

When Funding Comes with Strings Attached: Navigating Grant and Donor Restrictions

Genevra M. Williams, Mendrygal Law, PLLC

Overview

- UPMIFA Overview, Definitions
- Gift Instruments
- UPMIFA Investment, Management and Spending Considerations
- Donor Intent
- Review of Gift Restrictions
- Regulatory Framework; Structural Considerations; Related Issues

UPMIFA - Generally

- Misconceptions around what “UPMIFA” is
- Misconceptions regarding what UPMIFA does and who it applies to
- Intersection of competing issues and regulatory environments in the restricted gift space
- Confusing verbiage as between lawyers and accountants regarding restrictions

Common Myth: “Accountants and lawyers speak the same language”

- Restrictions for legal purposes vs. accounting purposes
- Significant area of confusion
- What do lawyers mean?
- What do accountants mean?
- How do you approach the disconnect?

UPMIFA - Overview of Terms

- UPMIFA – Uniform Prudent Management of Institutional Funds Act
 - As adopted in your particular state
- Superseded Rules:
 - UMIFA - Uniform Management of Institutional Funds Act, as adopted in your particular state

Donor Intent – Interaction with UPMIFA

- A primary focus of UPMIFA and all state-adopted versions is protecting donor intent and laying out the rules related to it
- Donor intent trumps:
 - “Subject to the intent of a donor, . . .”
 - “Unless stated otherwise in the gift instrument ...”
- Specific exceptions to this general rule where UPMIFA provides flexibility:
 - i.e., terms designating a gift as “endowment”; use only “income,” interest,” or “dividends” or “rents, issues, or profits”; or “preserve the principal intact”
 - i.e., release and modification provisions

Gift Instruments – UPMIFA

- Donor gift document in whatever form available
- Expansive definition
- Can include:
 - Electronic writing
 - Will, deed, grant, or conveyance
 - Agreement or memorandum
 - Articles/Certificate or Bylaws (where gift is made for general purposes)
 - Minutes of meetings
 - Canceled checks
 - Institutional solicitation (where gift is made in response)

Gift Instrument, cont.

- For this purpose, a “record” means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form So, anything in hard copy or electronic format.
- Opportunity for increased education among the gift planning community as to the impact of their documents and the importance of document retention.
 - Full picture of donor intent
 - Institutional memory and its impact on accounting and financial statements

But, ..

- State Attorney General or Charities Bureaus' perspective can vary here
- As a practical matter, they often enforce donor intent and restrictions

UPMIFA – General Approach

- UPMIFA takes a two-tier approach – its provisions apply to “Institutional Funds” (the duties and factors related to management and investment) and a portion (the expenditure/appropriation/spending rules) only apply to “Endowment Funds”
- So, whether (and how) UPMIFA applies to you depends on **whether you have an institutional fund or endowment fund**
- UPMIFA potentially applies to all charitable entities regardless of form (e.g., non-profit corporations, non-profit associations, limited liability companies, trusts)

UPMIFA Definition – Institutional Fund

- “Institutional fund” – a fund held by an institution exclusively for charitable purposes
- “Institution” – Includes:
 - A person (other than an individual) organized and operated exclusively for charitable purposes
 - A government or governmental subdivision, agency, or instrumentality, to the extent it holds funds exclusively for charitable purposes
 - A trust that had both charitable and non-charitable interests, after all non-charitable interests have expired

What is Not an Institutional Fund?

Excludes:

- Program-related asset – an asset held by an institution primarily to accomplish a charitable purpose and not primarily for investment.
- A fund held for an institution by a trustee who is not an institution (e.g., an individual or commercial corporate trustee).
 - But note limitation here
- A fund in which a non-institution (non-charitable) beneficiary has an interest

Examples

- Nearly all funds held by a charity will be “institutional funds”
- Examples:
 - Operating bank account
 - An endowment held within your charity for a specific purpose, such as scholarships
 - Development fund to pay for a new building
- Not institutional funds:
 - A fund held by an individual to benefit a local charity
 - A fund held by a for-profit company, even if it is for charitable purposes (i.e., Company X raises funds from its employees to benefit the March of Dimes)

UPMIFA Definition – Endowment Fund

- Under UPMIFA, an institutional fund (or any part) that, **under the terms of a gift instrument, is not wholly expendable by the institution on a current basis.**
 - So .. there is a legal restriction on the timing of the expenditure
- Does not include board-designated aka quasi-endowments since there is no gift instrument.
- Significant difference between the legal definition of an “endowment fund” under UPMIFA and the accounting definition, which is generally broader (a fund to provide income for the maintenance of a nonprofit).

Pop Quiz: Are You Still With Us?

1. Riveted – UPMIFA is my new beach read
2. Second monitor, first priority... mostly
3. Eating lunch, but listening with my whole heart
4. Wait, there's a video?

