

Creating and Building Endowments for Small Museums

By Carol Norris Vincent
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***Author Caveat:** This paper is intended to serve as guidelines for museums which are considering providing for the stability of their future through endowment funds. Whenever possible, the organization's board should consult with professionals to make sure that the plan they have developed will meet legal and accounting standards.*

Creating and building endowments is an essential responsibility for the boards of museums and other non-profit organizations. Endowments are the vehicles which will provide the stability for organizations which hope to be viable institutions in the 21st century.

Endowments are defined as funds "used to accumulate those assets that have been given to the museum on the condition that the principal of the gift is to be kept intact and that only the investment income it produces can be used to meet the museum's needs" (Daughtrey and Gross, p. 76). This definition confirms the *intent* of endowment funds: they are investment vehicles whose principal is never touched and will continue *in perpetuity*. Only the interest or dividend earnings are spent (*Profitable Fund Raising Strategies*).

Accounting Requirements

Because of recently mandated accounting standards established by the Financial Accounting Standards Board (FASB), non-profit organizations are required to report assets and statements of activity under three funds: Unrestricted, Temporarily Restricted, and Permanently Restricted.

Under these new guidelines, Unrestricted Fund would include Current Operating Fund, Board Designated Funds (for various projects), and Board Designated Quasi-Endowment. The term "endowment" has been defined earlier. Unrestricted funds are those that may be used for any purpose deemed appropriate for the organization. There should always, of course, be the qualifying statement "within the organization's operating budget" or, perhaps, "deemed appropriate by the board."

Restricted Funds (both Temporarily and Permanently Restricted), however, are those funds that can only be used for the purpose defined. These include donor restrictions and grants, most of which are given for restricted purposes. In addition, the board may also launch campaigns to solicit donations for specific projects. When solicitation is made for a stated purpose, even if the donor does not state specifically in the letter of transmittal that it is restricted, if the donor is responding to a solicitation for a specific purpose, the donation then can be considered restricted.

Temporarily Restricted Funds include all monies restricted by outside donors and grantors. Permanently Restricted Funds are the true Endowment Funds.

Accounting for museum funds – whether Unrestricted, Temporarily Restricted, or Permanently Restricted – is somewhat different than accounting for other non-profits and certainly for-profit businesses. The museum's bookkeeper and accountant should refer to booklets such as *What a Difference Nonprofits Make: A Guide to Accounting Procedures* and museum-specific resources such as *Museum Accounting Handbook* as well as conforming to the standards passed by the Financial Accounting Standards Board. As stated earlier, quasi-endowment funds are stated as Unrestricted. Donor restricted or board established (through an endowment campaign) endowment funds are reported as Permanently Restricted.

Strengthening Organizations Through Endowment Building

Ideally, an organization will not need to rely on starting its own endowment fund. If the board is doing its job of building donor support for the organization, usually a donor can be found who would enjoy the pleasure of establishing a donor restricted endowment fund into which other endowment contributions from donors could be placed. There is no limit on the size of gift that can start an endowment fund; even a very small gift can be used to start one. Further gifts will help the fund grow.

Even though a donor may begin an endowment fund for an organization, the board still has the responsibility for making sure that all the accounting, investment, and usage policies are in place so that good stewardship over the donor restricted endowment is maintained.

Donors give for many reasons, and finding the *right* donor(s) for endowment funds is not really difficult, for "when a donor makes a gift to an endowment fund, something rather magical takes place. Because only earnings from the endowment are spent, the principal remains intact. That means an endowment will keep funding yearly projects for your nonprofit *forever!*" (*Profitable Fund Raising Strategies*).

One important policy statement needs to be established before seeking donor restricted endowment funds and that is at what level gift you will "name" an endowment. Named endowments require separate recognition and accounting, and therefore require more time,. It would not be wise to permit a \$500 gift to be named the John Doe Endowment Fund, whereas it might easily be imagined that a \$10,000 gift would gratefully be named the Mary Smith Endowment Fund for Pioneer Living Exhibits, for example.

In addition, the policies or procedures might define other kinds of benefits the donor might expect *in perpetuity*. These should be recognized as an important responsibility of the board because of the generosity of a gift of this magnitude. Such benefits might include named recognition on a plaque somewhere, invitations to special dinners, etc. Never forget the importance of continued gratitude to your major donors.

