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at CHAPEL HILL

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## **MEMORANDUM**

To: Colleagues with University-Affiliated Foundations

From: Dennis Press *Dennis Press*  
University Controller

Re: Procedures for June 2011 Payout

Date: May 17, 2011

The purpose of this memorandum is to provide information regarding the procedures for the June 2011 distribution of endowment earnings and your entity's involvement in ensuring that the distribution is correct. University-Affiliated Foundations invest their endowments in The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. (Chapel Hill Investment Fund). Each June the Chapel Hill Investment Fund makes a distribution (or "payout") to the participating, affiliated foundations. The approved distribution rate each year is targeted to be approximately 5 percent of market value, but the actual distribution could be lower if necessary to prevent an unapproved invasion of the endowment principal.

With the March 2009 passage of the Uniform Prudent Management of Institutional Funds Act (UPMIFA), an invasion of principal of an endowment is allowed under certain circumstances. The attached document, Administration of Underwater Endowments, provides the prioritized steps that the University follows in addressing the issue of underwater endowments. This approach was previously endorsed by the boards of The Endowment Fund of the University of North Carolina at Chapel Hill and The University of North Carolina at Chapel Hill Foundation, Inc. As you did last year, your foundation should determine what portion of the calculated payout should be distributed for underwater endowments, and what portion should be retained for investment in the Chapel Hill Investment Fund to avoid an unapproved invasion of principal.

Your foundation's role in ensuring that the UPMIFA standards are accurately applied is critical. The University's Accounting Services Office maintains the *Unit Accounting System* (UAS), which tracks the detailed market values, contribution values, and other data for each endowment fund. Your affiliated foundation has the complete documentation for each of your endowment funds, and also the authority and responsibility to determine how UPMIFA applies to each endowment. A monthly *UPMIFA Compliance Report* is available through UAS.

If the calculated payout for an endowment fund does not require an adjustment, no action is needed. If the calculated payout for an endowment fund does require an adjustment, University Accounting Services is able to provide two alternative options:

- A. Use an automated adjustment to avoid any principal invasion based on UAS data.

This option will provide an automated process to prevent any invasion of endowment principal caused by the distribution of the calculated payout. Accounting Services will automate the process to return any portion of the calculated payout that causes an invasion of endowment principal for the University Statutory Endowment and the endowments of The UNC-CH Foundation, Inc. based on the data in the UAS system. If your foundation wishes to select this option for all of your endowment funds in the Chapel Hill Investment Fund, please indicate your decision in a memorandum or email to me which would need to be received by June 7, 2011.

B. Process an on-line journal entry to modify the calculated payout for selected endowment accounts.

This option will provide an on-line process to prevent invasion of endowment principal caused by the distribution of the calculated payout for selected endowment accounts based on your foundation records.

To use this option, the foundation should take the following actions:

- 1) Review Foundation records and the *UPMIFA Compliance Report* to determine the amount of any needed adjustment to the calculated payout for an endowment fund. The compliance report displays detailed data on each participating fund for your foundation that is underwater. Your foundation records can be used to determine if the contributions included any net accumulated gains for the endowment. In these instances, the column for the *No Invasion Transfer* on the report may need to be recalculated. The compliance report is available monthly through UAS.
- 2) For any adjustments to the calculated payout for an endowment fund, use the on-line journal entry system.
  - a) Select option for *Trust & Special Transfers / Agency Endowment Income to Agency Endowment Principal Account*.
  - b) From the Justification drop down box, select *Required UMIFA / UPMIFA Additions according to Policy*.
  - c) The dollar amount of the journal entry for each endowment will be the portion of the calculated payout that should not be distributed in order to avoid a principal invasion.

To record an entry prior to the close of fiscal year 2010-11, submit the entry no later than July 6, 2011.

If you have any questions, please contact me or John Carlson, Investment Accountant, in Accounting Services at [jcarlso@email.unc.edu](mailto:jcarlso@email.unc.edu) or 843-4476. Thank you for your collaborative efforts regarding this important issue.

cc: University Business Managers

**Administration of Underwater Endowments for  
The Endowment Fund of the University of North Carolina at Chapel Hill and  
The University of North Carolina at Chapel Hill Foundation, Inc.**

The endowment spending rules contained in UPMIFA require that an endowment, foundation or other charitable organization act in good faith, with the care that a prudent person would ordinarily exercise under similar circumstances and consider, if relevant, the following seven factors:

1. The duration and preservation of the endowment fund
2. The purposes of the institution and the endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the institution
7. The investment policy of the institution.

The position of the University of North Carolina at Chapel Hill is that implementing the flexibility afforded by UPMIFA to invade principal should be an **option of last resort**.

We have therefore developed and prioritized steps that we recommend be taken as we navigate through this process:

- Examine the activity supported by each underwater endowment to determine if it is essential to continue in the upcoming fiscal year or if it can be deferred.
- If it is determined that continuing the activity is essential, pursue the following funding options in this order:
  - Use any income from the prior year's distribution remaining in the endowment's spending account;
  - Use any unspent income that has been re-invested into the endowment;
  - Seek other institutional funds to support the activity.
- If, after considering the funding options described above and reviewing the applicable endowment agreement, it is determined that invading the principal of an endowment fund may be prudent, contact the donor and discuss the following alternatives:
  - An expendable gift equal to or in excess of the amount needed to avoid invading principal; or
  - Invading principal, subject to prudent limitations on expenditures, so that the actual distribution is reduced by 2.5% of the calculated distribution for each 1% the endowment is underwater with no use of principal if the endowment is 20% or more underwater.