



Applying the New Requirements of UPMIFA and FSB 117-1

On July 1, 2008, the State of New Hampshire adopted new regulations related to the management of permanently restricted endowment funds. Coupled with FASB Staff Position 117-1 issued on August 6, 2008, these new regulations will require most institutions to re-analyze their endowment funds to ensure compliance. The following information is designed to clarify the implications of these new regulations and to provide suggestions for steps that should be initiated by institutions as soon as possible.

Overview

In New Hampshire, the enactment of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) provides charities with greater flexibility in managing their permanently restricted endowment funds. It is enacted as RSA Chapter 292-B and replaces its predecessor the Uniform Management of Institutional Funds (UMIFA) in its entirety. UPMIFA incorporates the experience gained in the last 35 years under UMIFA by providing even stronger guidance for investment management and enumerating a more exact set of rules for investing in a prudent manner.

History

Trust Law prior to UMIFA – charities were restricted to spending the interest and dividends on securities actually earned and received.

UMIFA – allowed charities to spend the appreciation in these funds in excess of the historic dollar value in addition to the actual income earned through interest and dividends based upon a predetermined percentage of the market value deemed to be prudent. An endowment fund whose market value fell below the historical market value at the time the gift was made, could not be drawn upon for endowment spending purposes until the historical dollar value was restored.

UPMIFA

As adopted in New Hampshire, UPMIFA applies to institutions administering permanently restricted endowment funds and includes additional requirements if these funds aggregate a market value of \$2m or less. This act eliminates the historic dollar value limitation on endowment spending and instead allows the trustees to spend a percentage of market value deemed to be *prudent*, even if doing so would cause the fund to fall below its historical dollar value (i.e. underwater funds).

The appropriation for expenditure in any year of any amount greater than 7% of the fair market value of an endowment fund, calculated on the basis of fair market value determined at least quarterly and averaged over a period of not less than 3 years immediately preceding the year in which the appropriation for expenditure was made, creates a rebuttable presumption of imprudence. For an endowment fund in existence for fewer than 3 years, the fair market value of the fund shall be calculated for the period of time the fund was in existence.



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UPMIFA (continued)

Under UPMIFA and according to the NH RSA 292-B:4, institutions administering permanently restricted endowment funds with a market value of \$2m or more shall notify the Attorney General upon adoption of the provisions of RSA 292-B. This notification should include the name and address of the fund, the current market value of the fund and a statement that the funds will be managed pursuant to UPMIFA. Boards should be particularly careful in making this decision (EXAMPLE 6).

If an institution has permanently restricted endowment funds with an aggregate value of *less than \$2m*, the institution shall notify the attorney general at least 60 days prior to an appropriation for expenditure of an amount that would cause the value of the permanently restricted endowment funds to fall below the aggregate historic dollar value. During the 60-day period the attorney general may require the institution to obtain court approval for the proposed expenditure.

FASB Staff Position No. FAS 117-1

On August 6, 2008 the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds*, which will also affect many nonprofit entities. This Staff Position will require significant additional disclosure in the financial statements of nonprofits with endowment funds.

Definitions

Historic Dollar Value: The sum of the value of the fund at the time of its creation, accumulation (as directed by the donor), and all subsequent contributions to the fund.

Prudence: In adopting UPMIFA, new state legislation specifies in greater detail what “an ordinarily prudent person in a like position” should do when making decisions related to endowment funds.

“In making a determination of appropriation [endowment spending] or accumulation, the institution shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstance, and shall consider, if relevant, the following factors:

- 1) *duration and preservation of the endowment fund;*
- 2) *the purposes of the institution and the endowment fund;*
- 3) *general economic conditions;*
- 4) *effect of inflation and deflation*
- 5) *the expected total return from income and the appreciation of investments;*
- 6) *other resources of the institution; and*
- 7) *the investment policy of the institution.”*



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What can you do now to prepare for your year end audit?

- ⊗ Ensure that the required communication has been made with the NH Attorney General's office (see previous page for requirements)
- ⊗ Review permanently restricted gift files to determine the historic market value of gifts. Utilizing these documents entities must calculate the amount of accumulated appreciation or depreciation that has been added to or deducted from the original value of these permanently restricted gifts. Most institutions have been accumulating this appreciation and depreciation as a component of permanently restricted or unrestricted endowment funds. Based on the state's interpretation of UPMIFA, accumulated appreciation and depreciation related to these permanently restricted gifts will be reclassified to temporarily restricted net assets. The remaining permanently restricted amounts will represent the historic dollar value of gifts (see above definition). If documents are missing, please contact us as we may have historical gift documents in our files.
- ⊗ Review investment policies (in particular spending policy) to ensure the seven standards of prudence have been met and documented appropriately – see above.
- ⊗ Discuss new disclosure requirements under 117-1 with the investment committee (or similar group). The FASB requires these new disclosures upon adoption of UPMIFA and consist of the following components (examples have been provided for your reference):
 - The governing Board's interpretation of relevant law underlying net asset classification (i.e. what the board defines as restricted endowment and quasi-endowment)¹.
 - Donor-restricted endowments in net deficit condition (i.e. underwater) (EXAMPLE 1)
 - Endowment investment policies, including return objectives and risk parameters, how these objectives relate to the spending policy, and strategies for achieving the objectives (EXAMPLE 2 & 3)
 - Description of the endowment spending policy (EXAMPLE 4)
 - Table showing composition of endowment by net asset class (EXAMPLE 5)
 - Table showing endowment roll-forward by net asset class (EXAMPLE 5)
 - Nature of restrictions

