

Management of Institutional Funds in Massachusetts

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Introduction

On July 2, 2009, Governor Patrick signed into law a Massachusetts version of the Uniform Prudent Management of Institutional Funds Act (“UPMIFA”). UPMIFA is a model act that provides rules of construction concerning the investment, use and modification of funds held by operating charitable organizations, including endowment funds.* It has been adopted in many other states. The Massachusetts version (“Mass. UPMIFA”) is codified as Chapter 180A of the Massachusetts General Laws. It replaces the previous Chapter 180A (the “Prior Statute”), which dealt with the same subject for some 35 years.**

Headline: Elimination of the Concept of Historic Dollar Value

Mass. UPMIFA brings a key change to the Commonwealth with regard to the appropriation of funds from an endowment fund: it eliminates the concept of the historic dollar value of a gift and, in turn, provides a charity some latitude to draw from so-called underwater endowment funds. In effect, Mass. UPMIFA sanctions application of a reasonable spending rate to all of a charity’s endowment funds, even if in a given case, the value of a fund may have dropped below the original gift amount. Any drawing on a fund must be prudent, and a charity must preserve an endowment fund as a permanent fund. However, the latitude provided by Mass. UPMIFA will be especially helpful to charities in times of declining market values. The Prior Statute provided that appropriating in one year more than 7% of the market value of an endowment fund (determined over a trailing 12-quarter period) would give rise to a rebuttable presumption of imprudence. By contrast, there is no “7%” provision in Mass. UPMIFA.

Application

Mass. UPMIFA:

- Applies to (a) funds held for charitable purposes by a charitable organization of any form, except for trusts in which an individual or a commercial entity is a trustee, (b) a governmental entity to the extent it holds funds for a charitable purpose, (c) (unlike the Prior Statute) a split-interest trust after non-charitable interests have terminated and (d) under a special Massachusetts twist, a fund held by the trustees of a charitable community trust. (Section 1.)

* UPMIFA, promulgated by the National Conference of Commissioners on Uniform State Laws, has been issued with extensive comments (the “Comments”) that provide guidance. Go to www.nccusl.org.

** The Prior Statute had the title “Uniform Management of Institutional Funds Act” and was known as “UMIFA.”

- Applies to institutional funds existing on or established after June 30, 2009 and to decisions made or taken on or after June 30, 2009. (Section 7.)
- Does not apply to program-related assets; i.e., assets held to accomplish charitable purposes rather than for investment. (Section 1.)
- Establishes default rules; if a donor expresses a contrary intent in a gift instrument, the donor's requirements will control. (Sections 2, 3 and 4.) Records that establish the terms of a gift include electronic records. (Section 1.)
- Applies on a fund-by-fund basis. (Section 1.)

Scope

Mass. UPMIFA provides rules of construction in four areas:

- The management and investment of funds.
- The appropriation or accumulation of an endowment fund.
- The delegation of management and investment functions.
- The release or modification of restrictions on a gift.

In general, Mass. UPMIFA treats these subjects in more detail than the Prior Statute did and thus is more prescriptive.

Prudent Person Standard

For individuals as they make investment decisions, and for institutions as they make decisions concerning the use or accumulation of endowment funds or the delegation of the management and investment of funds, Mass. UPMIFA establishes a prudence standard: those individuals, or the institution itself, must act in good faith with the care that an ordinarily prudent person in a like position would exercise under similar circumstances. (Sections 2, 3 and 4.) This formulation is essentially the same as the standard set forth in Massachusetts General Laws Chapter 180, section 6C for the conduct of directors and officers of nonprofit corporations. According to the Comments, "similar circumstances" include the charitable nature of an organization and for individuals, the knowledge and skills that each one brings.

The Management and Investment of Funds

Section 2 of Mass. UPMIFA deals with standards for prudent management and investment of funds by an institution. These standards are designed to accord with standards for charitable corporations set forth in the Revised Model Nonprofit Corporation Act and standards for trusts set forth in the Uniform Prudent Investor Act. The Massachusetts version of the latter is codified in G.L. c. 203C. See the attached chart showing, by subject area, the requirements of Mass. UPMIFA, the Massachusetts Prudent Investor Act and the private foundation provisions of the federal tax code.

