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Uniform Prudent Management of Institutional Funds Act (UPMIFA)

Presented by CSU and KPMG LLP

CSU The California State University

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Topics

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Background

- In July 2006, the National Conference of Commissioners on Uniform State Laws approved the Uniform Prudent Management of Institutional Funds Act (UPMIFA).
- UPMIFA is designed to replace the existing Uniform Management of Institutional Funds Act (UMIFA).

UMIFA vs. UPMIFA

UMIFA	UPMIFA
Two principles: 1. Assets would be invested **prudently** in **diversified** investments that sought growth as well as income 2. Appreciation of assets could prudently be spent for purposes of any endowment fund held by a charitable institution	Incorporates the experience gained in the last 35 years under UMIFA and provides for even stronger guidance for investment management and enumerating a more exact set of rules for investing in a prudent manner.

Allowed endowments to:
● Invest in any kind of assets
● Pool endowment funds for investment purposes
● Delegate investment management to others (e.g., professional investment advisors).
	Requires:
	● Investment "in good faith and with the care an ordinary prudent person in like position would exercise under similar circumstances."
	● Prudence in incurring investment costs, authorizing "only costs that are appropriate and reasonable."
	● Factors to be considered in investing include:
	    ● Effects of inflation
	    ● Investment decisions must be made in relation to overall resources of the institution and its charitable purposes.
	    ● No investment decision may be made in isolation, but in light of the fund's entire portfolio.
	    ● Investment should be part of a strategy "having risk and return objectives reasonably suited to the fund and the institution."
	    ● Diversify assets as an affirmative obligation unless "special circumstances" dictate otherwise.
	● Investment experts, whether in-house or hired, are held to a standard of care consistent with that expertise.

UMIFA vs. UPMIFA (con't)

UMIFA	UPMIFA
●Initiated the concept of total return expenditure of endowment assets for charitable program purposes. ●Permitted prudent expenditure of both appreciation and income replacing the old trust law concept that only income (e.g., interest and dividends) could be spent. ●Asset growth and income could be appropriated for program purposes, subject to the rule that a fund could not be spent below "historic dollar value".	● Builds upon UMIFA's rule on appreciation ● Eliminates the concept of "historic dollar value" ● Provides better guidance on prudence ● Makes the need for a floor on spending unnecessary ● Seven criteria to guide yearly expenditure decisions:***** 1. Duration and preservation of the endowment fund 2. Purposes of the institution and the endowment fund 3. General economic conditions 4. Effect of inflation or deflation 5. Expected total return from income and the appreciation of investments 6. Other resources of the institution 7. Investment policy of the institution ● Optional provision that allows states to enact another kind of safeguard against excess expenditure. If a state does not want to rely solely upon the rule of prudence provided in UPMIFA, the state may adopt a provision that creates a rebuttable presumption of imprudence if an institution expends an amount greater than 7 percent of fair market value of a fund, calculated in an averaging formula over three years. **Per SB 1329, Section 18504, (d)(2), the CSU is exempt from the 7 percent rebuttable presumption of imprudence.** **These standards mirror the standards that apply to investment decision-making, thereby unifying both investments and expenditure decisions more concretely.*

UMIFA vs. UPMIFA (con't)

UMIFA	UPMIFA
● The only option with respect to a restriction, was "release" of the restriction.	●Authorizes a modification that a court determines to be in accordance with the donor's probable intention. If the charity asks for court approval of a modification, it must notify the state's chief charitable regulator. ●Allows a charity to modify a restriction on a small (<$25,000) and old (>20 years old) fund without going to court. **SB 1329 allows up to $100,000.** ●If a restriction becomes impracticable or wasteful, the charity may notify state charitable regulator, wait 60 days, and then modify the restriction consistent with the charitable purposes expressed in the original gift.

FAS 117-1

- On August 6, 2008, FASB issued FASB Staff Position (FSP) FAS 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
  - Guidance on net asset classification of *donor-restricted endowment funds* for not-for profit organization that is subject to UPMIFA.
  - Improves disclosures about an organization's endowment funds (both donor-restricted endowment funds and board-designated endowment funds), whether or not the organization is subject to UPMIFA.

Net Asset Classification for Funds Subject to UPMIFA

- Classify a portion of a donor-restricted endowment fund of perpetual duration as permanently restricted net assets.
- The portion of a donor-restricted endowment fund that is classified as permanently restricted net assets is not reduced by losses on the investments of the fund, except to the extent required by the donor. Likewise, the amount of permanently restricted net assets is not reduced by an organization’s appropriations from the fund.
- Classify the portion of the fund that is not classified as permanently restricted net assets as temporarily restricted net assets (time restricted) until “appropriated for expenditure”.
- Appropriation for expenditure:
  - Occurs upon approval for expenditure (e.g., annual budget, or during the year as unexpected needs arise such as for emergency relief efforts).
  - If approval is for a future period, appropriation occurs when that period is reached.
- Financial statement reclassifications required:
  - Upon appropriation for expenditure, the time restriction expires to the extent of the amount appropriated and, in the absence of any purpose restrictions, results in a reclassification of that amount to unrestricted net assets.
  - If fund is also subject to a purpose restriction, the reclassification of that amount to unrestricted net assets would not occur until that purpose restriction is met, in accordance with the provisions of ¶ 17 of Statement 116.