¹ Quasi-endowments typically consist of (1) accumulated unspent earnings on endowment, including earnings on permanently restricted net assets (2) accumulated operating surpluses; and (3) any board-designated endowment

EXAMPLE 1**Funds with Deficiencies**

(Disclosure required by paragraph 15(d) of Statement 124)

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Organization to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were \$200 as of June 30, 200Y. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the Board of Trustees. There were no such deficiencies as of June 30, 200X.

EXAMPLE 2**Return Objectives and Risk Parameters**

Organization A has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for a donor-specified period(s) as well as board-designated funds. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of the S&P 500 index while assuming a moderate level of investment risk. Organization A expects its endowment funds, over time, to provide an average rate of return of approximately 9 percent annually. Actual returns in any given year may vary from this amount.

EXAMPLE 3**Strategies Employed for Achieving Objectives**

To satisfy its long-term rate-of-return objectives, Organization A relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Organization targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

EXAMPLE 4**Spending Policy and How the Investment Objectives Relate to Spending Policy**

Organization A has a policy of appropriating for distribution each year 5 percent of its endowment fund's average fair value over the prior 12 quarters through the calendar year-end preceding the fiscal year in which the distribution is planned. In establishing this policy, the Organization considered the long-term expected return on its endowment. Accordingly, over the long term, the Organization expects the current spending policy to allow its endowment to grow at an average of 4 percent annually. This is consistent with the organization's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

EXAMPLE 5**Changes in Endowment Net Assets
for the Fiscal Year Ended June 30, 200Y**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 6,947	\$ 46,380	\$ 95,673	\$ 149,000
Investment return:				
Investment income	298	2,396	286	2,980
Net depreciation (realized and unrealized)	<u>(413)¹²</u>	<u>(2,185)¹³</u>	<u>—</u>	<u>(2,598)</u>
Total investment return	(115)	211	286	382
Contributions	—	—	2,000	2,000
Appropriation of endowment assets for expenditure	(448) ¹⁴	(7,002) ¹⁵	—	(7,450)
Other changes:				
Transfers to create board- designated endowment funds	500	—	—	500
Endowment net assets, end of year	<u>\$ 6,884</u>	<u>\$ 39,589</u>	<u>\$ 97,959</u>	<u>\$ 144,432</u>

Note to Reader: In this example, the changes in unrestricted net assets included \$125 of depreciation on investments and \$75 of appropriations for expenditure for donor-restricted endowment funds in which there was a deficiency as of June 30, 200Y, with respect to the amount required to be retained in perpetuity.

Investment returns classified as changes in permanently restricted net assets represent only those amounts required to be retained permanently as a result of explicit donor stipulations. To the extent that actual investment income attributable to funds with such stipulations was less than \$286, the organization would reclassify to permanently restricted net assets a portion of the temporarily restricted net assets associated with those funds and, to the extent there are insufficient temporarily restricted net assets, then unrestricted net assets. That reclassification would be displayed separately from investment return in the above table. If unrestricted net assets are reclassified, this would result in a presentation in the endowment net asset composition table that is similar to that associated with the situation described in the preceding paragraph.

¹² \$(413) = (288) + (125)

¹³ \$(2,185) = (2,310) + 125

¹⁴ \$(448) = (373) + (75)

¹⁵ \$(7,002) = (7,077) + 75

EXAMPLE 6

<u>Endowment Restriction</u>	<u>6/30/09 Market Value</u>
Unrestricted endowment funds	800,000
Board-designated endowment funds	500,000
Temporarily Restricted endowment funds	1,000,000
Permanently Restricted endowment funds*	1,500,000
	<u>3,800,000</u>

(Under this example the institution would not be required to notify the NH Attorney General that the provisions of RSA 292-B were adopted, but would be required to notify them 60 days prior to appropriating any amounts that would cause the fund's market value to be less than its historical amount)

<u>Endowment Restriction</u>	<u>6/30/09 Market Value</u>
Unrestricted endowment funds	100,000
Board-designated endowment funds	100,000
Temporarily Restricted endowment funds	450,000
Permanently Restricted endowment funds*	2,200,000
	<u>2,850,000</u>

(Under this example the institution would be required to notify the NH Attorney General that the provisions of RSA 292-B were adopted, but would not be required to notify them 60 days prior to appropriating any amounts that would cause the fund's market value to be less than its historical amount)

*based on historic dollar value