As noted above, individuals making investment decisions must observe a statutory prudence standard. In addition, under Mass. UPMIFA, individuals must observe the duty of loyalty contained in other Massachusetts laws. In the case of a corporation, this means acting in the reasonable belief that one's actions are in the best interests of the corporation, and in the case of a trust, it means acting solely in the interest of a beneficiary or beneficiaries of the trust. In substance, anyone making investment decisions should be sure to disclose any personal interests that might compromise the person's ability to act objectively and then abstain from voting on any matter involving those interests.

According to the Comments to UPMIFA, the statute follows "modern portfolio theory" for making diversified investments and considering risk and return objectives.

Mass. UPMIFA:

- Specifies nine considerations, detailed in the attached chart, that an institution is to consider, including the tax consequences of an investment; (e.g., unrelated business income tax resulting from investment in a hedge fund), general economic conditions, possible effects of inflation or deflation and expected total return.
- Establishes a duty to diversify.
- Establishes a duty to investigate facts relevant to the management and investment of a fund.
- Requires an institution to consider a particular asset in the context of the institution's portfolio of investments and overall investment strategy.
- Imposes a special duty on a person who has special skills or expertise, or who has been selected in reliance on the person's representation to that effect, to use those skills or expertise.
- Establishes a duty to minimize costs and, in a special Massachusetts twist, requires that these costs be allocated among funds before any amounts are appropriated for expenditure.
- Does not restrict the kinds of property or types of assets that an institution may select.

Practice Point: As a matter of good practice, a charitable organization should have a written investment policy approved by the organization's governing board. Investment policies should be developed, or reviewed and revised, with a view toward incorporating the requirements of Mass. UPMIFA. Note: Under guidance issued by the Financial Accounting Standards Board as a staff position (FSP FAS 117-1), an organization issuing audited financial statements must include a description of the organization's return objectives and risk parameters, how those objectives relate to the organization's spending policies and strategies employed for achieving those objectives.

The Appropriation or Accumulation of Endowment Funds

The appropriation or accumulation of endowment funds is governed by Section 3 of Mass. UPMIFA. As noted above, the statute makes a critical change from the Prior Statute as to appropriation from an endowment fund: it eliminates the concept of historic dollar value and permits appropriation (or accumulation) of so much of an endowment fund as the institution considers prudent, under the standard described above, for the uses, benefits, purposes and duration of a given fund. Comments to UPMIFA indicate that: (a) the donor of an endowment fund is presumed not to be concerned about a distinction between income and principal, but rather to intend that a fund support current expenditures and be preserved permanently, and (b) the rule in question is to be viewed as a rule of construction and as such may be applied to existing funds without violating donor intent or constitutional restrictions.

In making decisions as to appropriation or accumulation, the institution is to consider seven particular factors, if relevant:

- The duration and preservation of the endowment fund.
- The purposes of the institution and the endowment fund.
- General economic conditions.
- The possible effect of inflation or deflation.
- The expected total return from income and the appreciation of investments.
- Other resources of the institution.
- The investment policy of the institution.

Comments to UPMIFA make it clear that an institution may not use the latitude provided in that section to convert an endowment fund to one that may be spent currently. Rather, if a donor has required that a fund be retained as an endowment fund, the institution must honor the donor's intent by drawing and accumulating funds in a manner that preserves the purchasing power of a fund over time. Note that an institution is to focus on the purposes of a fund as well as the purposes of the institution. As with the Prior Statute, a donor may by the express provisions of a gift override the latitude provided by Mass. UPMIFA.

Practice Point: As a practical matter, appropriation from an endowment fund is likely to occur in two different ways. One is through application of a spending rate. While a rate of 4% or 5% per year of the market value of a fund determined on a trailing basis (usually at least 12 quarters) is generally regarded as prudent, an organization would do well to document, in minutes of the meetings of the governing board, its reasons, in light of the factors listed above, for adopting a given rate. Note: An organization issuing audited financial statements is required under FAS 117-1, referenced above, to include a description of its spending policy.

