



# **SPENDING AND MANAGEMENT OF ENDOWMENTS UNDER UPMIFA**

**Findings of a 2010 Survey of Colleges, Universities, and Institutionally Related Foundations Conducted by AGB in partnership with Commonfund Institute**



**AGB** ASSOCIATION OF  
GOVERNING BOARDS  
OF UNIVERSITIES AND COLLEGES

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## Acknowledgments

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## I N S T I T U T E

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*Spending and Management of Endowments under UPMIFA: Findings of a 2010 Survey of Colleges, Universities, and Institutionally Related Foundations Conducted by AGB in partnership with Commonfund Institute.*

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## Spending and Management of Endowments under UPMIFA

Over the past two years, adoption of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) has fundamentally changed the regulatory context in which boards make decisions regarding spending from underwater endowments. This survey of 207 colleges, universities, and affiliated foundations provides the only national data on the ways higher education boards are managing spending under the new law and provides college and university boards and executives with important insights into the ways spending and governance practices are evolving.

The value of higher education endowments declined by approximately 19 percent on average between June 2008 and June 2009 and may have rebounded by 20 percent between June 2009 and 2010. On average, the value of higher education endowments is, however, still below their value two years ago, and the purchasing power of many higher education endowments is significantly eroded from June 2008 levels. This survey demonstrates that UPMIFA has enabled institutions to provide ongoing support for endowed purposes during a period of unprecedented financial hardship. It also suggests that UPMIFA has encouraged governing boards of colleges, universities, and affiliated foundations to devote increased attention to endowment spending and develop increasingly sophisticated and supple decision-making practices.

The Uniform Law Commission promulgated the Uniform Prudent Management of Institutional Funds Act (UPMIFA) in August 2006 after four years of drafting and study. UPMIFA represents a substantial modernization of the law of nonprofit endowment investment governance, which had remained largely unchanged since the 1972 Uniform Management of Institutional Funds Act (UMIFA). UPMIFA has been enacted in 46 states, the District of Columbia, and the U.S. Virgin Islands, and introduced in New York and Mississippi; Florida and Pennsylvania are the only states in which UPMIFA has not been introduced or enacted. Perhaps the main change made by UPMIFA is the elimination of the concept of “historic dollar value” or HDV as the default amount of an endowment fund that must be preserved in perpetuity in the absence of specific donor stipulations as to spending or accumulation. UPMIFA replaces this rule with a more carefully articulated standard of prudence and enumerates seven factors boards should take into account when making spending decisions. This has provided boards with greater flexibility to distribute funds from “underwater” endowments (accounts that have fallen below HDV) but has also forced them to develop new processes for making decisions regarding spending and accumulation. Although UPMIFA does not specify an amount that must be set aside as principal, it emphasizes the perpetuation of the purchasing power of the fund, and new accounting standards (addressed herein) require boards to define amounts of funds to be classified as permanently restricted.

The Association of Governing Boards of Universities and Colleges (AGB), Commonfund Institute, and the National Association of College and University Business Officers (NACUBO) have worked closely with the Uniform Law Commission throughout the drafting of UPMIFA and jointly funded educational materials to help inform lawmakers and charities about the new statute. This survey, conducted in partnership with Commonfund Institute and building on similar research conducted by AGB in 2009, documents significant changes in spending practices following enactment of UPMIFA as well as changes in the way boards have adapted to the new law since AGB’s 2009 survey on the same subject. It is hoped that findings and related governance recommendations in this report will help boards address the challenge of balancing the need for current spending with their obligation to rebuild and sustain the purchasing power of their endowments in coming years.

## Key Findings

On average, underwater funds accounted for 22.4 percent of the total value of endowment funds held by colleges and universities at the end of the 2009 fiscal year ending June 30, 2009 (NCSE data).<sup>1</sup>

Under UPMIFA, institutions and affiliated foundations have adopted new spending practices yielding greater ongoing distributions from underwater endowments as well as adopting a variety of more flexible methods for determining distributions from underwater endowments. AGB's survey findings include (as seen in Table 4):

- 46.9 percent are continuing distributions in keeping with their normal spending rule, an increase of 8.7 percentage points over practice prior to the enactment of UPMIFA;
- 25.1 percent are discontinuing all distributions from underwater funds, a decrease of 16.4 percentage points from practice prior to UPMIFA;
- 9.7 percent are distributing only interest and dividends, a decrease of 7.2 percentage points from practice prior to UPMIFA;
- 12.5 percent employ a threshold or tiered approach to spending or some other flexible methodology; and
- 6.8 percent of institutions described a flexible process for determining distributions from underwater funds that was used in lieu of or in conjunction with the spending practices listed above.

After the enactment of UPMIFA, 47.1 percent of institutions and foundations which previously discontinued all distributions or distributed only interest and dividends from underwater endowments adopted a new spending approach likely to yield greater ongoing distributions supporting endowment purposes.

College, university, and affiliated foundation boards are actively involved in making decisions about spending from underwater funds. Survey findings include:

- 75.8 percent of boards approve decisions regarding spending from underwater funds;
- 68.2 percent of institutions have some formal policy addressing spending from underwater funds; and
- 48.3 percent of boards document decisions regarding underwater funds in their minutes.

Only 14.5 percent of institutions and foundations have made use of provisions in UPMIFA allowing charities to modify restrictions on smaller and older funds that have become impracticable or wasteful.

Institutions and foundations have also made changes to endowment-management practices not immediately related to spending from underwater funds but in keeping with UPMIFA's updated prudence standard for investment and management of charitable funds. Nearly one-third (28.5 percent) of institutions have changed their approach to portfolio construction to focus on factors such as risk reduction, inflation protection, and liquidity; 11.6 percent have made changes in their due diligence and risk management procedures; and 19.3 percent have made changes in investment management staffing and support.

AGB's recent *Statement on Conflict of Interest* has advocated heightened conflict-of-interest standards for board members involved in investment decision making. While 97 percent of boards have some type of conflict-of-interest policy, only 60.9 percent of institutions and foundations have conflict-of-interest policies that apply to all volunteers responsible for investment decision making; 15.9 percent have policies which include especially rigorous provisions applicable to investment decision makers; and 13.5 percent have policies addressing board members' parallel or "side-by-side" investments.

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1. NACUBO-Commonfund Study of Endowments

## Survey Participants

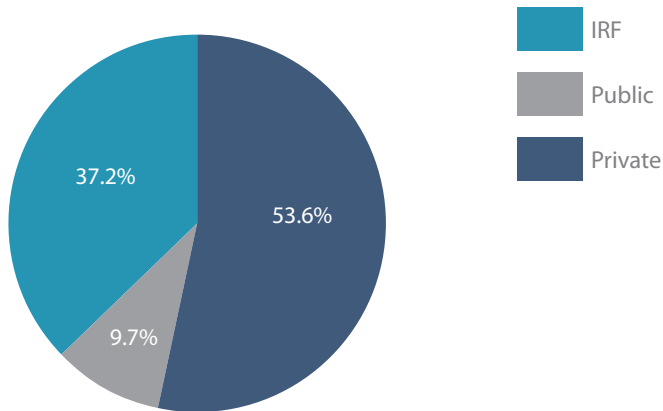
Invitations to participate in the online survey were sent to chief financial officers of public and private institutions and CEOs and finance officers of foundations affiliated with public institutions in the 46 states (and the District of Columbia) that had enacted UPMIFA as of April 8, 2010. The survey was open between April 8 and May 18, 2010. Two-hundred and seven institutions and affiliated foundations submitted usable data, including 110 private institutions, 77 institutionally related foundations, and 20 public institutions.

