The Foundation Guidebook

For new foundations and those new to philanthropy

exponent philanthropy

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Exponent Philanthropy is the country's largest association of funders—more than 2,000 members strong. Our powerful and vibrant network of private and community foundations, philanthropic families, and individual donors practices a style of philanthropy motivated by personal passion, community needs, and the strong desire for better outcomes. We provide programs, resources, and connections that maximize our members' dollars and time for the benefit of a diverse set of communities and causes.

The Foundation Guidebook reflects two decades of Exponent Philanthropy staff, board, member, and consultant contributions. We are grateful for Sara Beggs who wrote the original edition and oversaw subsequent revisions.

Exponent Philanthropy
1720 N Street NW
Washington, DC 20036
www.exponentphilanthropy.org
@exponentphil

The world's greatest structures are significant and remarkable: the pyramids, the Parthenon, and the Great Wall of China. Each is an enduring expression of the people who built it.

You have an incredible opportunity to build something remarkable with your foundation. Small or large, new or established, your foundation can be a lasting expression of who you are and make an impact for years to come. We applaud your choice to build something of such significance, and starting with *The Foundation Guidebook,* we look forward to lending a hand along the way.

The Foundation Guidebook is written for those new to the world of private foundations. It provides the baseline knowledge necessary for running a foundation that will allow you to get on with the really important work of making a difference. You'll learn how to build a foundation through thoughtful design and careful construction. Recognizing, though, that you have a lot to do in too little time, this guidebook focuses on practical ways to get the job done simply.

This book is for you, whether you are:

- Starting a foundation or filling a position that has existed for decades
- Serving as board member, executive director, administrator—or all three!
- Running a foundation that was established as a nonprofit corporation or trust
- Hoping to engage family members or to turn instead to community members
- Planning for a foundation life of 10 or 100 years
- Operating with volunteers or are fully staffed

Exponent Philanthropy encourages you to flip to the chapters you need when you need them; a quick scan of the book may help you to identify your highest priorities. Keep in mind that foundation work is an iterative process, so do revisit chapters as your needs change.

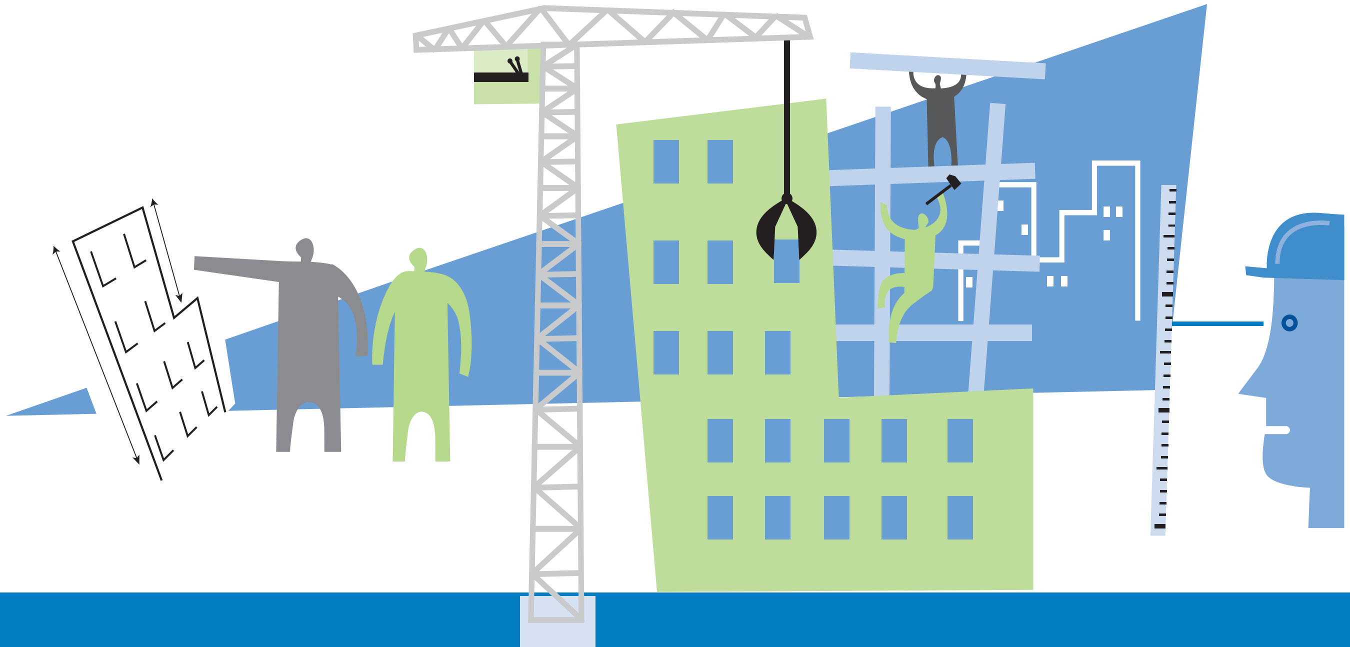
Wherever you are in the life of your foundation, we hope *The Foundation Guidebook* will help you build and participate in something significant and fulfilling. As one small foundation manager said, "It's demanding; it's exhausting. But it's the best work I've ever done." We hope you'll come to the same conclusion: that this is the best work you've ever done.

Our thanks to the Ford Foundation for funding *The New Foundation Guidebook* in 2003, the publication we have updated and adapted to create a resource for anyone new to the world of private foundations.

CHAPTER 4

CHAPTER 5

CHAPTER 6



Chapter One

DESIGNED WITH PURPOSE: FOCUS

Every important structure starts with a purpose in mind. What will you build? What is the purpose or niche you envision for your foundation? What specific change do you desire to achieve through the work of your foundation? How will the design of your foundation embody the values of its builders? It's up to you.

Starting a Foundation

Download a free copy of "How to Start a Private Foundation" for an "A to Z" overview of the steps to start a private foundation.

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In This Chapter

- A focus is a powerful tool for making an impact.
- Don't be afraid to choose a narrow focus; it's only a guideline.
- Some boards find it possible to develop a meaningful focus only after they find commonality among their deeper values.

This chapter has a single theme: defining your purpose or focus. Few people have the opportunity to define the purpose of an institution. Even fewer have the opportunity to work toward their defined focus. You are likely to have the distinct privilege of both.