All of the policies and procedures should be in place *before* soliciting endowment gifts.

Creating an Endowment Fund by Launching a Campaign

If no donor is forthcoming to provide an endowment fund (a Permanently Restricted Asset), what are the steps that a board can take to begin endowment building?

First, decide to launch a campaign to establish an endowment fund. Pass a board resolution (see sample) establishing the fund and what limitations there are on it.

Next, follow the usual steps for fundraising:

1. Prepare a case statement
2. Decide upon a dollar goal
3. Decide upon a method of solicitation, both in-person asking (to get the larger gifts) and by mail
4. Develop a list of prospects (those who have **Linkage** to your museum, **Interest** in your mission, and **Ability** to give – known in the fundraising field as LIA)
5. Find the appropriate people to make the campaign successful
6. Develop a public relations plan so that your community knows the campaign is going to happen
7. Plan the campaign for the appropriate time (in your museum's development and in your community)
8. Have enough staff and/or volunteers to handle the whole campaign, including soliciting gifts, accounting for these gifts, and thanking every donor
9. Make sure you have enough financial resources (whether you pay for them or they are donated – things such as paper, envelopes, printing costs, postage) to launch the campaign.

Finally, when preparing the actual donor solicitation, state it very carefully so that the donor *knows* that gifts received in response to this solicitation will be used to establish an endowment fund. In this way, the board can begin a true endowment, rather than a quasi-endowment (see below).

Creating an Endowment Fund "Creatively"

A quite simple way to create an endowment fund is for the board to decide that they want an endowment fund and then "pass the hat". Obviously, the board will already have taken the steps mentioned above so that all of the policies are in place. They can then decide to become individual donors to create an endowment fund by making their own gifts at a board meeting. Of course, you will expect that you will have 100% support from your board if you use this very creative approach (which actually occurred at one Indiana museum)!

Creating a Quasi-Endowment Fund

It is also possible, and even desirable, that a museum board establish an endowment from its own resources: excess operating support and revenue or unrestricted bequests, for example. However, this is known as a "quasi-endowment", because when a board establishes an endowment and places restrictions on its use, it of course can also *un*-restrict that use. But the museum's policies governing the quasi-endowment can be designated in such a way that, while it is legally considered unrestricted, it will indeed function much as a permanently restricted endowment fund.

One of the main reasons for boards to establish their museum's endowment is that a donor may not be forthcoming to establish a donor restricted endowment, a *true* endowment. Or perhaps your organization is not ready to launch an endowment campaign. Yet, your organization wants to provide some stability by investing some resources you have and using only the interest from that investment for operating expenditures. The answer would be to establish a quasi-endowment fund.

As stated earlier, under the new FASB guidelines board established endowments (unless developed as described above) can be reversed by the board and therefore are called "quasi-endowments" and are accounted for under the category Unrestricted Funds. However, the board can make it very difficult for itself to use these funds for anything other than investment unless a real need develops to invade the principal of the fund.

The following are appropriate steps to take to begin a quasi-endowment fund:

1. Consider establishing a policy (see sample) stating that all bequests, unless restricted otherwise, will become part of the quasi-endowment fund. (Note: by taking this step, the board sets the stage to begin discussion with planned giving prospects to encourage them to restrict their bequests to the museum's endowment fund, if one is in place, or for their bequest to become an Endowment Fund.)
2. State what other funds can become a part of the principal of the quasi-endowment fund. (This would be the statement that prohibits placement of *true* endowment gifts in the museum's quasi-endowment fund; a donor established endowment would become a separate endowment, as it is possible for many endowments to exist for one organization.)
3. Determine how the quasi-endowment fund will be invested. (Establish an investment policy [see sample] and who will oversee the investments – a committee, a bank trust department, an investment broker, etc.)
4. State how the fund will be used. (Consider permitting the interest and dividends to accumulate in the fund until it reaches a certain point, at which time the income will then begin to be used for operating or project expenses.)
5. Provide the mechanism by which the restrictions placed on the endowment by the board can be reversed, making sure that this mechanism provides for clear, sound

thinking before the serious step of using all or part of the principal of a carefully developed endowment is taken.