Unlike private grant-making foundations, the institutionally related foundations (IRFs or “affiliated foundations”) included in this survey are 501(c)(3) charities that raise and manage private resources in support of an affiliated public institution or system. Public institution endowment may be held and managed by the institution itself but is more commonly held by a separate institutionally related foundation. For reporting purposes, some public institutions combine endowment held directly by the institution along with endowment held by its affiliated foundation(s). Asset sizes used throughout this report refer to total investable assets, excluding pension fund assets and operating cash, which may include donor-restricted endowment as well as “quasi” or board-designated endowment. The spending provisions of UMIFA and UPMIFA apply only to donor-restricted endowment, but institutional endowment sizes reported in the NACUBO-Commonfund Study of Endowments (NCSE) generally refer to the larger pool of total investable assets.

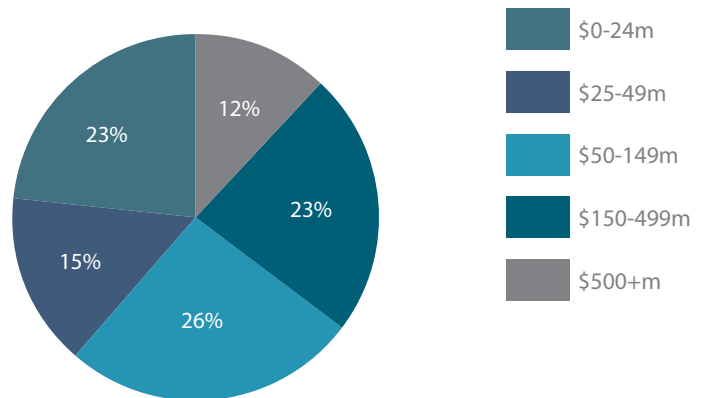
**Table 1: Endowment cohorts and institution types**

|           | Aggregate   | \$0-24 m   | \$25-49m    | \$50-149m  | \$150-499m | \$500m+  |
|-----------|-------------|------------|-------------|------------|------------|----------|
| Aggregate | 207 (100%)  | 48 (23%)   | 32 (15%)    | 54 (26%)   | 48 (23%)   | 25 (12%) |
| Private   | 110 (53.6%) | 24 (50%)   | 18 (56.25%) | 31 (57.4%) | 28 (58.3%) | 9 (36%)  |
| Public    | 20 (9.7%)   | 6 (12.5%)  | 4 (12.5%)   | 6 (11.1%)  | 4 (8.3%)   | 0 (0%)   |
| IRF       | 77 (37.2%)  | 18 (37.5%) | 10 (31.25%) | 17 (32.1%) | 16 (33.3%) | 16 (64%) |

**Chart 1: Participants by institution type**

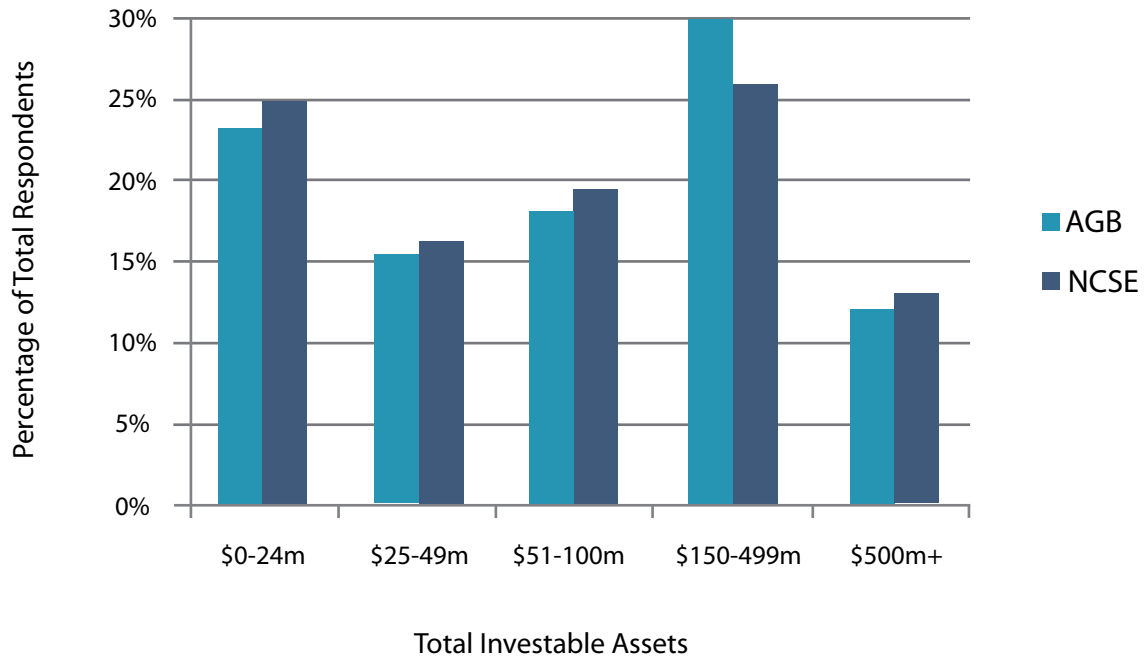


**Chart 2: Participants by endowment size**



The 207 institutions and foundations included in the current survey represent a similar distribution in terms of endowment size to the 842 institutions included in the 2009 NCSE data. The current AGB data include a higher proportion of public institutions and foundations than the NCSE sample.

**Graph 1: Comparison of current AGB sample with 2009 NCSE sample**



## Spending from Underwater Endowments

UMIFA defined historic dollar value (HDV) as the value of contributions made to an endowment fund, without increases or decreases from investment results, inflation, or other factors. “Underwater funds” refers to donor-restricted endowment accounts for which the market value has fallen below historic dollar value. According to NCSE 2009 data, underwater funds accounted for an average of 22.4 percent of the total value of true endowment funds held by colleges, universities, and affiliated foundations in fiscal year 2009. The proportion of underwater funds correlates closely to endowment size. Underwater funds accounted for 26 percent of assets at institutions with endowments of \$25 million or less and just 11.5 percent of endowments held by institutions with investable assets of \$1 billion or more. Public institutions and foundations also had higher percentages of underwater endowment (26 and 36 percent, respectively) compared with private institutions, which had 16.9 percent of endowment value underwater. This reflects the fact that many public institutions have more recently established endowment funds that have had less time to appreciate in value.