Alternatively, a governing board might consider making an appropriation, perhaps well above the 4-5% rate, from a particular fund for a particular purpose. For example, if a charity had an older fund with significant appreciation over the original gift amount, it might wish to make a substantial one-time appropriation for a particular project, such as a building project. Once again, minutes of the governing board should reflect consideration of the factors specified by Mass. UPMIFA. In either case there could, for example, be a report from a board committee or management that reflects consideration of the required factors and is accepted by the board.

Considerations in a Declining Market

Like the Prior Statute, Mass. UPMIFA uses the words “appropriate for expenditure.” Those words as contained in the Prior Statute have not been interpreted in any reported appellate court decisions in Massachusetts, but they suggest an important distinction. By dictionary definitions and common parlance, to “appropriate” means to set aside for a particular purpose. Expenditure may follow, but it is distinct from appropriation, just as with legislative appropriations that are made before the beginning of a fiscal year. The language of Mass. UPMIFA indicates that the point for determining reasonableness is the time of appropriation, not of expenditure. Many organizations start work on an operating budget months before the beginning of a given fiscal year. In that context, they determine how much is to be appropriated from the organization’s endowment funds for the coming year. That amount is appropriated as the budget is approved, and expenditure follows later, during the fiscal year. If an organization has acted reasonably at the time of appropriation, a later drop in market values as expenditure occurs should not undermine the reasonableness of the original decision. However, as a practical matter, if values drop significantly, an organization should consider as a matter of prudence whether actual spending should be adjusted during the course of the year.

Delegation

Mass. UPMIFA permits delegation of management and investment functions externally and internally. (Section 4.) Delegation to an external agent is subject to the prudence standard described above. Specific rules are:

- The institution must act prudently in selecting an agent, establishing terms of delegation and reviewing compliance.
- The agent must exercise reasonable care in complying with the scope and terms of delegation.
- By accepting delegation, the agent submits to the jurisdiction of the courts of the Commonwealth.

Under Mass. UPMIFA, an institution may also delegate management and investment functions to its committees, officers and employees to the extent permitted by other laws of the Commonwealth. Massachusetts General Laws Chapter 180, section 10C, cross-referencing Massachusetts General Laws, Chapter 156B, section 55, permits delegation of the powers of a board to a committee of directors, subject to some limited exceptions that do not include investment management. Massachusetts common law permits the delegation of some executive powers to officers. Any person acting under delegated powers must observe the prudence standard described above.

Practice Point: An organization's governing board should document through board votes its decisions with regard to delegation. For example, if an external agent is engaged, the minutes should document the process used for selecting the agent, and if authority is delegated to a board committee, the extent of delegation should be clear. As to the latter, a board might reserve to itself authority to approve outside investment managers and to set parameters for asset allocation while giving a committee authority to act on all other matters. A good place for addressing a matter of delegated authority of an investment committee would be in an organization's investment policy, as referenced above.

Release of Restrictions

Mass. UPMIFA addresses the release of restrictions on a fund in Section 5.

The statute provides that with the consent of a donor, an institution may release or modify a restriction on the management, investment, purpose or (in a Massachusetts twist) the duration of a particular gift, provided that a release or modification may not allow a fund to be used for a purpose other than the charitable purpose of the organization.

If consent of a donor cannot be obtained, a court may, upon request of an institution, release such a restriction: a) if the restriction has become impracticable or wasteful, or b) if it impairs the management or investment of the fund or c) if due to changed circumstances, modification will further the purposes of the fund. The Massachusetts Attorney General must be made a party to any such proceeding. In effect, this formulation is a broad codification of Massachusetts common law as to so-called deviation proceedings; that is, proceedings to modify a subordinate term of a fund.

Also, if a charitable purpose or restriction on the use of a fund becomes unlawful, impracticable, impossible to achieve or wasteful, then at the request of an institution, a court may modify the purpose of the fund or a restriction. Again, the Massachusetts Attorney General must be made a party to the proceedings. This statutory formulation is slightly broader than the standards under the common law doctrine *cy pres*.