Enhanced Disclosures for All Endowment Funds

- Not-for-Profit organizations, whether or not subject to UPMIFA, shall disclose information to enable users of financial statements to understand the net asset classification, net asset composition, changes in net asset composition, spending policies, and related investment policies of its endowment funds (both donor-restricted and board-designated).

Enhanced Disclosures for All Endowment Funds (con't)

- At a minimum, organization shall disclose the following information in its financial statements:
  a. Description of governing board's interpretation of the laws that underlie the organization's net asset classification of donor-restricted endowment funds.
  b. Description of organization's policies for the appropriation of endowment assets for expenditure (its endowment spending policies).
  c. Description of organization's endowment investment policies (include return objectives and risk parameters; how they relate to the organization's endowment spending policies; and strategies employed for achieving those objectives).
  d. Composition of organization's endowment by net asset class at the end of the period, in total and by type of endowment fund, showing donor-restricted endowment funds separately from board-designated endowment funds.
  e. Reconciliation of the beginning and ending balance of organization's endowment, in total and by net asset class, including, at a minimum, (as applicable): Investment return, separated into investment income (e.g., interest, dividends), and net appreciation or depreciation of investments; contributions; amounts appropriated for expenditure; reclassifications, and other changes.

Enhanced Disclosures for All Endowment Funds (con't)

- Organization also shall provide information about the net assets of its endowment funds, including:
  a. Nature and types of permanent restrictions or temporary restrictions (¶ 14 and 15 of Statement 117).
  b. Aggregate amount of deficiencies for all donor-restricted endowment funds for which fair value of the assets is less than the level required by donor stipulations or law.
- Below is an illustrative example of the Disclosures from FAS 117-1

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Impact of Adoption

- When enacted, UPMIFA is to be applied **retroactively** (unless specifically amended in jurisdiction) to all donor-restricted endowment funds in existence as of the effective date of UPMIFA in the relevant jurisdiction
- The Staff Position modifies what is often referred to as the “deemed spent” or the “first dollar rule,” a requirement in ¶ 17 of Statement 116.
- Under the provisions noted above, organizations may have previously deemed “spent” earnings on endowment funds that were never specifically appropriated for spending.
- According to the Staff Position, in initially applying the net asset classification guidance, in addition to considering the time restrictions imposed by UPMIFA, an organization must consider a donor-imposed purpose restriction to be **reinstated** to the extent that the restriction was previously deemed “spent” but the amount had not been “appropriated” for expenditure.
  - For example, a not-for-profit organization with an endowment for scholarships for many years may have granted more dollars in scholarships than it appropriated for through its budgets to be spent from the earnings on the scholarship endowment.
  - When the Staff Position is adopted, the organization will have to reclassify the amount released that is in excess of the amount specifically appropriated for scholarships.

Effective Date and Transition

- Effective for fiscal years ending after December 15, 2008 (June 30, 2009 for CSU FASB Auxiliary Organizations)
- When initially applying the net asset reclassification, organizations should report the reclassification as a separate line item on the statement of activities.

Senate Bill No. 1329

- On September 30, 2008, the Governor approved Senate Bill No. 1329.
- This Bill repealed the provisions of UMIFA and enacted the UPMIFA.
  - Changed the rules applicable to charitable institutions, so charity may spend the amount it deems prudent after considering the donor's intent, the purposes of the fund, and relevant economic factors.
  - Allows modification of a restriction without court approval not exceeding $100,000 and older than 20 years, with notice to the Attorney General.
  - Authorizes a court, upon petition by the Attorney General, to order the winding up and dissolution of a nonprofit public benefit corporation without meeting the requirements of existing law, on the ground that it is impossible or impractical to meet some or all of those requirements.

References

- To view this recording, please go to the Financial Accounting Services Training, Education & Development portal
  - https://zeta.calstate.edu:8250/portal/page?_pageid=74,1&_dad=portal&_schema=PORTAL
- To view the PowerPoint presentation, please go to the Systemwide Financial Services website
  - http://www.calstate.edu/sfo/

Summary

In light of UPMIFA, FASB issued FAS 117-1, Endowments of Not-for-Profit Organizations:

- Guidance on net asset classification of *donor-restricted endowment funds* for not-for profit organization that is subject to UPMIFA.
- Improves disclosures about an organization’s endowment funds (both donor-restricted endowment funds and board-designated endowment funds), whether or not the organization is subject to UPMIFA.

Questions and Answers

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- **Are GASB entities required to follow FAS 117-1?**
  - No. However, both GASB (University and Auxiliary Organization) and FASB entities shall adhere to SB No.1329 **(attached)**. Therefore, we recommend that GASB entities also re-evaluate its endowment fund policies.
- **If an organization's policy allows for invasion of principal and accumulated income, how much of the endowment should be classified as "permanently restricted"?**
  - An organization subject to UPMIFA must classify as permanently restricted net assets the portion of the donor-restricted endowment fund that must be retained permanently in accordance with explicit donor stipulations or, absent such stipulations, the amount the organization's governing board determines must be retained permanently under relevant law.
  - Do not reduce the amount of permanently restricted net assets by the fund's investment losses unless such losses are related to specific investments that the donor required to be maintained. **(Refer to KPMG article attached)**
- **How should organizations account for underwater funds?**
  - Organizations should continue to account for underwater funds as a reduction of unrestricted or temporarily restricted net assets, rather than as a reduction of permanently restricted net assets. **(Refer to Minutes of FASB Board Meeting attached)**
- **How are endowment funds invested in the SWIFT pool affected?**
  - Endowment investments in the SWIFT pool are subject to UPMIFA.