### Spending Practices Prior to the Enactment of UPMIFA

Under UMIFA, a charity could generally spend from an endowment fund any amount of the appreciation above HDV that it deemed prudent. In the absence of specific donor stipulations regarding spending or accumulation of funds, charities were, in most UMIFA states, obliged to suspend distributions from underwater accounts or limit distributions to amounts equal to interest and dividends generated by the account. In practice, most charities sought not only to preserve the original dollar value of the fund but to grow the fund and sustain its long-term purchasing power. It should be emphasized that both UMIFA and UPMIFA are default statutes which apply only to donor-restricted endowments for which no gift instrument exists or for which gift instruments do not include stipulations regarding spending or accumulation. UMIFA posed several serious challenges for institutions. Following the market decline of 2001 and 2002, many institutions systematically reviewed all their gift agreements to determine if they specified spending practices and, in some cases, contacted donors to amend agreements and/or make supplementary gifts to provide ongoing support for the endowment purpose while the fund recovered. Many institutions also tapped operating reserves and other unrestricted funds to supplement decreased distributions from underwater accounts.

Survey participants reported the following spending practices prior to the enactment of UPMIFA (Table 2):

- 41.5 percent of all institutions and foundations surveyed suspended all distributions from funds at or below HDV;
- 38.2 percent continued distributions in accordance with their normal spending rule;
- 16.9 percent distributed only interest and dividends for underwater funds; and
- 3.4 percent made distributions at some other reduced rate.

This is generally in keeping with findings of AGB’s 2009 survey and, once again, the high proportion of institutions (38.2 percent) that reported that they had “continued distributions in keeping with (their) normal spending rule” prior to the enactment of UPMIFA is surprising. In most states, UMIFA was interpreted as requiring charities to suspend distributions from donor-restricted underwater funds or distribute only interest and dividends unless the gift instrument specified some other spending approach. Comments made by some institutions reporting that they continued making distributions in keeping with their normal rate indicate that they in fact suspended distributions from underwater funds and tapped quasi-endowment or operating reserves or solicited new gifts to continue funding endowment purposes at expected levels. Others commented that gift agreements specifically allowed for spending below HDV and, although the question explicitly asked about spending from accounts without donor direction as concerns spending or accumulation, this suggests that some respondents who reported continued distributions were likely referring to distributions from funds that would not have been subject to UMIFA’s spending rule.

Public institutions and foundations, which typically have a larger proportion of recently established endowment funds, were more likely to suspend distributions than were private institutions. The likelihood that an institution would continue

to spend from underwater funds correlates directly with endowment size and may reflect the fact that underwater funds account for a significantly smaller proportion of larger, and presumably older, endowments.

**Table 2: Spending practices prior to the enactment of UPMIFA**

|   | Aggregate | \$0-24 m | \$25-49m | \$50-149m | \$150-499m | \$500m+ | Private | IRF   | Public |
|---|-----------|----------|----------|-----------|------------|---------|---------|-------|--------|
| Number  | 207       | 48       | 32       | 54        | 48         | 25      | 110     | 77    | 20     |
| Discontinued all distributions for funds at/below HDV                       | 41.5%     | 56.3%    | 53.1%    | 42.6%     | 29.2%      | 20.0%   | 35.5%   | 42.9% | 80.0%  |
| Distributed only interest and dividends for funds at/below HDV              | 16.9%     | 12.5%    | 12.5%    | 16.7%     | 22.9%      | 20.0%   | 15.5%   | 20.8% | 10.0%  |
| Continued distributions in keeping with normal spending rule                | 38.2%     | 29.2%    | 31.3%    | 38.9%     | 45.8%      | 48.0%   | 47.3%   | 35.1% | 5.0%   |
| Continued distributions at a reduced rate other than interest and dividends | 3.4%      | 6.3%     | 3.1%     | 1.9%      | 2.1%       | 4.0%    | 0.9%    | 6.5%  | 5.0%   |

### Spending Practices under UPMIFA

As mentioned above, UPMIFA eliminates the concept of HDV and requires institutions to consider a range of factors, including the duration and preservation of the fund, the purposes of the institution and the fund, general economic conditions, the possible effects of inflation and deflation, the expected total return from income and appreciation of investments, other resources of the institution, and the investment policy of the institution when making decisions about spending or accumulation of endowments. Thirteen states and the U.S. Virgin Islands included an optional provision which creates a rebuttable presumption of imprudence for spending at rates over 7 percent.

Institutions and foundations reported (Table 4) that they currently follow or plan to follow the practices listed below for spending from underwater endowments (for which gift agreements do not dictate particular practices):

- 46.9 percent are continuing distributions in keeping with their normal spending rule;
- 25.1 percent are suspending distributions from funds at or below HDV;
- 9.7 percent are distributing only interest and dividends;
- 8.2 percent have established a threshold at which they will suspend distributions from underwater accounts. The average and most common threshold is 80 percent of HDV:
  - o 3 institutions reported thresholds of 90 percent
  - o 5 institutions reported thresholds of 80 percent
  - o 3 institutions reported thresholds of 75 percent
  - o 1 institution reported a threshold of 70 percent
  - o 1 institution reported a threshold of 65 percent
  - o Others were in the process of determining the threshold; and
- 4.3 percent have established a tiered system in which the distribution rate for underwater funds decreases incrementally and is eventually suspended when the fund value drops to a designated percentage of HDV.

**Table Set 3: Examples of tiered formulas for spending from underwater funds**

| Fund Value as a Percent of HDV | Spend Rate                  |
|--------------------------------|-----------------------------|
| 90-99%                         | 50% of normal spending rate |
| 75-90%                         | 25% of normal spending rate |
| <75%                           | Suspend distributions       |

| Fund Value as a Percent of HDV | Spend Rate                          |
|--------------------------------|-------------------------------------|
| 75%-99%                        | 75% of previous year's distribution |
| <75%                           | Suspend distributions               |

| Fund Value as a Percent of HDV | Spend Rate                  |
|--------------------------------|-----------------------------|
| >95%                           | Normal spending rate        |
| 95%                            | 50% of normal spending rate |
| 90%                            | Suspend distributions       |

| Fund Value as a Percent of HDV | Spend Rate                  |
|--------------------------------|-----------------------------|
| 90-99%                         | 75% of normal spending rate |
| 80-90%                         | 50% of normal spending rate |
| 70-80%                         | 25% of normal spending rate |
| <70%                           | Suspend distributions       |

| Fund Value as a Percent of HDV | Spend Rate            |
|--------------------------------|-----------------------|
| 95-99%                         | 4.5%                  |
| 90-95%                         | 3.5%                  |
| 85-90%                         | 2.5%                  |
| 80-85%                         | 1.5%                  |
| 75-80%                         | 0.5%                  |
| <75%                           | Suspend distributions |

| Fund Value as a Percent of HDV | Spend Rate                  |
|--------------------------------|-----------------------------|
| 80-100%                        | Normal spending rate        |
| 75-80%                         | 75% of normal spending rate |
| 70-75%                         | 50% of normal spending rate |
| 60-70%                         | 25% of normal spending rate |
| <60%                           | Suspend distributions       |

| Fund Value as a Percent of HDV | Spend Rate                  |
|--------------------------------|-----------------------------|
| >90%                           | Normal spending rate        |
| 75-90%                         | 50% of normal spending rate |
| <75%                           | Suspend distributions       |

In comments, 14 institutions (6.8 percent) described a flexible decision-making process whereby decisions about spending from underwater funds are made on a case-by-case basis; typically require input from administrators, board members, or donors; and take the purpose of the fund, current needs, and the degree to which the purchasing power of the fund has been compromised into account. Such approaches include:

- Requiring all fund administrators to actively opt in to receive distributions from underwater funds; distributions from underwater funds are no longer automatic.
- Allowing spending below HDV, but if management deems the valuation slide as something other than temporary, the distributions would be reduced or suspended.
- Reviewing spending on all funds on a case-by-case basis. Exceptions may be approved by the board to allow additional spending if existing commitments warrant, or spending may be reduced for funds that have decreased in value significantly.
- Continuing spending from underwater funds only with special request and appropriate justification.
- Discontinuing distributions from funds at or below HDV unless approved by executive management through a petition process.
- Every underwater fund is individually assessed as to the most prudent draw that should be taken. The recommended draws for each underwater fund must be approved by the board of trustees.
- Discontinuing distributions from underwater funds with an exception for 12 months for urgent needs if approved by donor and the endowment-review committee.