Mass. UPMIFA includes another special twist relating to modifications. It provides, in substance, that the Massachusetts Supreme Judicial Court may delegate either of the judicial modification powers just described to the Massachusetts Attorney General, subject to dollar limits or other requirements as the Court may establish.

Financial Statement Presentation

The Financial Accounting Standards Board ("FASB") has issued standards that govern the treatment of endowment funds in audited financial statements. FAS 117-1, referenced above, provides guidance applicable in states where UPMIFA has been adopted. Under FASB's rules, there will be a disjunction between the statutory elimination of the concept of historic dollar value and retention of that concept for purposes of financial statements.

The rules that have been in effect for some time in Massachusetts are as follows. When an institution receives an endowment fund, the value of that fund is reflected on the institution's statement of activities (income statement) and on its statement of financial position (balance sheet) as a permanently restricted fund. The value recorded as a permanently restricted fund is the market value at the time of the gift. It does not change for financial statement purposes, even with fluctuations in market value. If the fund appreciates in value, the amount of appreciation is reflected in temporarily restricted net assets. This treatment comes from FASB Financial Accounting Standards No. 117, with a gloss from the Massachusetts Attorney General.

If the principal value of an endowment fund declines, the rules of FASB Financial Accounting Standards No. 124 control. The amount of decline is charged first to any temporarily restricted funds constituting appreciation over the historic dollar value of the fund. If any such appreciation is exhausted and the fund declines below its historic dollar value, then for financial statement purposes, the amount of the deficit is offset by a charge to unrestricted net assets. However, just as the original gift amount recorded as permanently restricted funds is not increased by appreciation, that amount is not reduced to reflect a market-value deficit. In effect, the unrestricted net assets account serves as the compensating account for financial statement purposes. The organization has no legal obligation to make up a deficit in the principal of its endowment funds, and independent auditors will typically be willing to include a note, based on an opinion of counsel, explaining that in the opinion of counsel, the organization has no obligation to fund a charge to unrestricted net assets.

FAS 117-1 addresses net asset classification of endowment funds in the case of organizations subject to versions of UPMIFA. As explained above, the rules have been that the historic dollar value of an endowment fund is treated as permanently restricted; any appreciation is treated as temporarily restricted; and movements in fund value affect temporarily restricted assets or unrestricted assets but not permanently restricted assets. FAS 117-1 contains the following formulation:

A not-for-profit organization that is subject to an enacted version of UPMIFA shall classify a portion of a donor-restricted endowment fund of perpetual duration as permanently restricted net assets. Consistent with paragraph 14 of FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*, and paragraph 22 of FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*, the amount classified as permanently restricted shall be the amount of the fund (a) that must be retained permanently in accordance with explicit donor stipulations, or (b) that in the absence of such stipulations, the organization's governing board determines must be retained (preserved) permanently consistent with the relevant law. (Section 5.)

As to the latter, FAS 117-1 acknowledges that pending the development of law interpreting UPMIFA, an organization should look to "other sources" for guidance, such as discussion in legislative committees, announcements from a state attorney general or a consensus of learned lawyers. This staff guidance also states that an organization should be consistent from year to year in its interpretation of applicable law.

It appears from discussion in FAS 117-1 that reference to "a portion of a donor-restricted endowment fund" means a portion of a fund as a whole. For example, a fund as a whole might be \$15,000 in amount, consisting of \$10,000 in original gift amount and \$5,000 in appreciation. In that case, FAS 117-1 would mandate treating a portion of the fund as permanently restricted. The obvious figure to use would be \$10,000, with the remaining \$5,000 in fund value being treated as temporarily restricted, just as under pre-FAS 117-1 rules. Perhaps some further guidance on this subject will emerge. Pending further developments, and notwithstanding the flexibility that the "portion" reference indicates, it may well be that practice as to classification will continue as before.

The Massachusetts Attorney General has issued guidance (April, 2011) with respect to FAS 117-1, a copy of which is attached.

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This article is for informational purposes only and is not intended as legal advice.