The Power of a Focus

When seasoned foundation leaders give advice to newcomers, they repeatedly share the following tip: Focus your giving. Not only is foundation work less overwhelming when boundaries are clear, but foundation insiders are more fulfilled when they know where to look for the effects of their work.

When starting and running a foundation, you'll have many decisions to make, but few will have such far-reaching effects as whether to focus your grantmaking around a few core issues or areas of interest. Taking time to focus can enable you to significantly increase your impact, spend your time on what matters most, contribute intellectually and monetarily to causes you care about, influence and collaborate with other funders, measure progress toward your goals, and strategically align all other aspects of the foundation with this purpose.

Funders agree that the most compelling focus is one in which foundation interests and values intersect with community needs and the foundation's internal resources. For example, when Arbor Brothers cofounders Scott Thomas and Sammy Politziner were determining on what to focus their grantmaking, they reflected on the experiences and beliefs that drew them to this work. "We believe in the transformative power of opportunity but recognize that social change is a slow and often painful process," said Sammy, "so we wanted to support organizations that attack a root cause of poverty by investing deeply in people over time."

To this end, Arbor Brothers supports nonprofits that serve low-income participants through education, youth development, and workforce training. Beyond targeting these specific sectors, Scott and Sammy further narrowed their focus based on geography by limiting their grantmaking to organizations that serve New York, Connecticut, and New Jersey. This local emphasis has allowed them to become intimately familiar with the challenges and resources of communities in these states. Moreover, after observing the often daunting management challenges many young social entrepreneurs face, the cofounders decided to target organizations that navigate the awkward phase between start-up and scale-up.

Author Jonathan Kozol offers wisdom about how narrow a focus should be: “Pick battles big enough to matter, small enough to win.” Defining a purpose that is sufficiently inspiring is critical, but it should be contained enough that you can define actionable steps for making progress.

Have an Open Discussion

Settling on a focus is not necessarily an easy step, especially if your foundation has functioned in an unfocused manner for some time. Consider having a discussion that teases out the concerns decision makers may have about defining a focus. During the discussion, keep in mind:

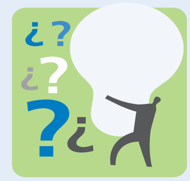
- **You can agree on a focus—**Board members may have strong and opposing opinions, but consensus is not impossible. Foundation boards often can find commonality by shifting the discussion away from personal interests or particular grantees to center on values instead. You’ll be surprised by the degree to which integrity, opportunity, compassion, and other values can create common ground.

- **You can accommodate board members with other interests—**Focusing the foundation does not preclude your board from setting aside a portion of its giving for discretionary grants. Many foundations allow board members and key staff to direct a portion of annual giving to organizations of their choice. You can also tap into board members’ interests by putting their talents and technical skills to use.

- **A focus does not prevent the foundation from being responsive—**If your foundation historically has given to many organizations that asked, focusing will indeed be a significant change—and one that feels less responsive to certain causes. Keep in mind that your foundation can be highly responsive to community needs by learning about the most critical ones and focusing your efforts there. You also can set aside a small amount of money for emergency response, if that type of giving is important to you.

- **A foundation isn’t limited to a single focus—**Many foundations have more than one focus. Be sure, though, that your assets, time, and energy are sufficient to achieve impact in more than one area. If investing in more than one area, consider taking on each focus area one at a time to effectively establish each. Some

Can we fund proposals that do not fit within our focus areas or mission statement?



Yes! Generally, a focus or mission statement provides guidelines for your giving; it usually is not a legal limitation. Foundations go beyond mission to take advantage of opportunities that arise or to help with emergencies. Others set aside a portion of their grantmaking each year for discretionary grants, and some of this giving falls outside mission. Be sure that you do not fund outside your bylaws or trust agreement, though, because those documents are binding.

Time-Saver

Exponent Philanthropy members can use the online **Member Directory** or **Member Discussion Groups** to find fellow members with expertise to share. Talk with your peers about choosing a focus, selecting and orienting board members, streamlining your work, and much more.

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foundations spend the year learning about a field before making critical decisions about how to invest.

- **A foundation can experiment with focus—**Initially, tentative foundations may apply only a small portion of the foundation's assets in a focused manner. Of course, the benefits of a focus will only be visible if the board and staff direct their time and energy accordingly.

- **A foundation can shift from unfocused to focused over time—**Even if you decide to focus, you can make the shift over a period of several years to give grantees time to find new funding sources. Using a small portion of your endowment for discretionary grants also can make the shift more palatable to trustees and key staff.

Board members may nevertheless struggle with the notion of focus—and understandably so. "Board members often engage in foundation work because it makes them feel good," said Elizabeth Snowdon of the Hill-Snowdon Foundation, "but changing the status quo to focus doesn't necessarily feel good. For starters, it's difficult to say no to some wonderful organizations." This period of transition can be challenging for funders, but typically it is for a limited period. After establishing a clear focus, most funders find that they say no much less often.

It is also important to discuss the advantages of focusing:

- **A focus directs your time wisely—**Board members and staff have limited time; use it wisely by focusing their efforts. A focus allows your key players to know issues and grantees more intimately and bring to bear their knowledge, reputations, and influence, all of which are equally, if not more, powerful than the foundation's dollars.

- **A focus allows you to know enough so that you'll make educated decisions and set realistic goals and well-informed strategies—**Ultimately, you only can measure success in a particular area if you first have defined what you are striving to achieve.

- **A focus allows foundation trustees and staff to communicate more effectively—**A focus will help you communicate what you do and why to current and potential grantees, fellow funders, elected officials, and others interested in your work. Nonprofits, in particular, benefit when foundations are clear about their priorities because they will spend less time pursuing a direction with little chance of success.

- **A focus provides a framework for decision making—**With a focus, other decisions about governance, grantmaking, administration, and investments will fall into place.

- **Successful businesses focus; foundations that focus see results too—**Businesses choose a market niche based on many factors, including their strengths, weaknesses, opportunities, and threats. Foundations can benefit from applying the same logic because, after all, many are led by people with savvy business minds.

Take Steps to Find a Focus

Many foundations use a combination of methods to settle on a focus. Be sure to allow enough time at a meeting or two or during a retreat for careful decision making. Once you consider the approaches that follow, it is important to recognize when you may need help. Some boards are able to facilitate productive discussions themselves, but others have greater success by engaging outside facilitators. Because agreement on a focus is of paramount importance, money for a consultant, if needed, is money well spent. Board members often must do the hard work of clarifying their own values and passions before they can articulate them for the entire board. Don't be surprised if it takes more than one meeting to arrive at consensus on a focus.