- The administration is authorized to reset the value of certain endowments for the purposes of applying the spending rule (1) if approved by the donor, (2) the endowment is the primary source of funding for a particular school or program, and (3) a determination is made that spending at a lower value can achieve the original purpose of the gift.
- Continue spending from underwater funds, but a board committee may determine an alternate spending rate appropriate to the circumstance.
- Underwater endowments are brought back to HDV at fiscal-year end from unrestricted endowments. As the market value returns, the unrestricted funds are reimbursed.
- No specific threshold at which distributions are suspended; a board committee reviews the current status of fund values compared to HDV and then evaluates the planned spending in the context of what is prudent for the institution overall.

## Changes in Spending Practice after the Enactment of UPMIFA

The 2010 survey data allow us to compare spending practice before (Table 2) and after (Table 4) the enactment of UPMIFA. Following the enactment of UPMIFA:

- The number of institutions discontinuing all distributions from underwater funds decreased by 16.4 percentage points, from 41.5 percent to 25.1 percent;
- The number of institutions distributing only interest and dividends decreased by 7.2 percentage points, from 16.9 percent to 9.7 percent;
- The number of institutions that made distributions from underwater funds in keeping with their normal spending rate increased by 8.7 percentage points, from 38.2 percent to 46.9 percent; and
- 12.5 percent of institutions employed a threshold or tiered approach compared with 3.4 percent of institutions that continued distributions at some rate (other than interest and dividends) prior to the enactment of UPMIFA. In addition to this, 6.8 percent of institutions described some flexible decision-making process (that may be employed in lieu of or in conjunction with other standard methods).

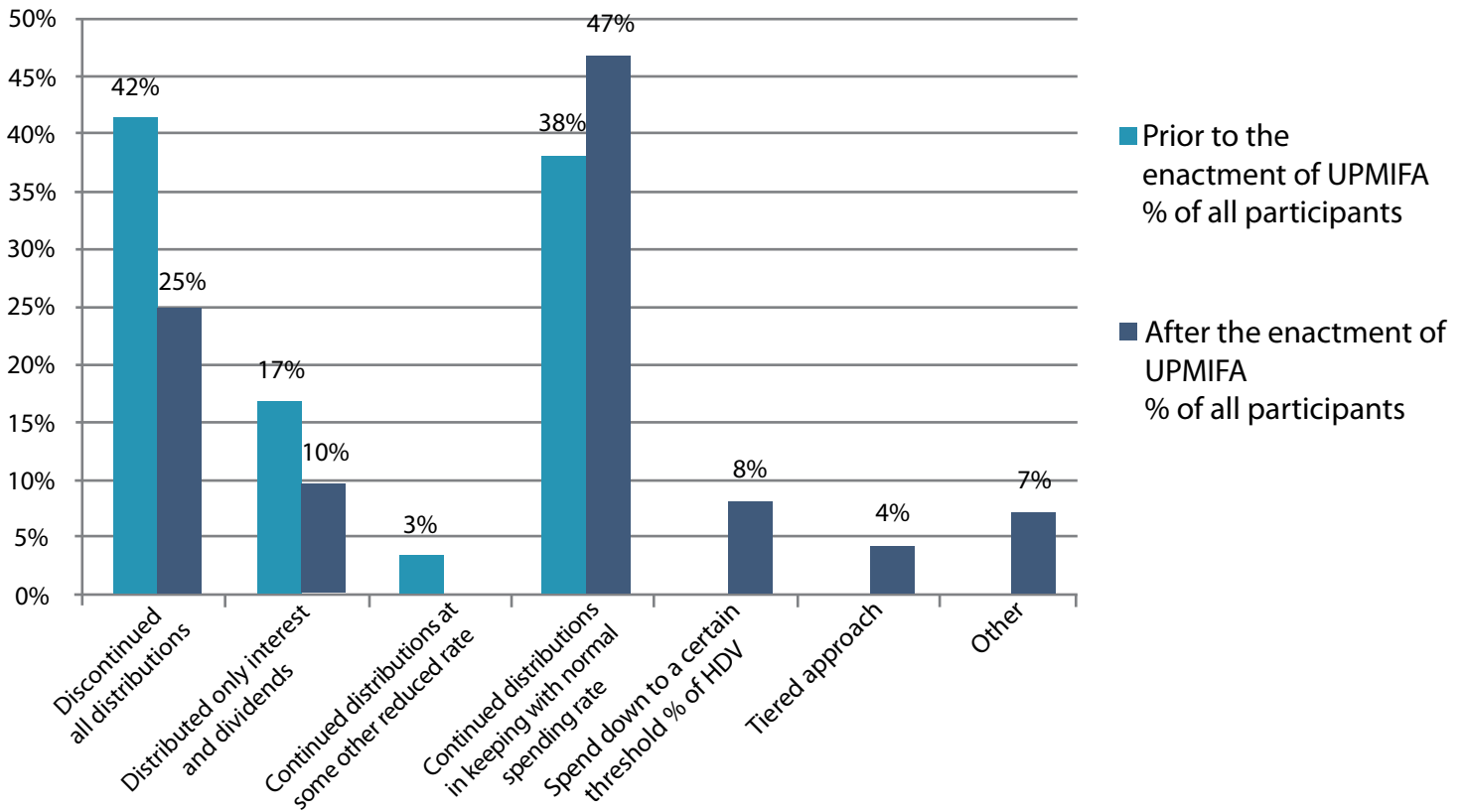
**Table 4: Spending from underwater funds under UPMIFA**

|   | Aggregate | \$0-24 m | \$25-49m | \$50-149m | \$150-499m | \$500m+ | Private | IRF   | Public |
|---|-----------|----------|----------|-----------|------------|---------|---------|-------|--------|
| Number  | 207       | 48       | 32       | 54        | 48         | 25      | 110     | 77    | 20     |
| Discontinue all distributions for funds at/below HDV          | 25.1%     | 43.8%    | 37.5%    | 25.9%     | 8.3%       | 4.0%    | 22.7%   | 24.7% | 40.0%  |
| Distribute only interest and dividends for funds at/below HDV | 9.7%      | 4.2%     | 9.4%     | 7.4%      | 18.8%      | 8.0%    | 10.0%   | 9.1%  | 10.0%  |
| Continue distributions in keeping with normal spending rule   | 46.9%     | 41.7%    | 37.5%    | 51.9%     | 47.9%      | 56.0%   | 52.7%   | 42.9% | 30.0%  |
| Spend down to a certain threshold % of HDV                    | 8.2%      | 6.3%     | 3.1%     | 9.3%      | 10.4%      | 12.0%   | 4.5%    | 11.7% | 15.0%  |
| Tiered approach   | 4.3%      | 2.1%     | 3.1%     | 5.6%      | 4.2%       | 8.0%    | 3.6%    | 6.5%  | 0.0%   |
| Other   | 6.8%      | 0.0%     | 9.4%     | 5.6%      | 10.4%      | 12.0%   | 6.4%    | 6.5%  | 10.0%  |

Prior to the enactment of UPMIFA, 121 institutions (58.4 percent of survey participants) discontinued all distributions or only distributed interest and dividends from underwater funds. After the enactment of UPMIFA, 57 (or 47.1 percent) of the 121 institutions which previously discontinued all distributions or distributed only interest and dividends adopted a new spending approach likely to yield greater ongoing distributions from underwater endowments than distribution of interest and dividends or complete cessation of distributions would have yielded.

