Ask the experts

Can You Tap Your Endowment During a Downturn?

What rules govern using endowment money during a crisis?

Q: Would you please address the use of endowments in times of crisis? I thought endowments were created specifically to provide organizations a ready source of funds when they find themselves in situations such as the current economic downturn. However, I'm hearing mixed messages—that organizations can tap the endowment for this purpose, that they can't, and that they can only tap it under certain circumstances. What's the real story?

A: First, it's important to distinguish between reserves and an endowment. Reserves are designed specifically to deal with the unexpected. Typically, organizations keep enough funds in a reserve to cover between six and nine—sometimes 12—months of operations, making this the first place to turn during a down economy.

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An endowment, on the other hand, is designed to generate new monies for an organization through the wise investment of contributions. The principal is preserved, and the interest is used—or left to grow—as determined by the conditions of the gift. (See "Clarifying Endowments" at www.CoreStrategies4Nonprofits.com for additional information.)

You mentioned that you've been getting mixed messages about the use of your endowment. This is probably because a number of factors govern the expenditure of endowment funds. The first is the original contract with the donor. Obviously, if gifts to the endowment were restricted, you can use them only for the purposes set out by the donor and accepted by your organization. If the gift was given without strings, you might be able to use money in your endowment to cover a shortfall, but that depends.

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It depends, among other things, on the current value of your endowment and the state in which your organization is incorporated. Traditionally, nonprofits were never allowed to access their endowments if the value of those endowments fell below their historic, or original, market value as a result of the vagaries of the financial markets. This was true even if a reasonable portion of those funds were legally committed to programs or projects in healthier economic times.

While about 40% of the states still prohibit the use of such depreciated funds, most states have reversed course and adopted the new Uniform Prudent Management of Institutional Funds Act (UPMIFA). (To see if your state has passed this act, go to www.upmifa.org.) This act was created specifically to ease the burden of an economic downturn. It lets people dip into a fund—even if it has fallen below its historic dollar value—as long as they're prudent in their spending and make preservation of the endowment's assets their top investment priority. As Richard Slutzky, First Vice President and Senior Philanthropic Consultant with the Merrill Lynch Center for Philanthropy and Nonprofit Management, reminds us, however, even charities in states that have adopted UPMIFA should have their CPA and/or attorney review the application of FASB 117 that prohibits the invasion of "permanently restricted funds" to see how it might apply to them.

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Of course, an organization's own investment policies must allow dipping into a depressed fund. And the board must understand the potential long-term impact of reducing the endowment before voting to approve such a measure. This potential impact includes the very real possibility that fewer people will be willing to commit in the future to an endowment that can be raided, as well as the grave possibility that the organization can become insolvent ■

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