The following are some drivers for finding a common focus among decision makers.

Passions

Some boards develop a focus built on common passions. Because those passions often are based on emotional connections, the following questions can help you uncover them:

- About whom or what do you care deeply?
- What excites you or brings you the greatest joy?
- What angers you or breaks your heart?
- What do you believe drives change?
- Has an event significantly shaped who you are or what you believe?

Common Values

Even individuals with outwardly polarized views can hold similar values, and, once found, those values can lead to a unifying focus. Uncover shared values by asking questions such as:

- What is critical for an individual to become a productive member of society?
- What was key to your becoming the successful and productive person you are today?
- What values guide your life choices?

Define Your Legacy

Donors have an incredible opportunity to leave a legacy. Whether you have a particular passion or simply want to influence future generations, you will be well served by clearly communicating your intent.

A formal statement of donor legacy, or donor intent, is an effective way to communicate your vision for the foundation. A simple letter or a videotaped interview will capture your intent for future generations, yet also leave room for them to shape the foundation. Statements of donor intent, although powerful, are not legally binding.

If your donor is no longer with you, don't despair. You can recreate donor intent by speaking to those close to the donor and considering what the donor supported during his or her lifetime.

A Focus Helps Grantseekers Too

A focus benefits not only your foundation but grantseekers too by letting them know if your interests match theirs. If a match occurs, grantseekers will know immediately that it may be worthwhile to find out more about you. Otherwise, they can quickly move on to another funder.

21/64, a nonprofit consulting group specializing in next generation and multigenerational strategic philanthropy, offers a deck of Motivational Values cards; each card states a value (e.g., justice, family). Individuals can prioritize the cards according to what motivates their philanthropy and then discuss their rankings with the group. Rebecca Richards of the Maxine and Jack Zarrow Family Foundation described her foundation's experience with the values cards: "We were surprised that all our board members selected three values in common: integrity, family, and responsibility."

Once your board has identified core values through key questions, group exercises, or other means, it can begin to articulate a focus based on those values.

Critical Community Needs

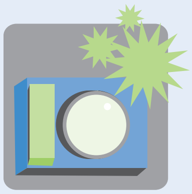
Although board members may have their own—often well-informed—visions for a community, it can be helpful to hear from the community about its needs. With awareness of the community's voice, board members can craft a focus that also incorporates board members' interests, strengths, and skills. For example, Tracy Family Foundation's board members shared common interests in education, family, and youth. After completing a community needs assessment that pointed to numerous critical needs, it became clear that education needed to become the foundation's primary focus. Its interests in family and youth would be addressed as secondary foci. If board members have difficulty finding commonality in community needs, consider choosing a focus that is new for all members. For example, The Tow Foundation found great power in group ownership of an unfamiliar but critical focus: juvenile justice.

Donor Legacy

If your donor—living or deceased—has expressed interest in a particular focus, consider how you might respect that wish. In the best scenarios, boards create a focus that also resonates with current board members. Even if the donor's interests are narrow, board members can still find fulfillment by looking deeper for values they share with the donor.

The Hau'oli Mau Loa Foundation's donor had no desire to constrict foundation decisions, but, to help future directors, she did share her motivations for establishing the foundation. In a letter, she explained her two areas of interest: bringing hope to those less fortunate, especially children, and environmental conservation. Following her death, the directors used those interests—and the values the donor exemplified—to settle on the foundation's focus areas and the way staff would do their work.

Foundation Snapshot: Focused on Finding the Right Levers | The Erol Foundation



Location: Geneva, Switzerland, and San Francisco, California
Assets: Pass-through foundation with approximately $3 million in grants and in-kind support annually
Number of board members: 3
Number of full-time staff: 0
Number of part-time staff: 3 (consultant team)

"When we established Erol," said Foundation Advisor Abbey Banks, "we committed to help resolve the imbalances caused by poverty. Optimistic but pragmatic, we sought the right lever for change: a program with great potential for impact and scale, where a relatively small but timely investment could catalyze growth.

We engaged social impact agency Amplifier Strategies to assess programs and partners working in this sector. Evidence-based research from renowned institutions led us to BRAC's [a nongovernmental organization] ultrapoor graduation program, which empowers families to move out of ultrapoverty through a series of carefully sequenced interventions. Erol and Amplifier spent time with BRAC, listening, building trust, gaining leadership buy in, and forging a strategy to bring graduation to those who need it most.

One result was a 3-year commitment to BRAC—both direct grants and in-kind support—to build its capacity to advocate for graduation on a global stage, expand implementation to new countries, and give technical assistance to other practitioners. The other result was Uplift, a collaborative initiative. With Erol as seed donor, Uplift is investing in leading organizations with the best graduation results that will reach 20 countries and lift the next 1 million families out of extreme poverty in the next 5 years."

Meaningful Grants

Foundations often uncover a focus by reviewing past grants. Look for grants that have addressed a particularly meaningful cause, have stood out because of impressive results, or have made board members proud. As Nan Pugh of Pugh Family Foundation said, "For 7 years, we simply made grants to nonprofits we liked. When we looked back at those programs, we realized that most dealt with poverty and education in southern Louisiana. Now our mission is to support organizations that address education and anti-poverty efforts within the Acadiana community."

A Single Strategy

Some foundations find focus via a single but powerful strategy. This approach allows a foundation to gain expertise that can be leveraged across issue areas. For example, The Fledgling Fund focuses on improving the lives of vulnerable individuals, families, and communities by supporting innovative media projects that target entrenched social problems.

Populations of Interest

Think about the populations that interest you. For example, your foundation may want to focus on improving a particular aspect of life for elderly people or for children. After defining a focus or two, some foundations are able to articulate an intended impact in each focus area. They can clearly envision what success will look like if they address the challenges of that focus effectively. Doing this in the early stages can shape every other aspect of your foundation's work from administration to your board. It is not typical for most foundations to have this type of clarity, though, without digging deeper and learning more about the field of focus.

Build a Powerful Mission

If you already have established a mission, you may want to change it based on your decisions about focus. Usually, funders maintain their fairly broad mission statements and simply publicize their focus area to provide clarity. If your mission statement is in conflict with the newly stated focus, however, it is recommended that you align them.