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Comparison Chart

	<u>Mass. UPMIFA *</u>	<u>Prudent Investor Act Chapter 203C*</u>	<u>Private Foundation Rules Tax Code §§4941, 4942, 4943 and 4944**</u>
1. Application	Institution – (a) any type of entity (other than an individual) organized for charitable purposes, (b) a governmental agency holding funds for charitable purposes, (c) a split-interest trust after non-charitable interests have terminated and (d) a fund held by the trustees of a charitable community trust; excludes commercial organization as trustee.	Trustee of fund.	Any type of §501(c)(3) organization classified as a private foundation.
2. Duty of loyalty	Person must comply with duty of loyalty imposed by law other than this act.	A trustee shall invest and manage the trust assets solely in the interest of the beneficiaries.	Self-dealing rules in §4941; exception for compensation for services that is reasonable and necessary and not excessive in amount. (§4941)
3. Duty of care	In good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.	As a prudent investor would, considering the purposes, terms and other circumstances of the trust, including those set forth in subsection (c) [see part 7 below]. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution.	Ordinary business care and prudence, under the facts and circumstances prevailing at the time of making the investment, in providing for the long- and short-term financial needs of the foundation to carry out its exempt purposes. (§4944)
4. Special duty	A person who has special skills or expertise, or is selected in reliance upon the person's representation that the person has special skills or expertise, has a duty to use those special skills or that expertise in managing and investing institutional funds.	A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has such special skills or expertise, shall have a duty to use such special skills or expertise.	No provision.
5. Duty to investigate	In managing and investing an institutional fund, an institution shall make a reasonable effort to verify facts relevant to the management and investment of the fund.	A trustee shall make reasonable effort to verify facts relevant to the investment and management of trust assets.	No provision.
6. Permitted types of investments	Subject to law other than this act, any type of investment consistent with the standards of this section [2].	Any kind of property or type of investment consistent with the standards of this chapter. Trust instrument references to "legal investments" or "investments permissible by law for investment of trust funds" do not change the statutory standard.	No <i>per se</i> restrictions. However, some investments will be closely scrutinized: trading in securities on margin, trading in commodity futures, investments in working interests in oil and gas wells, the purchase of "puts" and "calls," and "straddles," the purchase of warrants, and selling short. (§4944)

* Some provisions here are direct quotes, and some are paraphrases.

** Some provisions here are summaries of I.R.C. provisions, and some are direct quotes from regulations.

	<u>Mass. UPMIFA</u> *	<u>Prudent Investor Act Chapter 203C</u> *	<u>Private Foundation Rules Tax Code §§4941, 4942, 4943 and 4944</u> **
7. Investment Considerations	<ul style="list-style-type: none"> ▪ Charitable purposes of the organization and the purposes of the fund ▪ General economic conditions ▪ The possible effect of inflation or deflation ▪ The expected tax consequences, if any, of investment decisions or strategies ▪ The role that each investment or course of action plays within the overall investment portfolio of the fund ▪ The expected total return from income and the appreciation of investments ▪ Other resources of the institution ▪ The needs of the institution and the fund to make distributions and to preserve capital ▪ An asset's special relationship or special value, if any, to the charitable purposes of the institution 	<ul style="list-style-type: none"> ▪ Purposes, terms and other circumstances of the trust ▪ General economic conditions ▪ The possible effect of inflation or deflation ▪ The expected tax consequences of investment decisions or strategies ▪ The role that each investment or course of action plays within the overall trust portfolio ▪ The expected total return from income and the appreciation of capital ▪ Other resources of the institution ▪ Needs for liquidity, regularity of income, and preservation or appreciation of capital ▪ An asset's special relationship or special value, if any, to the charitable purposes of the institution 	<ul style="list-style-type: none"> ▪ The expected return (including both income and appreciation of capital) ▪ The risks of rising and falling price levels ▪ The need for diversification within the investment portfolio (for example, with respect to type of security, type of industry, maturity of company, degree of risk and potential for return). (§4944)
8. Taking account of context	Management and investment decisions about an individual asset must be made not in isolation but rather in the context of the institutional fund's portfolio of investments as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the fund and to the institution.	A trustee's investment and management decisions respecting individual assets shall be considered in the context of the trust portfolio as a part of an overall investment strategy reasonably suited to the trust.	The determination whether the investment of a particular amount jeopardizes the carrying out of the exempt purposes of a foundation shall be made on an investment by investment basis, in each case taking into account the foundation's portfolio as a whole. (§4944)
9. Diversification	An institution shall diversify the investments of an institutional fund unless the institution reasonably determines that, because of special circumstances, the purposes of the fund are better served without diversifying.	A trustee shall reasonably diversify the investments of the trust unless, under the circumstances, it is prudent not to do so.	See section 7 above. Also, § 4943 prohibits excess business holdings. (This provision applies also to public charities that are "Type III" supporting organizations.)
10. Costs	May incur only costs that are appropriate and reasonable in relation to the assets, the purposes of the institution and the skills available to the institution. Costs must be allocated to funds before appropriation is made.	In investing and managing trust assets, a trustee shall incur only costs that are appropriate and reasonable in relation to the assets, the purpose of the trust and the skills of the trustee.	No provision.

