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## Board Talking Points: Tapping Cash Reserves

As organizations struggle to fill funding gaps they will be tempted to tap cash reserves to meet ongoing expenses. As long as those funds are unrestricted, it is within the discretion of the board to decide how to spend the corporation's cash reserves. When, however, a donor has given a restricted gift, the organization is bound to honor that restriction. Below are some questions a board should consider when deciding whether or not to tap cash reserves to fund ongoing expenses:

1. Does the organization have any assets that are restricted?
2. Are the funds part of an endowment fund?
3. Can a portion of the endowment fund, other then principal, be withdrawn to fund ongoing expenses?
4. Can we borrow money from the endowment fund?
5. What do we have to do if the value of the endowment fund falls below historic dollar value because of investment losses?

Answers:

### 1. Does the organization have any assets that are restricted?

A restricted asset is an asset that a donor directs to be used for a specific purpose. The gift restriction can be contained in the gift instrument, e.g. a letter, or the restriction could be implied from the organization's fundraising material.

*For example, the invitation to Do Right's annual fundraiser states, "all proceeds will benefit Do Right's scholarship program." In this instance, the profit from the fundraiser would be considered an asset restricted to benefit the scholarship program and could not be diverted to support Do Right's other charitable activities. If the invitation stated, "all proceeds will support Do Right's activities, including its scholarship program" the proceeds would not be restricted.*

A not for profit corporation's board of directors cannot use a restricted donation for a purpose other then for which the gift was received without the consent of either the donor or court approval. NPCL §513(b). A court may lift the restriction when it finds the restriction to be "obsolete, inappropriate or impractical." NPCL §522(b). Restricted assets must be separately accounted for and the treasurer must make an annual report to the board regarding the use of restricted assets and any related income. NPCL §513(c). Therefore, any restricted assets should be identified in the organization's audited financial statements.

**2. Are the funds part of an endowment fund?**

Assets that are restricted are not necessarily part of an endowment fund. An endowment fund is a fund that "is not wholly expendable by the corporation on a current basis under the specific terms of all applicable gift instruments." NPCL §102(a)(13). Unless otherwise specified, donors intend their gift to the endowment fund will be invested and that any return on this investment will be available to the organization to spend on current program operations. NPCL §513(c).

Funds that the board has set aside in a "board restricted account" are not considered to be an endowment or restricted from an accounting perspective because the board has the authority to lift the restriction, as it had the authority to institute the restriction. Bjorlund et. al, New York Nonprofit Law and Practice, Lexis Nexis 2007 at 5-23.

**3. Can a portion of the endowment fund, other then principal, be withdrawn to fund ongoing expenses?**

There are circumstances under which a board can expend a portion of endowment funds to cover ongoing costs.

The value of contributions to the endowment fund in the aggregate constitutes the fund's "historic dollar value." NPCL §102(a)(16). The board has discretion to invest the endowment fund and then to spend any increases in value or "net appreciation" in good faith, and in support of the organization's programs. NPCL §§513(c) and 717(a). When deciding whether to spend any net appreciation, the board should consider the "long and short term needs of the corporation in carrying out its purposes, its present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions." NPCL §717(a). To calculate the net appreciation of an endowment fund available for expenditure you must: (i) determine the fair market value of the assets in the fund; (ii) subtract the historic dollar value of the fund; and (iii) subtract the unrealized appreciation of those assets that are not readily marketable. Decisions of the board to withdraw funds must be thoroughly documented in the minutes of the board's meetings. Office of the Attorney General, Charities Bureau, Advice for Not-for-Profit Corporations on the Appropriation of Endowment Fund Appreciation at page 2, (hereinafter "AG Advice") http://www.oag.state.ny.us/bureaus/charities/guides_advice.html.

*For example, Do Right raised $500,000 from donors to create an endowment fund. Do Right's board of directors placed $400,000 in a money market account that according to the last monthly statement is now worth $450,000, and the board invested $100,000 (with the donors consent) in a limited liability company which is opening a local restaurant as part of a community revitalization project. Based on information contained in the limited liability company's tax return Do Right estimates that its interest in the restaurant is now worth $125,000 but it cannot identify a purchaser for that interest. $50,000 is currently available to Do Right's board to expend.*

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| *Fair Market Value:* | *$575,000* |
| *Historic Dollar Value:* | *$500,000* |
| *Unrealized Appreciation of assets not marketable:* | *$ 25,000* |
| *Funds available:* | *$50,000* |

4. **Can we borrow money from the endowment fund?**

A board could decide that it is prudent to borrow money from its endowment fund that will be repaid over time when the value of the fund is above its historic dollar value. NPCL §717(a). If, however, an invasion of the endowment fund would cause its value to fall below its historic dollar value that could be considered a breach of the directors and officers duty of care. Id.

5. **What do we have to do if the value of the endowment fund falls below historic dollar value because of investment losses?**

The New York State Attorney General's office has concluded that a board cannot withdraw net appreciation from an endowment fund when that fund is at or below historic dollar value. AG Advice at 2. Should the value of an endowment fund fall below historic dollar value a board may "prudently" decide not to spend any income from the fund regains its historic dollar value. Id. at 1. The Attorney General's office also encourages organizations to inflation adjust the historic dollar value of the endowment fund.