It's best to keep your mission statement succinct: just a sentence or two at the most. A mission statement's power is in its simplicity, or its ability to be communicated easily.

The following are examples of mission statements:

- The Sunflower Foundation serves as a catalyst for improving the health of Kansans. —Sunflower Foundation, Topeka, Kansas

- The foundation focuses on enrichment and empowerment of children and youth under age 19 to prevent exploitation, poverty, and injustice. —The Susan A. and Donald P. Babson Charitable Foundation, Boston, Massachusetts

- The Ann Campana Judge Foundation exists to promote, undertake, support, and fund philanthropic projects in and relating to developing countries that focus on water, health, sanitation, and student involvement. —Ann Campana Judge Foundation, Albuquerque, New Mexico

Getting to Focus by Discovering Commonality in Culture and Values

Crafting your focus around common interests is often easier said than done. Individuals can have wide-ranging and even opposing perspectives that make commonality seem like a distant reality. That's when it's time to look a little deeper: to the culture and values held dearly by each of us. Even individuals with outwardly polarized views can hold similar values, which, once found, can be a powerful source of unity.

Marker Goldsmith Advisors uses the following questions in its work with foundations to tease out shared grantmaking culture and values:

- Are you comfortable with recognition or do you prefer anonymity?
- Are you inclined to fund prestigious institutions or the neediest causes?
- What interests you more: funding already successful projects or starting something on your own?
- Do you tend to be risk tolerant or risk averse?
- Do local, regional, national, or international issues invoke your strongest passion?
- Do you see yourself as having significant or minimal involvement with those to whom you give money?
- If you are a family foundation, is keeping the family together more important than funding a particular cause?
- Is it important for the foundation to exist in perpetuity, or should that decision be based on other factors, such as the specific mission you choose or the interests of the board?

Write responses on a flip chart and ask individuals to place stickers next to the responses that resonate most. Note those areas for which the greatest consensus exists, and build this culture into whatever focus area you choose.

The Philanthropic Initiative, a nonprofit advisory team, suggests that individuals respond to the following questions before a group discussion on focus:

- What is important to you and what values guide the choices you make in life? Rank the top five.
- What values are/were important to the donor or the donor's family, if a family foundation?
- What values speak to the kind of philanthropy for which the foundation wants to be known?

Other resources to help you uncover shared values include The Values Edge System and the Motivational Interviewing Network of Trainers; you can find both online.

Chapter Two

ARCHITECTS OF THE PLAN: BOARD OF DIRECTORS

Having an effective team of architects is critical to transforming your dreams into a reality. This team is responsible for designing a structure that can fulfill its purpose and for overseeing the building process. Choose your architects wisely: They are the key to your success.

A Privately Organized Public Institution

Private foundations have a great deal of freedom, and that freedom should drive the foundation to be as effective as possible for the public good. As John W. Nason wrote in *Foundation Trusteeship: Service in the Public Interest,* "Foundation funds, because they have been committed to the service of the public good, belong in the public domain.... Trustees are servants of the public because the public are the beneficiaries of the foundation.... Foundations are a privately organized public institution."

In This Chapter

- It is both a tremendous honor and responsibility to serve as a foundation board member.
- It matters who is on your board. Take time to choose wisely.
- Clearly outline expectations of board members.
- A few strategic policies can bring clarity and efficiency to your board.
- Your board is a living entity. It can grow or stagnate based on board dynamics, the board's ability to take feedback, and the board's willingness to deal with bigger issues.

Your board of directors is responsible for leading the foundation in legal and ethical choices, sound financial decisions, effective operations, smooth transitions, and maximum impact. This chapter outlines the duties of the board and its members, discusses how to identify and recruit new board members, and describes ways to operate effectively as a board.

Note: The members of a board may be known as *board members, directors,* or *trustees,* depending on a foundation's structure. These terms are used interchangeably throughout the philanthropic community, as well as in this guidebook. Terms such as *foundation managers* or *grantmakers* apply generally to board members and top-level foundation staff.

The Full Board's Roles and Responsibilities

The roles and responsibilities of the full foundation board include:

- **Building a healthy board—**Foundations are established to instill philanthropic values in future generations, pursue a narrow mission, or give back to a particular community, just to name a few reasons. When choosing board members, the most effective foundations balance a desire to fill a particular role with a need for certain skills and expertise. Your board is responsible for orienting new board members to their responsibilities and providing ongoing learning opportunities to keep them engaged. *This chapter provides more details.*

- **Operating effectively as a board—**Use meetings, retreats, and committees, as needed, to accomplish your work. Also develop, support, and adhere to the operating policies and procedures you deem important. The most productive boards regularly evaluate their effectiveness and make changes, as needed. *This chapter provides more details.*

- **Planning for future board leadership—**Both family and independent boards have a responsibility to prepare for subsequent generations of foundation leaders. Boards that address the issue of succession early often have significantly smoother transitions compared with those that wait. *See page 28*.

- **Setting direction—**Your board can provide effective leadership by defining a clear focus and high-level strategy for your giving, and establishing—and holding to—values to guide daily operations. *See Chapter 1*.

- **Staying legal and ethical—**Your board is ultimately responsible for adhering to legal standards and ethical norms. Board members must ensure that the foundation follows its articles of incorporation, bylaws, and policies; complies with federal and state requirements; and holds to its mission and purpose to serve the public good. *See Chapter 3*.

- **Overseeing investments and finances—**As fiduciaries, your board must manage and oversee the foundation's portfolio. Board members may delegate investment management to committees or outside advisors, but, ultimately, they retain responsibility for the foundation's assets. The board also is responsible for setting financial controls and overseeing the foundation's budget and expenses. *See Chapters 4 and 5*.

- **Making sure the work gets done—**The board is collectively responsible for ensuring that work gets done well—whether by volunteers, consultants, or staff. *See Chapter 5*.

- **Being effective grantmakers—**Beyond setting clear direction, the board needs to be willing to learn deeply about a topic, engage authentically with grantees by listening, learn about what is and isn't working, and serve as a knowledgeable ambassador for the foundation. *See Chapter 6*.

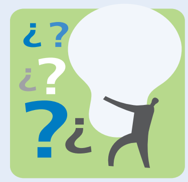
An Individual Board Member's Duties

According to nonprofit corporation law in most states, board members are expected to meet certain standards of conduct and carry out organizational responsibilities. These responsibilities are the duties of obedience, loyalty, and care.