The number of institutions that continued making distributions from underwater funds increased by 8.7 percentage points, from 38.2 percent to 46.9 percent after the enactment of UPMIFA. These changes reflect a variety of factors including evolving fiscal circumstances, institutional needs, investment returns, and future return expectations, but UPMIFA has also clearly enabled boards to adapt their spending in response to changed contexts.

**Graph 2: Comparison of spending practices before and after enactment of UPMIFA (2010)**



### Comparison of 2009 and 2010 Spending Practices

The current AGB research highlights a number of changes in the way institutions are managing spending from underwater funds under UPMIFA as well as the ways institutions are adapting to the change from UMIFA to UPMIFA.

UPMIFA was enacted in 16 additional states in the period between the 2009 and 2010 surveys. A comparison of the spending practices reported in the two surveys suggests that boards have made enormous progress in adapting their policies and practices in response to the changed regulatory context.

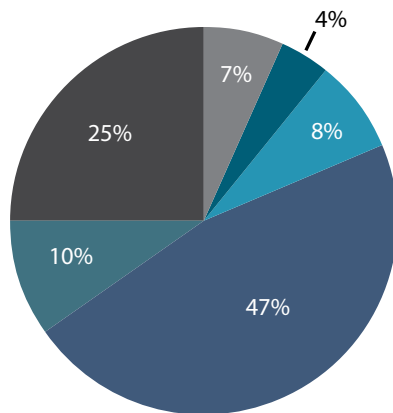
The most striking change from practices reported in the 2009 survey is the 15.6 percentage point increase (from 31.3 percent in 2009 to 46.9 percent in 2010) in the proportion of institutions and foundations that reported that they were continuing spending from underwater funds in keeping with their normal spending rule under UPMIFA.

The proportion of institutions/foundations that discontinued all spending or distributed only interest and dividends from underwater funds remained about the same as it was in 2009.

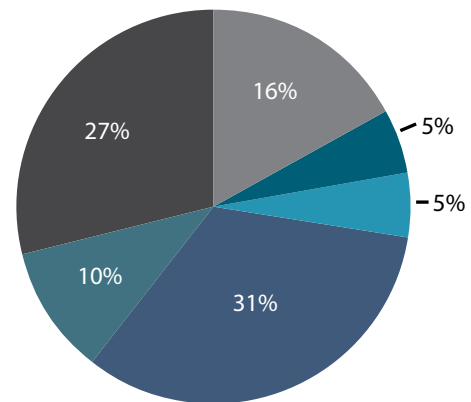
The proportion of institutions that, following the enactment of UPMIFA, employed a tiered or threshold approach increased 5.8 percentage points, from 6.7 percent in 2009 to 12.5 percent in 2010. Along with the various flexible approaches to spending outlined above, this suggests that institutions are developing increasingly sophisticated ways of managing underwater funds.

Given the high percentage of endowment funds that remain underwater and the widely held assumption that market returns will not soon match those to which investors became accustomed in recent decades, it might have been expected that institutions and foundations would have ratcheted back on spending from underwater funds in the past year. Both the 2009 and 2010 surveys, however, suggest just the opposite. As noted above, almost 60 percent of institutions in the 2010 survey that suspended distributions or distributed only interest and dividends under UMIFA adopted a new spending practice under UPMIFA yielding greater funding for endowment purposes. In 2009, almost three-quarters of institutions that suspended distributions or distributed only interest and dividends under UMIFA adopted a new spending practice yielding great support for endowment purposes under UPMIFA. For more detailed information on 2009 spending practices, see *Management of Underwater Endowments Under UPMIFA: Findings of the 2009 AGB Survey*, referenced at the end of this report.

**Chart 3: Practices under UPMIFA in 2010**



**Chart 4: Practices under UPMIFA in 2009**



- Discontinue all distributions for funds at/below HDV
- Distribute only interest and dividends for funds at/below HDV
- Continue distributions in keeping with normal spending rule
- Spend down to a certain threshold % of HDV
- Tiered approach
- Other

### Variation of Spending Practice According to Purpose of Fund

Only 7.7 percent of institutions reported that they varied their spending practice for underwater funds according to the purpose of the fund. This is down 2.9 percentage points from 10.6 percent in 2009, but this may reflect the adoption of flexible spending decision-making processes like the ones described above. Among institutions that do vary spending practice according to the purpose of the fund, 82.4 percent do so to provide continued funding for student financial aid, and 17.6 percent continue distributions for faculty support.

## Use of the Provision Allowing for Release or Modification of Funds

UPMIFA includes a provision that allows a charity to modify a restriction on a small (less than \$25,000) and mature (over 20-years old) fund without going to court. If a restriction has become impracticable or wasteful, the charity may notify the state charitable regulator, wait 60 days, and then, unless the regulator objects, modify the restriction in a manner consistent with the charitable purposes expressed in any documents that were part of the original gift. Note that the specifics of the provision may vary from state to state, and many legislatures modified the provision to increase the threshold value below which institutions can modify restrictions that may have become illegal, impracticable, or wasteful.

- \$25,000: Arkansas, Delaware, Idaho, Indiana, Louisiana, Michigan, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Dakota, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Texas, Utah, U.S. Virgin Islands, West Virginia, Wisconsin, and Wyoming
- \$50,000: Alabama, Alaska, Arizona, D.C., Hawaii, Illinois, Iowa, Kansas, Kentucky, Maryland, Minnesota, Missouri, Vermont, Virginia
- \$75,000: Washington (indexed)
- \$100,000: California, Colorado (indexed), Georgia, Maine (indexed), North Carolina
- \$150,000: Tennessee
- \$250,000: New Jersey and Ohio (Hawaii and Virginia allow up to \$250,000 with attorney general’s consent)

Only 14.5 percent of institutions and foundations reported having made use of this provision.

