



Kentucky Passes Uniform Prudent Management of Institutional Funds Act (UPMIFA)

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For almost 35 years the Uniform Management of Institutional Funds Act (UMIFA) was the law of the land in most states for organizations with institutional funds and permanent endowments. In 2006, the Uniform Prudent Management of Institutional Funds Act (UPMIFA) was created to update the prudence standard that applies to the management and investment of charitable funds and to modernize the rules governing expenditures from endowment funds. As of March 2010, 47 states (*including Kentucky which enacted the law on March 25, 2010*) had either enacted, or were in the process of introducing legislation to enact, UPMIFA or a version of it.

UPMIFA is the Law

Under UPMIFA, institutional funds may or may not be subject to donor restrictions. Endowments are institutional funds that are donor restricted under the terms of the gift instrument. UPMIFA applies to nonprofit charitable entities. It does not apply to trusts managed by non-charitable entities, such as corporations, or to trusts managed by individuals; these are governed by the 1994 Uniform Prudent Investor Act (UPIA). UPMIFA applies to all institutional funds, whether they were created before or after the enactment of the statute. However, it does not govern the management of board designated endowments. UPMIFA sets standards for endowment spending and preservation of the original gift in accordance with donor intent. It requires even stronger guidance for investing funds such that funds be invested “in good faith and with the care that an ordinarily prudent person in a like position would exercise under similar circumstances”. As for spending, UPMIFA requires that an organization “may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines to be prudent for the uses, benefits, purposes and duration for which the endowment fund is established”. UPMIFA includes seven criteria that are to be used by an organization to guide its yearly expenditure decisions.

FSP FAS 117-1 is the Accounting Standard

In August 2008, the Financial Accounting Standards Board (FASB) in response to UPMIFA issued FASB Statement of Position 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* (FSP FAS 117-1). This standard was effective for fiscal years ending after Dec. 15, 2008. The first part of the FSP is applicable only to UPMIFA enacted states and jurisdictions. The second part of the title, “*Enhanced Disclosures for All Endowment Funds*”, communicates to all organizations with endowment funds (both donor restricted and board designated) that, while you may ignore UPMIFA if you are not in an UPMIFA-enacted state or jurisdiction, you cannot ignore the disclosure requirements of FSP FAS 117-1.

Enhancements of UPMIFA-Increased Levels of Transparency and Clarity

There are two major changes to institutional fund management and endowment accounting under UPMIFA. The first is the elimination of historic dollar value as the amount recorded for accounting purposes as permanently restricted net assets and as a threshold for endowment spending, and the second is a change in the legal classification of earnings.

Original donor gift instruments, especially for endowments that have existed for many years, may not be detailed enough to contain sufficient documentation of donor intent for purposes of UPMIFA. Because of this potential lack of documentation, UPMIFA provides “Rules of Construction” that allow a charitable organization to focus on the implied donor intent with regard to spending, the desire to create an endowment of permanent duration, and the ability to react accordingly with respect to investment strategies and spending policies once that determination has been made.

Another positive outcome of UPMIFA is that it provides a framework to allow for the modification of donor restrictions in limited circumstances. When donor gift instruments are written with too narrow a focus, over time it may become difficult or impossible to fulfill the gift intent as originally stated by the donor. An example is a medical research organization that received a gift to fund research of a certain disease that is now cured. The organization cannot use the funds for the donor’s original intent since there is no longer a need for that specific research. Fortunately, UPMIFA offers two areas of guidance for that type of situation. UPMIFA allows an organization to apply retroactive rules of construction that place the organization in the donor’s shoes and charge them with honoring express or implied donor intent. Also, UPMIFA allows the restrictions on older, smaller funds (more than 20 years and less than \$50,000) to be removed through notifying the Office of the Attorney General, rather than through the courts.

Under UMIFA (the old law), unless the donor gift instrument indicated otherwise or relevant law required, earnings were not classified explicitly as restricted assets for legal purposes. UPMIFA (the new law) requires that earnings, unless otherwise instructed by the donor gift instrument, be classified as donor restricted for legal purposes until they are appropriated for expenditure. More clearly stated, under UPMIFA and its Rules of Construction, donor intent extends not just to the original gift corpus at historic dollar value, but to earnings on the related investments. Therefore, earnings are donor restricted in nature until such time as the board appropriates them to be used in meeting the donor’s intent. Under FSP FAS 117-1, this results in earnings being reported as temporarily restricted net assets until appropriated. Under UMIFA (the old law) earnings on such funds were reflected as unrestricted net assets, unless otherwise donor restricted. This difference in UMIFA (old) and UPMIFA (new) results in substantially different accounting and reporting outcomes based solely on the enactment status of the state in which the organization operates.

Summary

UPMIFA and FSP FAS 117-1 require organizations to account and report donor-restricted and board designated endowments in ways that are very different from requirements under previous guidance. Boards of Directors, finance and accounting personnel, development personnel and investment managers need to understand both the UPMIFA law and the new accounting, reporting and disclosure requirements under FSP FAS 117-1. There are opportunities to enhance donor relationships and to structure donor gifts in a way that will guarantee that a donor’s intent is being honored long after the gift has been made. For more information, upmifa.org is an excellent website to review the history and more detailed explanations of the act.