Duty of Obedience

The *duty of obedience* requires board members to be faithful to the foundation's central goals and follow the principles established in the foundation's bylaws, policies, and mission. Board members must avoid any action that may jeopardize the foundation's tax-exempt status and must comply with state and federal laws.

May a foundation pay board meeting expenses using foundation funds?



Yes, a foundation may cover all meeting expenses with foundation funds. In addition, it can even include those expenses in the 5% payout calculation if the entire meeting focused on the foundation's charitable activities. If, however, a foundation spends part of a meeting discussing investments, that portion of meeting expenses cannot be included in the foundation's 5% payout calculation. Fees, portions of salaries, or board meeting expenses related to investments do not count toward the 5% payout.

Setting Ethical Standards

Compared to laws, ethics generally are self-imposed and encourage a higher standard of conduct. Ethics address what we *should* do rather than what we *can* or *cannot* do; what is *right* rather than what is *mandated by law.* Board members typically confront ethical dilemmas surrounding conflicts of interest, abuse of power and privilege, the need for transparency, issues of nepotism, arrogance in dealing with grantees, and questions of ethical investing.

Most foundations agree that ethics are essential. A foundation, though, needs to go a step further by having its boards outline a code of ethics for the foundation and be prepared to face ethical dilemmas. An ethical foundation commits to accountability, openness, honesty, a wise application of resources, and obedience to the law.

Duty of Loyalty

The *duty of loyalty* requires board members to serve the foundation's best interests—not their own. They can do so in the following ways:

- **Appropriately handle conflicts—**Conflicts of interest arise when board members have personal or professional interests in proposed foundation transactions. Be sure to follow your conflict of interest policy in all board decisions. At a minimum, board members should disclose conflicts and recuse themselves from related decision making. *For more information and a sample policy, see pages 43–45.*

- **Not abuse opportunities or misuse assets—**Board members must not use their positions of trust to take personal or professional advantage of opportunities presented to the foundation. Similarly, they must not use foundation assets for personal use.

- **Avoid self-dealing—***Self-dealing* addresses particular prohibited transactions between a foundation and its *disqualified persons,* that is, individuals with a close relationship to the foundation and other entities controlled or owned by individuals with a close relationship to the foundation (*see pages 49–52*). Board members should avoid most financial interactions between a foundation and its disqualified persons, and should handle exceptions to self-dealing rules with utmost care. Common self-dealing violations include:

    - **The foundation pays excessive compensation to board or staff members—**If compensating the board or staff, be sure that compensation is reasonable and necessary by field standards and that the work qualifies as a personal service.

    - **The foundation rents space from a board member—**Disqualified persons, who include board members and their family members, cannot rent facilities to the foundation, although they may offer space free of charge.

    - **The foundation pays spouses' expenses—**Foundations may cover board members' necessary and reasonable expenses but not spouses' expenses, unless they too are serving the foundation in an official role or unless such payment is part of a compensation package for the board member and is reported on Form 1099 or W-2 for tax purposes.

Duty of Care

The *duty of care* requires board members to be diligent and prudent in managing the foundation, investment of its funds, and pursuit of its charitable mission. The duty of care does not require that board members make the right decisions in all cases, but, rather, in a fashion as would another prudent person. To fulfill this duty, board members should be informed and be active participants in the foundation by preparing for and attending meetings, serving on committees, carrying out assignments, and representing the foundation in the community. Board members are responsible even for meetings they do not attend, and ignorance of a policy failure or violation is an insufficient defense, in most cases.

Choosing Effective Board Members

Foundations rely on their board members' energy, talents, and skills to fill visionary, leadership, and supervisory roles. If the foundation is unstaffed, board members also are responsible for the ongoing management and operations of the foundation. Before you invite anyone on to the board, you will need to make several decisions. First, consult your bylaws or trust document for requirements or limitations on who and how many may serve on the board. Also think about what is best for the foundation and for those you will serve. Although it is privately organized, a foundation is a public institution, and, as such, requires a qualified and committed board of directors—whether they are family members or other individuals. Consider the tips for success discussed in this chapter.

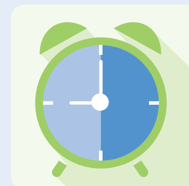
Focus on Your Fundamental Purpose

If the foundation will be a family entity:

- Determine your eligibility policy, and make it clear to potential members who is eligible or ineligible to join the board. Because many models for board membership exist, be thoughtful and creative about your approach so that it embodies your foundation's values and culture. Will it comprise lineal descendants only? Spouses? Far-flung cousins? Having policies in place early on helps when potentially tricky decisions arise—although you can always update policies to reflect a growing and changing family. If you will be including several generations over the years, find ways to formally engage younger generations. You might form junior boards or require that family members serve in an advisory role for a year or two so they may observe and learn before joining the board. Some foundations offer rotating seats for different generations or different branches of the family. *Read more in "Policies That Build, Not Burden" on page 36.*

- Determine if family members will automatically qualify or if they will be required to show a commitment to the work before receiving an invitation to be a full-fledged board member. Will the board benefit from non-family board members who provide needed expertise, increase diversity, or make the board more professional in its interactions? If so, what are the criteria for selection?

Time-Saver



Exponent Philanthropy members can download dozens of **sample documents** to reproduce or adapt, including:

- Board meeting agendas and minutes
- Board member position descriptions
- Board policies (e.g., conflict of interest, membership and participation, expense reimbursement)
- Board orientation documents

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Time-Saver

Let Exponent Philanthropy research, sift, and summarize for you! Download or order helpful **publications,** including these board-related titles:

- *The Trustee Handbook*
- Recruiting Foundation Trustees
- Bringing on the Board: Orienting Foundation Board Members
- Policymaking Made Clear

www.exponentphilanthropy.org

If the foundation will pursue a particular mission:

- Will you include people with experience related to that mission? In some cases, the foundation's executive director provides expertise to the board. Some boards are comfortable with staff participants; others are not. If the board decides to include staff, determine whether a staff member will be a full or ex-officio board member.

- Will you include people who have personally experienced challenges related to the mission or that represent that population (e.g., include people in academia if making grants for research)? Will foundation board members hold staff or board positions at grantee organizations, which is legal and ethical if the foundation has a conflict of interest policy in place to address such situations?