**Table 5: Use of the provision allowing for release or modification of restrictions on older and smaller endowments**

|        | Aggregate | \$0-24 m | \$25-49m | \$50-149m | \$150-499m | \$500m+ | Private | IRF   | Public |
|--------|-----------|----------|----------|-----------|------------|---------|---------|-------|--------|
| Number | 207       | 48       | 32       | 54        | 48         | 25      | 110     | 77    | 20     |
| Yes    | 14.5%     | 8.3%     | 21.9%    | 20.4%     | 6.3%       | 20.0%   | 11.8%   | 15.6% | 25.0%  |
| No     | 85.0%     | 91.7%    | 75.0%    | 79.6%     | 93.8%      | 80.0%   | 87.3%   | 84.4% | 75.0%  |

## Determination of Amounts to Be Classified as Permanently Restricted

In August 2008, the Financial Accounting Standards Board (FASB) promulgated a staff position (FAS 117-1) providing guidance on the net asset classification of donor-restricted endowment funds. According to FAS 117-1, the amount of a permanent endowment fund classified as “permanently restricted” must either be explicitly stipulated by the donor or, absent donor stipulations, must be determined by the governing board consistent with relevant law. FASB rules are not generally applicable to state entities that are under the purview of the Government Accounting and Standards Board (GASB), but some institutionally related foundations do report under FASB. Among survey participants, 60 percent of foundations and 55 percent of private institution boards have made a determination about the amount of funds (of those lacking specific donor stipulations concerning accumulation or spending) that must be permanently retained. The majority of respondents that described how they define amounts classified as permanently restricted in keeping with FASB’s guidance use some equivalent of HDV. Others referenced donor stipulations/gift agreements, but it should be underscored that FASB 117-1 only applies to endowments that lack specific donor stipulations concerning the accumulation or spending of funds. Comments describing how boards have defined amounts to be classified as permanently restricted suggest that boards are not yet well informed about FASB 117-1.

**Table 6: Has the board made a determination about the amount of endowment funds (lacking specific donor stipulations concerning accumulation or spending) that must be permanently restricted?**

|        | Aggregate | \$0-24 m | \$25-49m | \$50-149m | \$150-499m | \$500m+ | Private | IRF   | Public |
|--------|-----------|----------|----------|-----------|------------|---------|---------|-------|--------|
| Number | 207       | 48       | 32       | 54        | 48         | 25      | 110     | 77    | 20     |
| Yes    | 57.5%     | 56.3%    | 43.8%    | 61.1%     | 56.3%      | 72.0%   | 54.5%   | 59.7% | 60.0%  |
| No     | 42.5%     | 43.8%    | 56.3%    | 38.9%     | 43.8%      | 28.0%   | 45.5%   | 40.3% | 40.0%  |

### Endowment Fees Assessed by Institutionally Related Foundations

UPMIFA requires institutions to take a broad range of factors into consideration when making endowment spending decisions and to balance current needs with the obligation to maintain the long-term purchasing power of the endowment. The vast majority of institutionally related foundations assess a management or administrative fee, typically calculated as a percentage of the market value of the endowment, to support foundation operations and/or fund-raising functions. Given the long-term return on investments in fund raising, many institutions believe it makes sense to consider such a use of endowment revenue as a contributor to rather than an impediment to endowment growth. There are at present several conflicting factors that may lead institutions and foundations to change their practice regarding endowment fees. The market losses of recent years combined with diminished return expectations may lead some boards to reduce both fees and spending rates to forestall further erosion of fund values. At the same time, public institution foundations have faced severe revenue shortfalls as a result of decreased support from their affiliated institutions, decreased revenue from unrestricted investments, and decreased gift flows; many have tapped operating reserves and other unrestricted funds to supplement decreased distributions from underwater endowments. These factors have led many foundations to change their funding model and, in many cases, to increase their reliance on gift and endowment fees.

- 87 percent of the foundations participating in this survey assess an endowment management fee. The average assessment among participating foundations is 1.3 percent and the median assessment is 1 percent.
- 11.7 percent of those foundations with endowment fees suspend them for underwater funds.
- In the past 18 months, 13 percent of foundations surveyed increased their endowment management fees while 10.4 percent decreased them.

**Table 7: Use of endowment management fees by institutionally related foundations**

|        | All IRFs | \$0-24 m | \$25-49m | \$50-149m | \$150-499m | \$500m+ |
|--------|----------|----------|----------|-----------|------------|---------|
| Number | 77       | 18       | 10       | 18        | 16         | 15      |
| Yes    | 87.0%    | 72.2%    | 90.0%    | 77.8%     | 100.0%     | 100.0%  |
| No     | 10.4%    | 27.8%    | 0.0%     | 16.7%     | 0.0%       | 0.0%    |
| Fee    | 1.3%     | 1.3%     | 0.9%     | 1.5%      | 1.4%       | 1.2%    |

### Other Changes in the Management and Investment of Endowments

This survey was primarily intended to assess the ways institutions are adapting to UPMIFA's new standards regarding spending from underwater funds, but the legislation also enumerates a more exact set of rules for investing in a prudent manner than prior legislation (UMIFA). In light of this, and given the unprecedented investment challenges that boards have faced in the past two years, the current survey included several questions asking about other significant changes boards may have made in the past 18 months in the way they manage and invest endowment.

#### Changes in Allocation and Portfolio Construction

Fifty-nine survey participants (28.5 percent) changed their approach to portfolio construction to focus allocations less on traditional "buckets," such as domestic equity, international equity, fixed income, and other asset classes, to an approach

that classifies assets and strategies based on their role in risk reduction, inflation protections, growth, liquidity, and similar factors informing portfolio performance. In comments, 10 respondents indicated that they had increased their allocation to hedge funds, commodities, or other alternatives. Two respondents indicated that they had developed allocations adapted to the purpose/time horizon of funds. Two respondents specifically indicated that they had changed allocations to focus on growth, risk reduction, and inflation protection. This is in keeping with findings of the 2009 NCSE report, which found that one-third of institutions and foundations had made or were considering such changes.

### **Changes to Due-Diligence and Risk-Management Procedures**

Twenty-four survey participants (11.6 percent) have made changes to due-diligence or risk-management procedures. Comments included the following:

- Under no condition will we spend more than actual return on investment;
- Increased the frequency of investment committee meetings, included a representative from a securities firm on the committee, and reported to the executive committee and full board;
- Updated investment policy statement;
- Increased frequency of communication and meetings with managers;
- Added hedge fund asset class and commodity asset class;
- Increased committee involvement with investment managers and tightened investment policy;
- Began using ad hoc committees to study areas that might have potential for creating problems so that they are prevented before they happen;
- Increased liquidity stress testing;
- Adopted a crisis-management plan;
- Enhanced our ability to assess portfolio risk and thereby manage it proactively;
- Asset allocations much more sensitive to risk;
- More direct contact with investment managers;
- Created a password-protected investment committee Web site as a central location for committee members to access all investment-related documentation;
- Purchased risk-assessment and monitoring software;
- Increased onsite visits with managers prior to investing with them, and increased frequency with which investments are monitored.

### **Changes in the Composition of Investment Committees**

Fifteen (7.2 percent) survey participants have changed the composition of their investment committee. Five respondents commented that they had increased the number of committee members and/or increased the number of committee members with investment expertise. Two institutions replaced joint investment and finance committees with separate investment committees.

### **Changes in Staffing and Use of Consultants:**

- 9.2 percent (19) retained a new consultant;
- 4.3 percent (nine) outsourced endowment management;
- 3.9 percent (eight) increased the number of investment staff; and
- 1.9 percent (four) hired a chief investment officer.