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** Some provisions here are summaries of I.R.C. provisions, and some are direct quotes from regulations.

	Mass. UPMIFA*	Prudent Investor Act Chapter 203C*	Private Foundation Rules Tax Code §§4941, 4942, 4943 and 4944**
11. Expenditure rules	<p>Organization may appropriate funds or accumulate endowment funds without regard to historic dollar value as determined prudent for the uses, benefits, purposes and duration of the fund. Factors to be considered:</p> <ul style="list-style-type: none"> ▪ The duration and preservation of the endowment fund ▪ The purposes of the institution and the endowment fund ▪ General economic conditions ▪ The possible effect of inflation or deflation ▪ The expected total return from income and the appreciation of investments ▪ Other resources of the institution ▪ The investment policy of the institution 	No provision.	Organization must distribute 5% of investment assets per year. Reasonable and necessary administrative expenses count as qualifying distributions. (§4942)
12. Delegation	<ul style="list-style-type: none"> ▪ May delegate management and investment to external agent as is prudent. Prudence required in selection of agent, establishing terms of delegation and reviewing compliance <ul style="list-style-type: none"> ▪ In performing delegated functions, agent owes duty to institution to exercise reasonable care to comply with scope and terms of delegation ▪ An organization that meets its prudence obligations is not liable for the decisions or acts of an agent ▪ By accepting delegation, agent submits to jurisdiction of courts in the Commonwealth ▪ May also delegate management and investment functions to committees, officers or employees as permitted by laws other than the act 	<ul style="list-style-type: none"> ▪ May delegate management and investment to external agent as is prudent. Prudence required in selection of agent, establishing terms of delegation and reviewing compliance <ul style="list-style-type: none"> ▪ In performing delegated functions, agent owes duty to exercise reasonable care to comply with scope and terms of delegation ▪ A trustee that meets its prudence obligations is not liable for the decisions or acts of an agent ▪ By accepting delegation, agent submits to jurisdiction of courts in Commonwealth 	No provision.

* Some provisions here are direct quotes, and some are paraphrases.

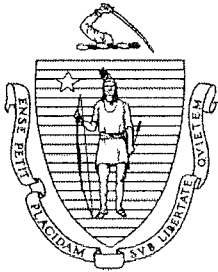
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	<u>Mass. UPMIFA*</u>	<u>Prudent Investor Act Chapter 203C*</u>	<u>Private Foundation Rules Tax Code §§4941, 4942, 4943 and 4944**</u>
13. Release or modification of restrictions	<ul style="list-style-type: none"> ▪ If a donor consents, institution may release or modify in whole or in part a restriction on the management, investment, duration or purpose of a fund ▪ Court may modify restriction on management, investment or duration of a fund if restriction: <ul style="list-style-type: none"> ▪ has become impracticable or wasteful; or ▪ impairs management or investment of fund; or ▪ if because of circumstances not anticipated by donor, modification will further purposes of fund ▪ Attorney General must be a party ▪ If a particular charitable purpose or restriction in a gift instrument becomes: <ul style="list-style-type: none"> ▪ unlawful, ▪ impracticable, ▪ impossible to achieve, or ▪ wasteful, ▪ court may modify purpose or restriction. Attorney General must be a party ▪ Supreme Judicial Court may authorize Attorney General to approve modifications below a specified dollar amount or in other situations 	No provision.	No provision.