If the foundation will serve a particular community:

- Will you recruit leaders who can represent and connect you to those you intend to serve?

- Will you recruit community members with a broad perspective on community needs who can help you to be strategic about your focus area?

Screen for Skills or Expertise

A particular skill may help the board to operate or make grants more effectively. Will you seek certain skills to enhance your foundation's effectiveness? For example, would someone who specializes in communications assist in furthering the foundation's cause? If the foundation board lacks skills in investment management, can you recruit someone to provide this expertise? Many foundations are eager to have the family's attorney or accountant on the foundation board. Although having an advisor who provides *pro bono* work has its benefits, understand that the potential for a conflict of interest is great.

Look for Helpful Attributes

Consider seeking out board members with qualities such as the following:

- Ability to balance the foundation's private and public trust by honoring the donor's legacy and responding to community needs

Are there benefits to having nonfamily members on a family foundation board?

Inviting nonfamily members onto a family foundation board can have tremendous benefits. The foundation can leverage outside resources; become more connected to the community; open the board to new (and potentially insightful) perspectives; and become a more responsive, open-minded organization. For some boards, the mere presence of a nonfamily member brings new civility to the boardroom.

Some foundations choose close family friends, such as the family attorney or longtime neighbors; others choose community leaders or individuals with expertise in a particular grantmaking area. Ultimately, the effectiveness of a nonfamily board member depends on an individual's personality, character, and expertise, and the degree to which all board members support the decision to invite that person.

- Time and willingness to be attentive and diligent, no matter how small the task
- Fresh ideas and perspectives
- Moral sensitivity to the act of giving
- Proven leadership and ability to work well in a team
- Courage to make hard choices among competing worthy needs
- Respect for others and comfort in allowing others to lead
- Tolerance of other viewpoints
- Active listening skills
- Practical wisdom
- Sense of humor

Create Position Descriptions

Once you have your criteria for choosing board members, create a written position description that establishes and differentiates roles, increases efficiency, and clearly describes the expectations of board members. When recruiting board members, ensure that candidates understand the responsibilities before they accept the position. *See page 26 for a sample board member position description.*

Sample Board Member Position Description

Function: To assist the foundation in realizing its opportunities for service and fulfilling its statement of purpose in the following areas:

Planning

- Clarify the foundation's mission, values, and focus, and periodically assess them to ensure relevance.
- Determine and review major policies guiding the foundation; revise as necessary.
- Plan for future board leadership (i.e., develop guidelines for succession).
- Annually review and approve the budget.

Board
- Recruit and orient new board members, as needed.
- Review the board's performance and take steps to improve that performance.
- Participate in continuing education that helps board members develop skills in their areas of responsibility.

Fiduciary
- Ensure prudent investment of foundation assets by creating and implementing an investment policy statement.
- Execute fiduciary duty of care to protect the foundation and its assets.

Grantmaking
- Become knowledgeable about focus areas and assist in setting a thoughtful direction for the foundation.
- Review grant proposals; make site visits, as needed; and vote on proposals.
- Seek out and maintain ties with key organizations and experts in the foundation's program areas.
- Assess the grantmaking program annually.

Operations
- Regularly communicate with the executive director.
- Monitor, advise, and support staff; review performance in relation to mission and goals.
- Review compensation and benefits policies.
- Review financial reports regularly.
- Review investment performance regularly.
- Review and revise the investment policy, as necessary.

Compliance
- Ensure that conflict of interest policies are followed throughout the foundation.
- Review compliance with relevant laws affecting the foundation.

Exponent Philanthropy members can visit www.exponentphilanthropy.org for additional sample position descriptions.

Orienting and Engaging Your Team

No one is born a board member; consequently, all new board members have a learning curve. An effective orientation can mean the difference between engaged and disengaged board members. It also can mean the difference between a foundation that functions legally or illegally.

What to Cover and When

What does every new (and seasoned) board member need to know about your foundation? Be sure to cover these topics:

- The basics of your foundation's mission, values, programs, finances, and people
- General responsibilities of foundation boards and the legal rules governing foundations
- Your board's structure, duties, procedures, operating norms, policies, expectations of time and travel, and roles of staff who work closely with the board
- Impact of the foundation's and grantees' work—sometimes best seen by visiting the grantees

You may address some topics in the abstract, but most are better addressed with accompanying materials. For this reason, many foundations assemble important documents into a board handbook, which is useful for orientation and throughout the board member's service.

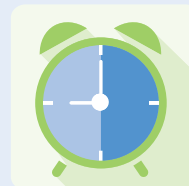
Keep in mind that, if someone is new to foundation work, it may be difficult for the new member to grasp information about the foundation in one sitting. Some boards orient new members over a series of meetings with key players and use the board handbook to start important conversations. If you choose to orient your board members over time, be sure to prioritize critical information. Board members must have a working knowledge of the law, how conflicts of interest are handled, and how to respond to the public.

Getting New Board Members Up to Speed

It's hard to be new. Help make it easier for new members on your board by:

- **Offering encouragement at board meetings—**Keep in mind that new board members might hesitate to speak up because "everybody else knows this." Throughout board meetings, encourage new members to ask questions and share their ideas.

Time-Saver



Check our **educational programs calendar** for upcoming events in a range of formats to help you get up to speed on the basics of governing a foundation. Popular programs include Foundations 101, Legal Essentials, and much more.

www.exponentphilanthropy.org

Successful Succession Starts Now

Succession tops the list of what keeps foundations up at night, yet many are reluctant to tackle the issue. Addressing succession early on has a number of benefits:

- Organizational strengths are best passed to future leaders while senior board members are still active.

- Disputes over mission, the pressure of geographic dispersal, uneven competencies and commitment across family branches, or poor leadership are best tackled sooner than later.

- Discouraging potential successors for too long is particularly dangerous in family foundations. By the time parents or grandparents are ready to be inclusive, the offspring may have moved away or invested their philanthropic interests elsewhere.

- **Giving early assignments—**If you assign work to new board members right away, they'll quickly develop a sense of purpose and belonging. Some foundations assign board members to committees or ask them to review recent grant proposals.

- **Implementing a buddy system—**Some boards pair a new member with a veteran (or recently retired member) who can answer questions and help the new member feel welcome. As one foundation board member said, "It's very useful for team building and motivation to have senior board members train less experienced members."