## Governance Practice

### Board Involvement in Spending Decisions

Institution and foundation boards in UPMIFA states are actively involved in making decisions about spending from underwater funds. Three-quarters (75.8 percent) of survey participants reported that the institution or foundation board approves decisions regarding spending from underwater accounts. Interestingly, boards of institutions with the largest endowments are somewhat less likely than average to approve spending decisions, and those at institutions with the smallest endowments are more likely to do so. Public institution and foundation boards consistently report higher levels of board engagement and oversight concerning spending from underwater endowments. This is in keeping with findings in our 2009 survey.

Although 75.8 percent of institutions reported that the board approves decisions regarding spending from underwater endowments, only 60.4 percent reported that the board or a board committee had discussed spending from underwater funds since the enactment of UPMIFA. This represents an increase of 3.9 percentage points over 2009.

*Recommendation:* While decisions regarding spending from underwater endowments may have limited impact on the overall financial circumstances of an institution, they represent a fundamental fiduciary responsibility. As the ultimate stewards of endowments, boards should be involved in decisions that could significantly undermine the long-term purchasing power of funds contributed with the intention that their ability to provide ongoing support for designated charitable purposes be preserved.

**Table 8: Does institution or foundation board approve decisions regarding spending from underwater accounts?**

|        | Aggregate | \$0-24 m | \$25-49m | \$50-149m | \$150-499m | \$500m+ | Private | IRF   | Public |
|--------|-----------|----------|----------|-----------|------------|---------|---------|-------|--------|
| Number | 207       | 48       | 32       | 54        | 48         | 25      | 110     | 77    | 20     |
| Yes    | 75.8%     | 83.3%    | 65.6%    | 81.5%     | 70.8%      | 72.0%   | 63.6%   | 90.9% | 100.0% |
| No     | 22.2%     | 14.6%    | 31.3%    | 18.5%     | 27.1%      | 24.0%   | 35.5%   | 9.1%  | 0.0%   |

A majority of boards rely on recommendations from staff regarding spending from underwater endowments. Finance and investment committees also commonly make spending recommendations. Public institutions seem to engage the broadest range of parties in making spending recommendations.

**Table 9: Parties making recommendations regarding spending from underwater endowments**

|                              | Aggregate | \$0-24 m | \$25-49m | \$50-149m | \$150-499m | \$500m+ | Private | IRF   | Public |
|------------------------------|-----------|----------|----------|-----------|------------|---------|---------|-------|--------|
| Number                       | 207       | 48       | 32       | 54        | 48         | 25      | 110     | 77    | 20     |
| Institution/foundation staff | 51.7%     | 39.6%    | 62.5%    | 55.6%     | 50.0%      | 56.0%   | 49.1%   | 50.6% | 70.0%  |
| Investment committee         | 39.1%     | 43.8%    | 28.1%    | 46.3%     | 39.6%      | 28.0%   | 32.7%   | 44.2% | 55.0%  |
| Finance committee            | 35.7%     | 52.1%    | 31.3%    | 38.9%     | 18.8%      | 36.0%   | 36.4%   | 35.1% | 35.0%  |
| Whole board                  | 25.6%     | 29.2%    | 15.6%    | 29.6%     | 27.1%      | 20.0%   | 19.1%   | 28.6% | 45.0%  |
| Executive committee          | 16.9%     | 8.3%     | 28.1%    | 14.8%     | 12.5%      | 32.0%   | 7.3%    | 23.4% | 45.0%  |

We specifically asked institutionally related foundations about parties other than foundation staff and board members who participate in making decisions regarding endowment spending. Nearly half of affiliated foundations (48 percent) also include institution staff (typically the institution president, chief financial officer, or governing board members) in decisions about endowment spending.

## Review of Gift Instruments

A majority (83.1 percent) of institutions and foundations have reviewed all gift instruments to determine which permanent endowment funds are subject to donor restrictions concerning the amount of the fund that must be permanently retained or other donor restrictions concerning accumulation or distributions from the fund since the passage of UPMIFA. This represents an increase of 10.8 percentage points over the 72.3 percent reporting the practice in 2009. It should be noted that the question asked specifically whether gift instruments had been reviewed since the enactment of UPMIFA, and many institutions and foundations conducted such reviews in 2001-02, prior to the enactment of UPMIFA.

*Recommendation:* UPMIFA is a default statute applying to donor-restricted endowments for which gift instruments do not provide specific guidance concerning appropriation or accumulation of funds. Boards have an obligation to honor the terms of gift instruments and should ensure that the institution's policies and practices support documentation of its compliance with donor intent as to both purpose and appropriation/accumulation of endowments.

## Board Policies

Nearly half (44 percent) of boards have formally approved a policy addressing distributions from underwater funds, 8.7 percent are currently considering such a policy, 15.5 percent of institutions have policies adopted by staff, and 12.1 percent have no plans to adopt such a policy (Table 10). In total, 68.2 percent of institutions and foundations either have some type of policy addressing spending from underwater funds or are developing such a policy. This represents an increase of 6.5 percentage points in the proportion of institution that have policies addressing spending from underwater funds since 2009.

*Recommendation:* UPMIFA's prudence rule encourages institutions to take a broad range of factors into account in making decisions regarding distributions from underwater endowments. Given that economic circumstances, institutional needs and resources, investment return expectations, and other factors will all vary from year to year, boards may decide not to adopt a policy dictating particular spending practices for underwater funds. Boards should, however, adopt a policy specifying how decisions regarding prudent appropriation or accumulation of underwater endowments will be made.

## Test of Prudence

Only 11.6 percent of boards have established a test or definition of prudence to use in determinations about spending from underwater funds. This represents an increase of 4.5 percentage points over the 7.1 percent that had done so in 2009. As noted previously, 6.8 percent of institutions have developed flexible decision-making processes to determine prudent spending.

*Recommendation:* Unlike UMIFA, in which HDV serves as a clearly defined point at which spending from endowments should be suspended or reduced, UPMIFA requires institutions to consider a range of factors, including the duration and preservation of the fund, the purposes of the institution and the fund, general economic conditions, the possible effects of inflation and deflation, the expected total return from income and appreciation of investments, other resources of the institution, and the investment policy of the institution. Variations in these factors could dictate a range of approaches from institution to institution, year to year, and even fund to fund. Boards may, accordingly, opt not to identify fixed limits above or below which they deem it imprudent to spend. They should, however, have policies in place addressing how they will determine prudent appropriations for expenditure from endowment funds. An optional provision, adopted by 13 states and the U.S. Virgin Islands, creates a rebuttable presumption of imprudence for spending over 7 percent (or some other specified amount) in any given year for all endowments (including funds that are not underwater) and boards should bear this in mind in their decision making.

## Documentation of Board Decision Making

Of survey participants, 48.3 percent document board-level decisions regarding underwater funds in their minutes. In the absence of a bright-line test of prudence, boards must be able to demonstrate the factors they have taken into consideration and the basis of their decisions. This represents an increase of 12.4 percentage points over the 35.9 percent that reported the practice in 2009.

*Recommendation:* Sound board process, including documentation of boards' decision making, is of critical importance in demonstrating prudence. Staff recommendations for spending from underwater funds, factors considered, and decisions taken should all be documented in minutes.