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RE: AGO Position on FASB Statement of Financial Accounting Standards No. 117-1,
Paragraph 8, and Related M.G.L. ch. 180A Issues

Issued April 2011

FASB Staff Position No. FAS 117-1 ("FSP FAS 117-1")

Paragraph 8 provides as follows:

For each donor-restricted endowment fund for which the restriction described in subsection 4(a) [subsection 3(a) in Massachusetts] of UPMIFA is applicable, a not-for-profit organization shall 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 by the organization.

To view the entire statement (available on the FASB website):
<http://www.fasb.org/pdf/fas117.pdf>

The AGO's Position

Pursuant to the Attorney General's responsibility under M.G.L. c. 12, s. 8, to enforce the due application of charitable funds, set forth below is the Attorney General's position on the proper treatment under Massachusetts law of donor-restricted endowment funds in financial statements prepared in accordance with No. FAS 117-1, and on related issues under the Uniform Prudent Management of Institutional Funds Act, adopted in Massachusetts as M.G.L. c. 180A ("UPMIFA").

The Office of the Attorney General has been requested to provide guidance to Massachusetts charities with respect to certain issues arising under UPMIFA and No. FAS 117-1.

Accounting requirements as to classification of funds for financial statement purposes and legal requirements under UPMIFA in some cases overlap and in some cases are distinct from each other. It is the current position of the Attorney General:

- That, in the absence of explicit donor stipulations contained in the gift instrument which state otherwise, the assets in a donor-restricted endowment are to be treated by an institution as restricted under the terms of UPMIFA, and hence unavailable for expenditure, until appropriated for expenditure by the institution.

- That, consistent with No. FAS 117-1, Paragraph 8, an institution shall in its financial statements classify the portion of a donor-restricted endowment fund that is not classified as permanently restricted net assets as temporarily restricted net assets until appropriated for expenditure by the institution.
- That, as of the date of the enactment of UPMIFA, there is no presumption that an appropriation for expenditure by an institution of an amount that is greater than 7% of the assets of a donor-restricted endowment fund in any given year is imprudent.
- That while under No. FAS 117-1 all or some portion of a donor-restricted endowment fund must be classified as permanently restricted for financial-statement purposes, UPMIFA nonetheless permits an organization to draw from an endowment fund even if that drawing would bring the fund below the dollar amount treated as permanently restricted for accounting purposes, provided, that, the fund is maintained as a permanent fund over time.
- That the term “appropriated for expenditure” should be considered from both an accounting, and a legal, perspective. No. FAS 117-1 Paragraph 9 provides that:

... appropriation for expenditure is deemed to occur upon approval for expenditure, unless approval is for a future period, in which case appropriation is deemed to occur when that period is reached. 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 the fund is also subject to a purpose restriction, the reclassification of the appropriated amount to unrestricted net assets would not occur until that purpose restriction also has been met, in accordance with the provisions of paragraph 17 of Statement 16.

If an organization takes action to appropriate funds for a future period, it is the position of this Office that regardless of delayed reclassification for purposes of financial-statement presentation, the fiduciary-duty standards of UPMIFA are to be applied when the board takes action. That would occur, for example, when a board approves a budget, even though expenditure, and hence reclassification for financial-statement purposes, will not occur until a future period. A board’s actions should be evaluated for fiduciary-duty purposes in light of considerations before the board at the time of action. If a board authorizes the use of funds for a future period and subsequently finds that as that period arrives, circumstances bearing on the board’s original decision have changed significantly, then as a matter of ongoing fiduciary duty, the board should consider whether its original judgment should be modified.

Please note that this position is effective with respect to M.G.L. c. 180A as the statute currently applies to institutional funds.