- **Providing professional development—**Consider sending new board members to training sessions or workshops, excellent ways to provide further orientation and to connect them with their foundation peers.

Keeping Board Members Engaged

Serving on a board is a big commitment. Board members are asked to give time and energy to the foundation—often with no compensation and little recognition. If attention wanes, if energy noticeably lags during meetings, or if members stop showing up, it's time to do something about it.

These ideas can help:

- Invite board members on site visits to observe the good work made possible by the foundation's grants.

- Invite outside speakers from the community. Ask a board expert to talk about governance issues, or bring in a past grantee to discuss the results of a grant.

- Engage the board members in deep learning on your area of focus. Board members who contribute intellectually are less likely to lose interest.

- Plan a board retreat to conduct strategic planning or address conflicts or issues that are obstructing the board's effectiveness.

- Reassess your focus. Is it still relevant and effective? Can board members connect to it? If not, and if the board agrees and has the flexibility to do so, you might consider shifting your focus.

Engaging Early

Teaching children and young adults about philanthropy will help them to be better funders. Engaging the next generation also will provide you with new ideas to keep your philanthropy dynamic for all members of your family.

Consider these ideas for engagement:

- Invite younger family members to site visits and allow them to experience and be inspired by the impact of your giving.
- Take the time to educate your next generation about the history of your giving and where you focus your efforts. Interviewing donors and capturing the history in writing or on video is a great exercise for younger generations.
- Allow younger family members to make discretionary grants or match their individual giving to support the development of personal philanthropy.
- Encourage the next generation to become well versed in the issues about which they are passionate and to get involved as volunteers, not just as donors.

Building Healthy Boards

Want a healthy and engaged board? Read on to see where to focus your energy.

Ensure Good Board Dynamics

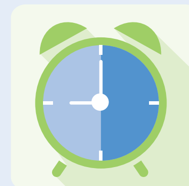
When faced with the inevitable challenges of governance and grantmaking, foundation boards have a real advantage over individuals who act independently—if the dynamics are right. To foster good board dynamics:

- **Hold board members to high standards—**Expect all board members to understand, respect, and appreciate differences. Boards with good dynamics recognize that each member brings a unique perspective and purpose. They embrace varying viewpoints, encourage frank and meaningful discussions, and, as a result, make more informed and more effective decisions.
- **Address disruptive behavior—**To change bad habits requires commitment by the entire board—and it can be done. The board can address some behaviors by developing a statement of culture, solid decision-making processes, and clear lines of communication. It can handle other behaviors as they arise.

  Consistent keys to success include:

  - **Trust—**Invest time and energy in building trust with your fellow board members and staff. A lack of trust will lead to little openness to change. Listening well, meeting each person where he or she is, and giving board or staff members what they need are part of building trust.

Time-Saver



Introduce young people to strategic, thoughtful philanthropy with our 7-part **Teen Philanthropy Café** series designed to facilitate peer discussions and fun activities around giving. *For families and adults who work with young people.*

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> ### Committees That Work
>
> Board committees and advisory groups are practical ways to manage the board's work because small groups often are more focused and efficient than a full board.
>
> A *committee* provides advice to the board on a particular topic and usually comprises several board members, although outsiders may be invited to participate. Committees may include grants committees, finance committees, or nominating committees.
>
> *Advisory groups* usually comprise external individuals to provide technical expertise or program assessment. Advisory groups are commonly mission specific (e.g., education or social services) or generational (e.g., involving children or grandchildren).
>
> Both committees and advisory groups can be standing (i.e., permanent) or ad hoc (i.e., as needed). They can engage former board members, cultivate future board members, and bring fresh perspectives and skills to the board without adding members.

  - **Urgency and inspiration—**Urgency creates motivation to act. And yet, if not properly balanced by inspiration, too much urgency can paralyze others. Look for an ally within the foundation to encourage the change. Talk with other foundations to find creative solutions.

  - **Small increments—**It takes great effort and determination for an individual to accomplish significant change; it's even more complicated for a group to do so. Incremental changes often are easier to manage and feel less perilous. They allow you to test new ideas on a small scale and make adjustments as you go so that you are moving toward a goal without risking precious resources.

  - **Outside help—**You can address many boardroom dynamics—particularly those involving families with complex dynamics from past years—by bringing in outside facilitators.

- **Learn key effectiveness skills—**These skills include learning:

  - How to manage change by becoming aware of common patterns, pitfalls, and opportunities that arise in moments of change—and how those close to your work may react to it—so that you can help your foundation maneuver adeptly

  - How to develop a sensitivity to the power dynamics inherent in philanthropy among funders and grantees, donors and other board members, and family members

  - Tips and techniques for having difficult or courageous conversations, which are inevitable in life and work

Founders often see the foundation as a catalyst for family unity. This goal may or may not be a realistic one; nevertheless, founders will play a significant role in setting the tone. If they desire unity and cooperation, founders can set an example by valuing opinions and contributions. This approach is especially challenging if the founders continue to view the foundation's assets as personal rather than held in the public trust.

Hold Meaningful Retreats

To be legally compliant, your foundation must hold meetings. To be effective, it can hold retreats. A board retreat or other special meeting is an excellent way to focus on an issue that is too significant to handle well within a typical office meeting. You might consider a board retreat at the following times:

- The board wants to discuss strategic issues (e.g., future of the foundation's grantmaking or the foundation's governance structure).

- The foundation undergoes a period of growth or transition (e.g., a change in leadership or asset size, or a generational shift).

- Board members seem less engaged or enthusiastic about the foundation's work.

The key to a meaningful retreat is preparation, which sometimes takes as much time as the retreat itself. Good planning is well worth it, though, to create a successful retreat and convince board members of the value of retreats for years to come.

Consider Geographic Dispersion

When board members live in different parts of the country, the situation can present several challenges to a foundation board. Board members may lose touch with one another or may lose excitement for the foundation's mission. Newer board members may have little or no connection to the original founder or the place where grants are made.

Although many models exist for ensuring engagement from geographically dispersed board members, the following guiding questions can help steer the board in a direction that is intentional and productive:

- What's important for our board's operations: to honor the donor's original intentions for the foundation or to engage in work that is important to current board members, or some combination of the two?

- What's important for our foundation's programs: Would we rather see the impact of focused giving through our grants or engage the varied interests of individual board members?