**Table 10: Governance practice under UPMIFA**

|   | Aggregate | \$0-24 m | \$25-49m | \$50-149m | \$150-499m | \$500m+ | Private | IRF   | Public |
|---|-----------|----------|----------|-----------|------------|---------|---------|-------|--------|
| Number  | 207       | 48       | 32       | 54        | 48         | 25      | 110     | 77    | 20     |
| The institution has reviewed all gifts  | 83.1%     | 83.3%    | 87.5%    | 83.3%     | 79.2%      | 84.0%   | 80.0%   | 85.7% | 90.0%  |
| The board or a committee thereof has discussed spending from underwater funds   | 60.4%     | 60.4%    | 37.5%    | 75.9%     | 64.6%      | 48.0%   | 54.5%   | 63.6% | 80.0%  |
| The board or a committee thereof has formally approved a policy addressing distributions from underwater funds  | 44.0%     | 41.7%    | 40.6%    | 42.6%     | 52.1%      | 40.0%   | 44.5%   | 46.8% | 30.0%  |
| The board is currently considering such a policy  | 8.7%      | 8.3%     | 12.5%    | 9.3%      | 4.2%       | 12.0%   | 5.5%    | 11.7% | 15.0%  |
| The board has no plans to adopt such a policy   | 12.1%     | 12.5%    | 6.3%     | 14.8%     | 16.7%      | 4.0%    | 10.0%   | 10.4% | 30.0%  |
| Institution staff members have adopted a policy addressing distributions from underwater funds (not formally approved or adopted by the board)  | 15.5%     | 20.8%    | 25.0%    | 13.0%     | 8.3%       | 12.0%   | 17.3%   | 11.7% | 20.0%  |
| The institution has no formal policy addressing distributions from underwater funds   | 16.4%     | 18.8%    | 12.5%    | 14.8%     | 20.8%      | 12.0%   | 19.1%   | 15.6% | 5.0%   |
| Board- or committee-level decisions regarding underwater funds have been documented in minutes  | 48.3%     | 47.9%    | 40.6%    | 50.0%     | 47.9%      | 56.0%   | 36.4%   | 61.0% | 65.0%  |
| The board (or a committee thereof, or the staff) has established a test or definition of prudence to use in determinations about spending from underwater funds   | 11.6%     | 8.3%     | 0.0%     | 14.8%     | 18.8%      | 12.0%   | 10.9%   | 14.3% | 5.0%   |
| The institution has no formal policy addressing distributions from underwater funds   | 16.4%     | 18.8%    | 12.5%    | 14.8%     | 20.8%      | 12.0%   | 19.1%   | 15.6% | 5.0%   |
| Institution staff members have adopted a policy addressing distributions from underwater funds (not formally approved or adopted by the board)  | 15.5%     | 20.8%    | 25.0%    | 13.0%     | 8.3%       | 12.0%   | 17.3%   | 11.7% | 20.0%  |
| The institution has reviewed all gift instruments to determine which permanent endowment funds are subject to donor restrictions concerning the amount of the fund that must be permanently retained or other donor restrictions concerning accumulation or distributions from the fund | 83.1%     | 83.3%    | 87.5%    | 83.3%     | 79.2%      | 84.0%   | 80.0%   | 85.7% | 90.0%  |
| The board (or a committee thereof, or the staff) has established a test or definition of prudence to use in determinations about spending from underwater funds   | 11.6%     | 8.3%     | 0.0%     | 14.8%     | 18.8%      | 12.0%   | 10.9%   | 14.3% | 5.0%   |

## Conflict of Interest Policies

In November 2009, the AGB Board of Directors adopted a statement on conflict of interest recommending that institutional policy on board member conflicts of interest should extend to the activities of board committees and apply to all committee members, including those who are not board members. The statement also recommended that boards should consider whether to adopt conflict-of-interest policies that specifically address board members' parallel or "side-by-side" investments and whether to adopt especially rigorous conflict of interest provisions applicable to members of the board investment committee. The AGB Board of Directors' *Statement on Conflict of Interest* is available online at [www.agb.org/conflict-interest](http://www.agb.org/conflict-interest).

- 60.9 percent of institutions and foundations in this study have conflict-of-interest policies that apply to all volunteers responsible for investment decision making, including those who are not governing board members.
- 15.9 percent of survey participants have conflict-of-interest policies that include especially rigorous provisions applicable to investment committee members and other investment decision makers.
- 13.5 percent have policies that specifically address board members' parallel or "side-by-side" investments in which the institution has a financial interest.

Not surprisingly, institutions and foundations with larger endowments are more likely to have more comprehensive and rigorous policies (Table 11). Public institutions and foundations are also significantly more likely to have conflict-of-interest policies applicable to all volunteers responsible for investment decisions and addressing side-by-side investments by board members.

**Table 11: Conflict of interest policies related to investment decision makers**

|   | Aggregate | \$0-24 m | \$25-49m | \$50-149m | \$150-499m | \$500m+ | Private | IRF   | Public |
|---|-----------|----------|----------|-----------|------------|---------|---------|-------|--------|
| Number  | 207       | 48       | 32       | 54        | 48         | 25      | 110     | 77    | 20     |
| Applies to all volunteers responsible for investment decision making                      | 60.9%     | 58.3%    | 50.0%    | 61.1%     | 64.6%      | 72.0%   | 47.3%   | 74.0% | 85.0%  |
| Includes especially rigorous provisions applicable to members of the investment committee | 15.9%     | 10.4%    | 12.5%    | 11.1%     | 14.6%      | 44.0%   | 15.5%   | 16.9% | 15.0%  |
| Addresses side-by-side investments  | 13.5%     | 12.5%    | 9.4%     | 11.1%     | 16.7%      | 20.0%   | 8.2%    | 15.6% | 35.0%  |

## Additional Resources

Related information on endowment spending and governance practices under UPMIFA can be found on AGB's Website at: <http://agb.org/uniform-prudent-management-institutional-funds-act>

Management of Underwater Endowments under UPMIFA: Findings of the 2009 AGB Survey. <http://agb.org/reports/2009/management-underwater-endowments-under-upmifa>

"What's a Prudent Payout from an 'Underwater' Endowment?," David Bass, *Trusteeship*, May/June 2009. <http://agb.org/trusteeship/2009/mayjune/whats-prudent-payout-underwater-endowment>

"Freedom Isn't Free," John Griswold and William Jarvis, *Mission Matters*, Spring/Summer 2009. <http://agb.org/sites/agb.org/files/u16/GRISWOLD.pdf>

"Asking about Asset Allocation," Viewpoint by William Jarvis, 2009 NACUBO-Commonfund Study of Endowments [http://agb.org/sites/agb.org/files/u16/NCSE2009\\_Viewpoint.pdf](http://agb.org/sites/agb.org/files/u16/NCSE2009_Viewpoint.pdf)

Financial Accounting Standards Board (FASB Staff Position 117-1): 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, and Enhanced Disclosures for All Endowment Funds. [http://www.fasb.org/pdf/fsp\\_fas117-1.pdf](http://www.fasb.org/pdf/fsp_fas117-1.pdf)

Other educational materials on UPMIFA and links to state statutes can be found at [www.upmifa.org](http://www.upmifa.org)