UPMIFA Protections and Duties

- Delegation of Management & Investment Functions
- Duty of Loyalty
- Duty of Care
- Duty to Diversity
- Duty to Manage Costs and Verify Facts

UPMIFA Factors – Managing and Investing

- General economic condition
- 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 need of the institution and of the fund to make distributions and preserve capital
- An asset's special relationship or special value, if any, to the charitable purposes of the institution

Endowment Spending Rules

- UPMIFA eliminated the historic dollar value or “HDV” spending floor, but it is not that simple.
- May appropriate so much of an endowment fund as **deem prudent for uses, benefits, purposes, and duration for which the fund is established.**
 - “Subject to the intent of a donor expressed in a gift instrument...”
 - Broad flexibility
 - One of the more valuable provisions in UPMIFA

Endowment Spending Rules, cont.

- However,..
 - Specific expenditure rules/standards (donor intent) in gift instrument control.
 - Spending is also subject to organization's spending policy, as amended from time to time.
- Note:
 - To limit the UPMIFA appropriation authority, a gift instrument must specifically state the limitation
 - Not enough – terms designating a gift as “endowment”; use only “income,” interest,” or “dividends” or “rents, issues, or profits”; or “preserve the principal intact” or words of similar import
 - Again, an education opportunity for development staff and advisors

Endowment Spending Rules – Appropriation

- Assets in an endowment fund are donor-restricted until appropriated for expenditure by the institution
- In making the determination to appropriate, an institution shall:
 - Act in good faith
 - Act with the care that an ordinarily prudent person in a like position would exercise under similar circumstances
 - Consider the listed factors

Endowment Appropriation Factors“We know how to record Board and committee minutes...”

Seven criteria/factors to guide Board regarding endowment spending:

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

“As long as we don’t spend below HDV, we are compliant...”

- UPMIFA eliminated the bright-line test (or “HDV”) in favor of multi-faceted prudence standards.
 - No longer can a Board spend any amount so long as it doesn’t affect HDV.
 - Allows spending from an underwater endowment (FMV < amount restricted by the donor) if the board determines it is prudent.
- Then, what is required to be maintained?

“If we don’t spend more than the percentages, no one will come knocking...”

- Common misconception that this is a safe harbor.
- Applies to expenditures from endowment funds, but not institutional funds
- **Imprudence is presumed** if endowment fund spending exceeds certain thresholds:
 - Funds > \$1MM – presumption at 7% FMV
 - University systems > \$450MM – 9% FMV
 - Funds < \$1MM – presumption at 5% FMV
- FMV determined quarterly and averaged over a 3-year period (or if in existence less than 3 years, for the period since inception).

Presumption of Imprudence

- Presumption is rebuttable if facts and circumstances dictate that an endowment fund expenditure was prudent.
- For example, a fund for a major construction project may have no expenditures for 3 years and then spend 20% in year 4.
- Charity has the burden to prove that the expenditure was prudent.

Spending Policies

- Myriad terms for endowments, including:
 - Income only
 - Calculated spending rate
 - Tiered spending rates
 - Board discretion
 - Spread the spending rate calculation over a multi-year period
 - Flexibility to invade within limitations
 - Emergency invasion provisions
- Periodic review

Modification & Release – UPMIFA

- Permits release or modification of restrictions by donor, charity, or court in specific instances
- Small/Old Funds – if restriction is unlawful, impracticable, impossible to achieve, or wasteful, an institution may release or modify a restriction without donor consent or court approval if all of these conditions are met:
 - Institutional fund < \$25,000
 - Institutional fund is more than 20 years old
 - Will be used consistent with charitable purposes
 - Requires Attorney General notice
- Example – \$15,000 fund set up in 1973 for the cure of polio – with AG notice, can release restriction and use for a purpose consistent with original purpose (i.e., maybe for the cure of other children's diseases)

Modification of Restrictions – Outside of UPMIFA

- What if the UPMIFA modification provisions don't apply?
- Does the gift agreement address?
- Can donor consent?
- Court Action
- Attorney General Approval

Donor Intent/Restrictions, Generally

- Contributions are inherently restricted by the purposes of the organization (organizational documents on the date of contribution)
 - Contributions are impressed with a charitable trust for the benefit of the public.
- Interpretation rules:
 - From the four corners of the instrument
 - Not what the grantor/donor “intended” to write, but the meaning of the words used. When there is no dispute about the meaning of words, no extrinsic evidence.
 - Recall the varying perspective of Attorney Generals and State Charities Bureaus in this regard

Donor Intent/Restrictions – Tracking Issues

- Tracking, Generally
 - Internally track proper management of restricted or conditioned gifts
 - Record-keeping / Documentation
 - Software, General Ledger, Excel or similar
- Tracing assets / Commingling assets
- Assets purchased with proceeds
- Improvements
- Lack of Record-Keeping/Bad Records

Checkpoint: Still Awake?

