the amount that was transferred into operations for the endowment spend. The resulting number represents the investment income and gains that we did not use during the year.

Actuarial (loss) gain on planned giving liabilities

This line includes the change of liability as the beneficiaries age one year and any change due to a planned gift maturing. It also includes the investment gain/loss of the charitable remainder trusts and pooled life income funds.

Pension and benefits adjustment

This line includes AFSC's share of retiree medical insurance premiums, change in the funding status of the pension plans, and the periodic pension expense.

Other nonoperating changes in net assets

This line includes the income and principal of charitable gift funds that were given to outside organizations.

Bottom line

The bottom row of the I&E table reflects the non-operating “adjustments” added to the operating surplus or deficit. The end of year net assets total matches with the net assets total in the balance sheet.

Previous year’s table

For those who want to compare each column of the I&E with the previous year, the next page of the audit gives a more detailed presentation for that year, as it appeared in the previous year’s audit (but incorporating any changes in format).

“Statements of Cash Flows”

The cash flow statement is not a “must read” document for any but the most dedicated financial information seekers. The balance sheet already gave us the level of cash and cash equivalents. The cash flow statement gives details on where the cash came from.

There are a few numbers here, however, that are highly interesting to those that care about the income streams and balancing the budget.

- First is the “matured gifts from planned giving program” – our treasured matured planned gift stream of unrestricted income. We noted above that this number was buried in the assets released from restrictions in the I&E and one had to go to the Note to find it. In the cash flow

statement, we see that money come in from the assets and head straight out to be spent in operations.

- Also of interest is the figure for “net benefit payments to annuitants,” because it conveys how much we pay out – in FY19, over 5% of the size of the total assets of those plans, which we saw in the balance sheet.

One can also watch the contributions to endowments and planned giving programs come in as cash, then go right back out into those investment pools.

Spending Report (“Statement of Functional Expenses”)

Finally, in the fourth major audit table, we see what AFSC spent its money on. The numbers include the unrestricted income, what was spent from restricted funds that we raised for specific purposes, and spending from grants. This table includes both budgeted spending and “off-budget” items like the costs of strategic planning. Off-budget items are approved by the Board, just as the budget itself is approved. The only item that appears here that does not enter budget discussions⁴ is the row at the bottom that reports on depreciation, which keeps track of the decline in asset value of buildings as required by GAAP to avoid over-stating the value of the organization’s assets.

As noted above, this table departs from the structure of the AFSC budget by “allocating out” certain costs. Information technology spending, for example, which is in the Central Office budget, is spread evenly across the organization. According to GAAP, all non-profit expenses must fall in one of three categories: Programs, Fundraising, or Management & General. The efficiency ratio, an important number driving charity watchdog ratings, is determined by Program Expense/Total Expenses.

Notes

As the Introduction pointed out, the Notes for the Audit carry a lot of information. The list of Notes is below, with some brief information on what is in each.

- (1) **Background.** General information on AFSC.
- (2) **Summary of Significant Accounting Policies.** Definitions of key terms.
- (3) **Investments.** Detail on how the various funds are held and the investment objectives of various holdings. At the end of this note are two key calculations referred to in the text above: investment gains not appropriated and charitable gift liabilities.
- (4) **Investment in Friends Center.** Details on the assets and liabilities of the Friends Center Corporation.
- (5) **Land, Buildings, and Equipment.**
- (6) **Pension Plans and Postretirement Benefits other than Pensions.** All the results of the actuarial calculation of obligations and the funds available to meet them are here.
- (7) **Net assets.** Carryover balances in restricted accounts; planned giving and endowment assets.

⁴ Update in March, 2024: The spending table also includes a line for “Net periodic pension and retiree medical benefit.” This item never appeared in the budget in my memory, probably because it was paid out of the assets of the formal and informal retirement plans, not operating funds. This number is quite large in audit spending tables before 2018 (as high as \$3 million) but drops dramatically from 2018 onwards, even going negative in some of the following years. The drop suggests that there was a change in the way spending from those funds was included in the budget at that time, under a new CFO.

- (8) **Related Party Transactions.** Friends Center bonds and funds at Friends Fiduciary.
- (9) **Allocation of Joint Costs.** Costs of informational materials that included fundraising appeals.
- (10) **Commitments.** Lease costs going forward.
- (11) **Contingencies.** Non-financial matters that might affect finances, such as lawsuits.
- (12) **Financial and liquidity resources.** This new Note added in FY19 provides a quick comparison of total assets with those that are set aside for specific uses. All the numbers in the table come from the balance sheet or other notes. See Table One below.
- (13) **Subsequent events.** This should be quite an interesting one to fill out in March 2020!

Table One: Liquidity Analysis Sources

Financial Assets		
Cash and cash equivalents	Balance sheet	
Accounts and notes receivable	Balance sheet	
Investments	Balance sheet	Other long term
Less:		
Endowment funds assets	Balance sheet; Note 7	In perpetuity plus accumulated gains plus Funds Functioning as Endowments, plus term endowments from Note 7
Net assets with donor restrictions	Balance sheet	Carryover balances in restricted accounts
Funded status, retirement	Note 6	Informal plan overfunding