6. Consider adopting a by-laws amendment that reinforces the complexity of undoing the restrictions on the board established endowment fund.

Perhaps you would like to name your fund something more appropriate to your organization than "quasi-endowment". Of course you may call the fund anything you wish; however, on accounting statements these board-designated funds will be listed under the category "quasi-endowment".

Expanding Endowments

Once a board established quasi-endowment, donor restricted endowment fund, or campaign established endowment fund is in place, the task of building these funds becomes much easier. However, don't be discouraged when annual operating donors may not want to also give to endowment funds. Donors to endowments have a particular approach to their philanthropic gifts and require a different approach when soliciting for these funds. It is important to focus on the fact that the gift will support the museum *forever*, and thus planned giving efforts often are very successful at building endowments. The board must be patient in waiting for gifts through planned giving, but the end result can be very rewarding.

Investing Your Museum's Funds

Maximizing returns on investments is a responsible approach when providing for your museum's long-term stability. In order to do this, it is usually wise to commingle funds (the actual "cash") while keeping the funds separated on paper in your accounting system. This is particularly true if none of your separate funds is sufficiently large to invest at a good rate of return.

Too often museum boards leave the responsibility of investing to well-meaning committee members, a banker, or an investment broker. However, the board should take the responsibility of creating an investment policy not only for endowment funds but for temporarily restricted funds which are invested.

An investment policy statement is a formal, written document outlining the investment objectives, goals, and guidelines for a portfolio and is part of the investment planning process. Its purpose is threefold:

- to establish a clear understanding between the museum and the investment manager(s);
- to provide guidance and limitations in the investment of the fund; and
- to provide a meaningful basis for the evaluation of the fund and the manager's performance.

This statement then becomes the guiding document for your organization's investment committee which will either oversee the investments as a committee or hire an investment manager, in which case the committee should meet regularly with the manager to see if the investment policies are being followed.

Conclusions

Four ways to establish endowment funds for your organization include

1. Finding a donor willing to establish an endowment with a major donation.
2. Launching a campaign which has as its sole purpose the establishment of an endowment.
3. "Passing the hat" at a board meeting.
4. Establishing a quasi-endowment fund, designating it so specifically that it functions much like a true endowment.

The information presented here should not be construed as legal advice. It is, however, intended to encourage museum boards to make that first step towards creating an endowment – whether you find a donor, launch a campaign, or establish one restricted by the board. Just the process of creating an endowment is an important step to a financially secure future for the museum – which is one of the major responsibilities of a museum board.

Sources

"Financial Accounting and Reporting Issues Facing Museums", presentation by Jeanna Campbell, CPA, with Geo. S. Olive & Co., at the Association of Indiana Museums' workshop on "Legal and Ethical Issues in Museums" (copies of handouts from this session are available by contacting Ms. Vincent.

Financial Accounting Standards Board, PO Box 5116, Norwalk, CT 06856-5116.

"How to Launch Your Own Endowment Fund", *Profitable Fund Raising Strategies*, Center for Management Systems Newsletter Group, Box 259, Akron, IA 51001.

Museum Accounting Handbook by William H. Daughtrey, Jr., and Malvern J. Gross, Jr., American Association of Museums, 1575 Eye St., N.W., Suite 400, Washington, DC 20007

"Starting an Endowment: The Basics" by Herrington J. Bryce, *Non-Profit Times* (April 1990), Box 7286, Princeton, NJ 08543-7285.

What a Difference Nonprofits Make: A Guide to Accounting Procedures, Accountants for the Public Interest, 1012 14th St., N.W., Suite 906, Washington, DC 20005.

Sample Policy Restricting Use of Bequests

Bequests received by the Douglas County Historical Society will be placed in the DCHS Maintenance Fund if the bequest is more than \$1,000 and if the bequest is not restricted by the donor. This policy becomes effective December 31, 1997.

This sample policy is one of many types that could be established by the board. Establishing policy is one of the primary responsibilities of boards. Policies should be approved by the board at a regular board meeting and should include an effective date for the policy to begin. Policies may be changed or ended at any time by the same type of action by the board.

