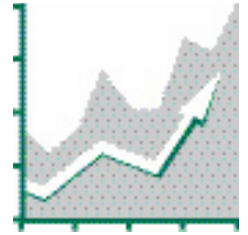


# Financial Adviser



## Why Nonprofit Organizations Need to Closely Monitor Endowment Income Distributions Under State Law

Recently issued guidance from the Financial Accounting Standards Board (FASB) is requiring many nonprofit organizations to take a closer look at the operations, accounting and financial statement disclosures related to their endowments.

FASB is a private, not-for-profit body created to protect the public's interest by developing generally accepted accounting principles. The guidance officially is called FASB Staff Position (FSP) 117-1 – and is entitled “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.”

One of the matters nonprofits need to address and consider is state law as it applies to endowment funds (this is also a required financial statement disclosure under FSP 117-1). Pennsylvania is one of three states that have not enacted a version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA). Pennsylvania Act 141 governs Pennsylvania law regarding nonprofit endowments.

PA Act 141 applies to investments/property held in trust (or donor restriction) as a restricted endowment only the “income” of which may be expended currently.

Nonprofit boards may elect to be governed under the Act, unless the gift/endowment is governed under a trust instrument or a donor restriction that is contrary to the Act. The law entails adopting and following a total return investment policy, and adopting a spending

policy. The election must be in writing, must specifically recite the subsection, and must be maintained with the organization's permanent records. The election is typically made as a motion and documented in the organization's Board minutes. The election is not filed with any department of the Commonwealth.

If the election is made, “income” is defined as a percentage of the value of the endowment assets. The Board must annually select in writing a percentage (from 2 percent to 7 percent) each year as income, determined to be “consistent with the long-term preservation of the real value” of the fund. The percentage selection must be maintained with the organization's permanent records; again, this is typically done by a motion passed by the Board and documented in the Board minutes. The value of the endowment assets is its fair market value determined at least annually and computed as the fair market value averaged over a period of three or more preceding years (or the entire holding period if less than three years).

If an election is not appropriately made under the Act, then “income” is defined under prior Pennsylvania law as interest, dividends, rents and royalties; that is, realized and unrealized gains are not income available for distribution. Realized and unrealized gains are added to the corpus or principal of the endowment fund. Additionally, under prior state law, the Board could allocate net realized gains to income as long as the total income

distribution was not in excess of 9 percent of the remaining value of the endowment fund (any excess would be added to principal). However, this “9-percent rule” was repealed by Act 141, so income available for distribution is simply interest, dividends, rents and royalties if a valid act election is not made.

The problem with not making the election under the Act requires organizations to develop investment policies that maximized interest and dividends in order to generate the most distributable income each year. This may not be the best investment policy to have long-term growth of the endowment funds.

All organizations should evaluate current Pennsylvania law as it relates to their endowment funds and determine what is in the best interest of the organization both in the short and long term.

*To learn more about the Act, please attend our upcoming Act 141 seminar on Tuesday, January 26. Information is available on [www.malinbergquist.com/act141](http://www.malinbergquist.com/act141).*

*Vincent F. Halupczynski, CPA heads the Not-for-Profit/Tax-Exempt Organizations Group of Malin Bergquist, Erie's fastest growing public accounting firm. Contact him at [vhalupczynski@malinbergquist.com](mailto:vhalupczynski@malinbergquist.com) or 814/454-4008.*

