



Board Talking Points: Tapping Cash Reserves (Updated)

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 Can a portion of the endowment fund, other than principal, be withdrawn to fund ongoing expenses?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 than 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) & 555(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). For gifts made prior to September 17, 2010, 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). For gifts made after September 17, 2010, expenditures from endowment funds are governed by a standard of "prudence" explained below.

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 be withdrawn to fund ongoing expenses?

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

Effective September 17, 2010, New York enacted the New York Prudent Management of Institutional Funds Act (NYPMIFA) relating to the investment of funds and the expenditure of endowment funds. Under NYPMIFA, subject to donor intent, an organization can expended endowment funds if the board determines in good faith that the expenditure is prudent and consistent with the purpose for which the endowment fund was created. In making this determination, the Board should consider eight (8) factors:

1. Duration and preservation of the endowment fund;
2. The purposes of the institution and endowment fund;
3. General economic conditions;
4. The possible effect of inflation or deflation;
5. The expected total return from income and the appreciation of investments;
6. Other resources of the institution;
7. Where appropriate and circumstances would otherwise warrant, alternatives to expenditure of the endowment fund, giving due consideration to the effect such alternatives may have on the institution; and
8. The investment policy of the institution.

NPCL §553(a). Every time a board authorizes expenditure from an endowment fund it needs to make a record (such as including the discussion in board minutes) describing the consideration given to each factor. Id.

For gifts made after September 17, 2010, an expenditure of more than seven (7) percent of the fair market value of the endowment fund within one (1) year will be presumed to be unwise or imprudent. This is called the rebuttable presumption of imprudence. Fair market value of the endowment fund is “calculated on the basis of market value determined at least quarterly and averaged over a period of at least five years immediately preceding the year in which the appropriation for expenditure is made.” NPCL §533(d). An expenditure of less than seven (7) percent within one year will not automatically be considered wise or prudent. § NPCL 533(d)(2).

If a nonprofit organization wants to apply the NYPMIFA expenditure rules to endowment funds received prior to September 17, 2010, it must provide donors with ninety (90) days written notice to the donor, if available, prior to withdrawing money from the endowment fund for the first time under the new standards. §NPCL 553(e)(1). The donor has the option of requiring the organization to apply the prior law to their gift rather than NYPMIFA. A donor is available if the donor is: (i) a natural person and is living; or (ii) if not a natural person (e.g. a corporation or foundation) is in existence and conducting activities; and (iii) can be identified and located with reasonable efforts. NPCL §551(j).

The notice must include a form to be used by the donor and must contain the following language:

Attention Donor:

Please check Box #1 or #2 below and return to the address shown above.

- ☐ #1 The institution may spend as much of my gift as may be prudent.
- ☐ #2 The institution may not spend below the original dollar value of my gift.

If you check Box #1 above, the institution may spend as much of your endowment gift (including all or part of the original value of your gift) as may be prudent under the criteria set forth in Article 5-A of the Not-for-Profit Corporation Law (the Prudent Management of Funds Act).

If you check Box #2 above, the institution may not spend below the original dollar value of your endowment gift but may spend the income and appreciation over the original dollar value if it is prudent to do so. The criteria for expenditure of endowment funds set forth in Article 5-A of the Not-for-Profit Corporation Law (the Prudent Management of Funds Act) will not apply to your gift.

NPCL §553(e)(1).

There are limited circumstances under which it is not necessary to give a donor notice prior to applying NYPMIFA. NPCL §553(e)(2).

4. Can we borrow money from the endowment fund?

NYPMIFA does not directly address the question of whether or not funds can be borrowed from an endowment fund as opposed to being spent from an endowment fund. However,

borrowing funds could be considered an “appropriation” of the endowment fund and, therefore, the Board of Directors should follow the same steps as it would when approving an expenditure of endowment funds. NPCL §553(a).

If an endowment fund’s operation is governed by the prior law, 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?

NYPIMFA eliminates the need to be concerned about historic dollar value and instead places focus on whether an expenditure of endowment funds is “prudent”.

If, however, the endowment fund continues to be governed by the prior law, 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. *A GUIDE FOR NEW YORK NOT-FOR-PROFIT CORPORATIONS CONSIDERING EXPENDITURE OF ENDOWMENT OR OTHER RESTRICTED FUNDS*, www.charitiesnys.com 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.

For more information please contact Linda Manley, Legal Director, at (212) 219-1800 ext. 239, lmanley@lawyersalliance.org.