Sample Resolution Establishing a Quasi-Endowment Fund

Whereas, the Douglas County Historical Society operates the Douglas County Historical Museum and wishes to provide funds in perpetuity for its maintenance; and

Whereas, the Douglas County Historical Society has received a significant gift from the estate of the late John S. Doe; therefore

Resolved, that \$10,000 from the John S. Doe estate gift become the principal of the Douglas County Historical Society Maintenance Fund; and

Resolved, that this principal shall be invested as described in the Douglas County Historical Society Investment Policy and the interest earned be accrued in the fund until the principal reaches \$20,000; and

Resolved, that the Douglas County Historical Society may add additional resources to this fund; and

Resolved, that after the principal in the DCHS Maintenance Fund reaches \$20,000, interest earned from investments will be withdrawn annually and used for maintenance of the Douglas County Historical Museum; and

Resolved, that the Maintenance Fund be established no later than December 31, 1997.

Note: It is best not to permit restricted contributions to be added to board designated funds. If a donor wants to give to an endowment fund, and all your organization has is a quasi-endowment fund, the wishes of the donor would give you the perfect opportunity to create a true endowment with the funds the donor wishes to give.

Sample Resolution Establishing an Endowment Fund

Whereas, the Douglas County Historical Society operates the Douglas County Historical Museum and wishes to provide funds in perpetuity for its operating needs; and

Whereas, the Douglas County Historical Society has the financial resources and plans in place to launch an Endowment Campaign; therefore,

Resolved, that a three-year Endowment Campaign be launched on September 1, 1997, to establish the Douglas County Historical Society Endowment Fund; and

Resolved, that the goal for this campaign will be \$10,000; and

Resolved, that the contributions received from this campaign shall become the principal of the DCHS Endowment Fund; and

Resolved, that donors and bequeathers may add additional resources to this fund and that additional gifts to the Endowment Fund shall be solicited in future years from friends of the Douglas County Historical Society; and

Resolved, that this principal shall be invested as described in the Douglas County Historical Society Investment Policy and the interest earned be accrued in the fund until the principal reaches \$20,000; and

Resolved, that after the principal in the DCHS Endowment Fund reaches \$20,000, interest earned from investments will be withdrawn annually and used for operating expenses of the Douglas County Historical Museum; and

Resolved, that the principal of the Endowment Fund be maintained intact in perpetuity by the Douglas County Historical Society.

This sample resolution is just one possibility for an endowment fund. The possibilities and variabilities are unlimited. Care and forethought should go into the preparation of the resolution which should be submitted in writing as a motion at a full meeting of the Board and acted upon at that meeting.

Sample Investment Policy Statement for an Endowment Fund

The purpose of Douglas County Historical Society Endowment Funds is to provide a permanent source of annual income for the Douglas County Historical Museum and specific projects described by each fund.

Management of Endowment Funds

The Investment Committee will oversee the investment of endowments funds and will be comprised of the treasurer, chair of the Fundraising Committee, the museum director, and an at-large board member.

Responsibilities of the Investment Committee

The Investment Committee will

- comply with all legal and tax regulations
- comply with the by-laws and guiding policies of the Douglas County Historical Society
- establish reasonable investment objectives
- develop investment policy guidelines which are consistent with the investment objectives

- select a qualified investment manager
- communicate these guidelines and objectives to the investment manager
- monitor and evaluate performance results

Investment Objectives

The Douglas County Historical Society's investment objective for its endowment funds is a balanced portfolio with primary emphasis on income.

Endowment funds may be pooled with larger investment funds, such as community foundation investment funds, to maximize income earned. Principal must be certified as secure.

[At this point in the policy, specifics regarding fixed income, equity investments, investment philosophy, asset allocation, diversification, and prohibited transactions may be incorporated eventually. Development of these aspects requires the assistance of experienced professionals and should be added after considerable thought and planning.]

Limitations

An Endowment Fund may be established for a specific project only with donated assets of \$10,000 or more per fund.

A Named Endowment Fund may be established only with donated assets of \$10,000 or more per fund.

Acceptance of donated assets for an Endowment Fund must be approved by the board of the Douglas County Historical Society in order to confirm that the fund's purpose is consistent with the mission of the society.

Donated assets in any amount may be accepted for Douglas County Historical Society endowment funds already in existence.

This sample Investment Policy Statement covers the minimum aspects of a statement and can be used as a guideline for elements of a policy to be considered by an organization.

About the Author (1997)

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