

Diverting Restricted Funds During a Crisis

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The COVID-19 pandemic has wreaked havoc on the finances of a broad swath of the nonprofit sector. For many organizations, some or most of their usual sources of revenue has stopped abruptly – and certainly – unexpectedly. With varying degrees of success, they are scrambling to find temporary revenue replacement including, where possible, pivoting to virtual activities.

Some groups are lucky enough to have money set aside in one or more “restricted” funds. Many wonder now if part or all of this set-aside money may be accessed and redirected to pay for general operating expenses or other necessities, or to fund short-term or possibly more permanent replacement programs or activities.

The Spectrum of Restricted Funds

The answer is: It depends.

This issue may turn on whether you’re applying the correct terminology under the circumstances. First, what you’re calling “endowed” funds or an “endowment” may not be a true endowment. Second, what you’re calling “restricted” funds may not be legally tied up in such a way that the restrictions or conditions can’t be removed in-house by a simple vote of the board of directors.

View this issue as if there’s an imaginary graph in front of you. At one end of the spectrum are funds that truly and firmly are in the endowment category – not always impossible to release but you may have to jump through significant hoops and possibly legal proceedings.

At mid-point on the spectrum is the situation in which money comes into your organization for a designated purpose or use or otherwise with conditions. If the source is a still-living donor, it may be relatively easy to ask for, and receive, permission, for a different use. The COVID-19 crisis is so demonstrably deep and widespread that the normal showing of dire need and extraordinary circumstances to vary the terms of a gift or grant is likely unnecessary. If the money is from a

government or foundation grant, approval for a change may be much more available than at any other time in recent memory. Since the initial days when the pandemic swept across the United States, these funders have stepped up to the plate with significant generosity and a corresponding relaxation of rules, conditions, and compliance terms.

At the far end of this imaginary graph are funds that appear to be “restricted,” but a closer look may reveal that this is money that has been designated solely by the board of directors for a capital campaign or for a particular program or activity. In-house restrictions like this may ordinarily be lifted by a simple vote of a majority of the directors.

Endowments

The first area of confusion is with so-called “endowments” or “endowed” funds. In philanthropic circles, that term is often loosely or imprecisely used. A “true” endowment is generally “held for a particular duration” (for instance, for a set term of years or “in perpetuity”) and “may be drawn upon for application towards the organization’s mission generally or for other specific restricted purposes.”

While an organization may have funds that are “restricted,” that does not “necessarily mean that the funds are an endowment fund.”

For some endowments, there may be a specific process outlined in the written gift instrument for releasing or modifying restrictions including by the consent of the donor. Generally, in the absence of donor approval or a specified procedure to follow, the charitable organization must look to whatever current version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) applies. That law will spell out how to go about getting permission to invade the endowment. Often, there are special, more lenient procedures, for certain smaller or older endowment funds.

Bear in mind, though, that where an endowment restricts funds “to a particular use,” it must be used solely for that purpose. That includes funds drawn from an endowment pursuant to consent or other specified permission in extraordinary circumstances. “Thus, the ability to invade an endowment may not necessarily solve the strain caused by the current crisis.

Donor-Restricted Funds

At the mid-point on that imaginary spectrum is the donor-restricted fund. Money is often described as “restricted” whenever it’s set aside for a particular purpose; awarding scholarships, for instance.

But whether that money can be applied to or for a purpose other than the designated one turns on whether the fund is subject to a “true restriction.” That would be the case when an unrelated donor or other third party has given the money for that express purpose or subject to a condition.

The simplest way around the restriction may be to reach out to the (still-living) donor to ask for permission to vary the terms of the gift either in the short-term or permanently.

If the donor doesn’t consent, or is not alive, or if there’s no specified procedure in a written gift instrument to alter the terms of the contribution, then the Uniform Prudent Management of

Institutional Funds Act (UPMIFA) will generally outline a procedure to follow. The “UPMIFA is generally designed to provide a framework for the administration of restricted funds held by nonprofits to the extent that the gift instrument is either silent or vague on a particular issue.”

As with the individual donor situation, if the restriction is from a government or foundation grant, the remedy may be the same; that is, seeking permission to change the terms. “Whether or not it will be approved depends on a few factors: the individual funder, their thinking in this moment, and their relationship to your organization and its programs.”

Early in the pandemic, and continuing through the present, a number of large foundations publicly pledged to “end business as usual and do what they can to support their nonprofit partners.”

Board-Restricted Funds

At the far end of the spectrum is the fairly common scenario where a “restriction” is imposed only by the organization’s board of directors. Legally, this is different from a donor-imposed restriction or an endowment. This is not a “true” restriction. Just as the board can simply impose it by a vote at a regular meeting, the board can just as easily lift or modify the conditions by voting to change them. In contrast, a restriction imposed by your Board is not the same as a donor restriction, as the Board can simply modify the restriction. Thus, Board restricted funds, typically, are not treated as restricted and may be appropriated as determined by the Board. [Continue with stuff from our question)

Even if the money in question is in a fund designated for – say – a capital campaign, but it was the board of directors that labeled it as such, it’s not a “true” restriction.” The board has the power to “unrestrict” the funds and authorize its use for any other purposes.

A fuzzier situation arises if a donor or other third party gives money to a specific fund that the board of directors has announced would be set aside for a designated purpose like capital improvements. In that case, the prudent path is to treat the money as if the donor had initiated or created the restriction on the funds. Of course, in that situation, the donor or third party can consent to lift the condition.

Conclusion

An important trend that started before the pandemic is “participatory grantmaking,” a practice recommended for funders to loosen their tight hold on the minutiae of how a grantee uses charitable funds. It’s a philosophy that recognizes that greater power-sharing and decision-making in the donor-donee relationship will be a positive step to creating a more inclusive and diverse philanthropic sector and will also contribute to greater progress in eradicating social problems

— *Linda J. Rosenthal, J.D., FPLG Information & Research Director*