1. Wide awake – I now say “historic dollar value” at parties
2. I’ve refilled my coffee at least twice
3. I checked my email “just once” (four times)
4. I’m here for the CLE credit... and these polls

Donor Intent – Related/Ancillary Issues

- Donor relations
- “Court of Public Opinion”
- Media/Public relations
- Sophisticated donors asking for more
- Charities and development staff becoming more creative
- Legal implications

What can go wrong?

- Reputational risk
- Donor relations
- Change in culture or values over time
- Change in circumstances
- Conflicts of Interest
- Donor actions/reputation
- Donor default on payment
- Restrictions or requirements the charity cannot handle
- Lack of clarity around provisions
- State regulatory enforcement
- Private donor enforcement (or attempts)
- Charitable pledges

Related Issues

- Donor privacy issues
 - Policy
 - Form 990, Schedule B
 - Employees
- Donor expectations

Gift Agreement Provisions

- No “one size fits all”
- Key is to accurately reflect the intent of both parties, and provide necessary flexibility for the future
- Issues to address:
 - General endowment restrictions/interaction
 - Protection of the charity
 - Flexibility in naming rights (e.g., bad actors or PR issues)
 - Expiration or lapse of naming rights
 - Flexibility if donor defaults on a pledge
 - Force majeure
 - Board variance power
 - Permissibility of desired restrictions
 - Donor or family member/related organization standing
 - Confidentiality / Donor privacy issues
 - Consider resolution mechanisms/alternate methods to resolve, including negotiation with living donors, specific provisions allowing for certain changes if certain conditions met, approval of descendants or relatives or committee

Gift Acceptance Policy

- Process oriented
- Who can accept?
- Who can act timely?
- Who approves and has signature authority?
- Gift acceptance committee or authorized individuals
- To what extent will organization vary from its norm of permissible restrictions (e.g., use, additional reporting, investment parameters, holding requirements, etc.)
 - Often see this in an Endowment Policy as well

Regulatory and Legal Framework – Gift Acceptance

- Federal/IRS
 - Completed gift
 - Charitable deduction
 - Quid pro quo rules
 - Conditional “get it back” restrictions
 - Impact on 501(c)(3) status
 - Private benefit
 - Private foundation rules (i.e., self-dealing)

Regulatory/Legal Framework – Gift Acceptance

- State
 - Donor intent
 - UPMIFA
 - Attorney General/Charities Bureau, Generally
 - Specific Role of Attorney General with Respect to Court Release or Modification
 - Other issues
 - Private litigation

Legal Status of Gift/Funds – Initial Questions

- How is the gift held?
 - A fund within the institution
 - Separate entity with 501(c)(3) status
 - Nonprofit corporation or trust
 - State of incorporation
 - Governing documents?
 - Fund with Local Community Foundation
 - Funds held by other institutions
 - Supporting organizations

Legal Status of Gift/Funds – Initial Questions

- How is it managed
 - Board of Directors? Investment/Financial or Endowment Committee?
 - Are there individuals with competing fiduciary duties?
 - Consider conflicts of interest where a donor also holds a significant position with the organization or endowment
- Purposes
 - What are the purposes of the organization?
 - What are the purposes of the restricted gift or endowment?
- Investment, spending, and related policies
- Control or impact/oversight/other rights of the operating charity

Other Restricted Gift Issues

- Over- or under-funding of restricted assets (including, but not limited to an endowment) compared to unrestricted funds
- Borrowing from restricted funds or an endowment
- Underlying “sub-funds” held within the endowment fund
 - Documentation?
- Involvement of legal department in development processes
- Policy-making should involve legal, finance/tax, marketing, and development/gift planning

Education/Training Issues – Staff

- Acceptance – when and how, pursuant to any policy(ies)
 - Applicable approval thresholds
- Importance of record-keeping
- Documenting conversations regarding intent, restrictions, and conditions
- Guidelines for communications with donors
- Checklists for potential issues
- Consider print and online solicitations also
- Periodic review and revisit existing restrictions
- Internal tracking of spending/investments

Endowment Structure – Options

- Internal Fund
- Separate 501(c)(3)
 - “Stand-alone” public charity
 - Public support test
 - Private foundation
 - Supporting organization
 - Types I, II and III
- Fiscal Sponsorship or Fund with Local Community Foundation
- Charitable Trust vs. Nonprofit Corporation
- Supporting organizations for 501(c)(4) and 501(c)(6)

Legal and Governance Implications – Endowment Structure

- Donor comfort/request
 - Prevent Board oversight
 - Limit to specific project or area of operations
 - Prevent use for general operations
 - Creditor protection
- Credit Protection (Charity, Take II)
- Operational
- Tax consequences
- Compliance burden
- Other implications of structure
- Related considerations
 - Control by operating nonprofit
 - Related, impact of conflicting fiduciary duties on overlapping directors
 - Enforcement of restrictions

Questions?

Genevra M. Williams
Mendrygal Law PLLC
genevra@mendrygallaw.com