- Do administrative limitations exist that will affect how the foundation can operate?

- How do these considerations balance with community needs?

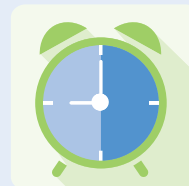
- Would the foundation benefit from a shift in focus so that board members remain engaged?

Assess Your Effectiveness

The most engaged boards consistently look at their effectiveness and make adjustments where needed. You can make a board assessment worthwhile by:

- Building buy-in among all board members by introducing the motivations for engaging in an assessment. addressing concerns, and committing to using the results for greater effectiveness

Time-Saver



Exponent Philanthropy designed a **Practical Board Self-Assessment** specifically with small-staffed foundations in mind. Use this comprehensive, flexible, and easy-to-use tool to catalyze conversations and amplify your impact.

www.exponentphilanthropy.org

Can we hold our board meetings by phone or online?

Although state laws regulate nonprofit meeting requirements, foundations generally may hold virtual board meetings as long as participants are able to hear sufficiently well. Check your state laws for specific guidelines to which you must hold.

The value of face-to-face meetings is undeniable. Nevertheless, virtual meetings do allow for people with busy schedules to remain involved and informed. Exponent Philanthropy encourages you to use some mix of in-person and virtual meetings based on your particular circumstances.

- Knowing what you want to accomplish as a board, that is, the goal(s) you will work toward and against which you will measure the foundation's effectiveness
- Setting up an assessment process that works—consider an anonymous survey or interviews by a third party—and if you can't get honest answers, realize that the assessment isn't worth your time
- Asking the right questions: Does the board have the right skills, and is it using them? Are board members engaged in strategic and important decisions? Are opportunities available for influence and respectful dissent in board meetings? Does a good relationship exist between the board and executive director, if any? According to the Center for Effective Philanthropy, these factors are characteristic of the most effective boards.
- Discussing the issues that surface, creating a plan for change, and making the necessary changes, recognizing that, if you don't follow through, the board is unlikely to engage in thoughtful assessment again

Tips for the Best Board Meeting Ever

Now that you've assembled your team, it's time for a board meeting. Don't underestimate the challenge of holding a good meeting. Without effort, it's easy to waste time and resources, dampen enthusiasm and interest, and end up without demonstrable results. Read on for ways to ensure that your meetings are effective. Although state law determines the number of times foundation boards must meet, many foundations opt to meet more often than the legal requirement. Decide what frequency is best for your board based on time commitment, desire for involvement, and grantmaking activity.

Generally, state law also requires foundations to record and retain board meeting minutes. Meeting minutes commonly include:

- Names of all people present
- Location, date, and time of the meeting
- Names of people who made and seconded motions
- Nature of motions proposed
- General nature of discussion
- Tallies of votes on motions (without attribution)
- Items to be reported back to the board
- Summary of committee reports
- Any action regarding financials, budget, or other documents, and references to these documents
- Next meeting date, time, and location

State law also may dictate what is included in board meeting minutes. Check with your attorney.

Develop a Clear Decision-Making Process

Foundation work involves difficult decisions. For boards—even those that appear to be unified—to have effective meetings, it is important to have a decision-making process in place.

The culture of philanthropy can often lead a board to think that consensus is the only option. Yet, according to Exponent Philanthropy member Judith Healey, a longtime foundation consultant and active board member, boards must agree to disagree and use the vote as a means of resolution: "If consensus is too highly valued as the only avenue to resolution, it may prevent board members from having genuine discussions and making genuine decisions. Board members will often feel compelled to simply agree with the strongest voice." In those cases, even the most committed members may question their contributions to the board.

Although no decision-making process works universally for foundations, Healey offers these tips for effective decision making:

- Establish a process based on shared values. For example, if respect is a key value, ensure that each person has an opportunity to be heard. If harmony is a key value, allow the board to table discussions so members can negotiate agreements.
- Insist that conduct be respectful, even in the midst of disagreement.
- State that consensus is preferable, but not more preferable than honesty.
- Resort to other methods when resolution cannot be found. For example, list the pros and cons of the issue on a flip chart. Give board members time (overnight or between meetings) to consider that list and take a vote after a period of consideration. Consensus often is achieved more easily through this process.
- Agree to resolve tie votes by a decision of the board chair.
- Respect the decision-making process and board chair's leadership of the process, even if disappointed with the outcome.

Create a Good Agenda

Your board chair uses an agenda as a tool to guide board meetings and encourage members to stay focused. To develop a good agenda, follow these tips:

- **Relate the agenda to the foundation's priorities—**Include specific agenda items that relate to the larger foundation goals and sort them by strategic issues and operational matters. Include time for board development topics, such as roles and responsibilities, how to read financial statements, and legal obligations.

- **Organize the agenda so that important items receive the most attention—**Indicate time limits for all agenda items, allow time for constructive debate on important issues, and identify which items are for discussion or are simply informative. A *consent agenda* groups routine actions together so one motion can approve all. If further discussion is needed, the board chair can move items from the consent agenda to the regular agenda. Be sure to designate a timekeeper.

- **Help the board to make well-informed decisions—**Recognize questions that must be addressed to reach a final decision, and provide the board with the information it needs to address those questions. It may be helpful to send out background material and related questions before the meeting so the board has sufficient time to consider the issues. When a written report is insufficient, invite advisors or committee members to participate.

Don't Hesitate to Facilitate

Effective facilitation is critical to effective board meetings. Facilitators wear many hats, including bringing an objective, unbiased point of view to the table; keeping a conversation on track; prompting nonparticipators to speak up; and, if necessary, diffusing disagreements or unproductive behavior (e.g., interrupting side conversations).

Facilitation is typically the board chair's responsibility, although another capable board member may assume the role, if needed. In other instances, an outside facilitator is the best choice, especially if communication difficulties are such that the board cannot perform the tasks at hand. The facilitator may be a hired consultant, family friend, professional skilled in facilitation, or colleague from another foundation. The key is to find someone who is acceptable to all board members and who complements your board's culture and working style.

Contact us at Exponent Philanthropy for the names of facilitators who work closely with foundations.

Board Meeting Checklist

Before the meeting:

- Let members know the date, place, and time well in advance.
- Assign (or remind members) of board roles and tasks so that they may come prepared.
- Plan the meeting with a facilitator (if appropriate) and get input from the full board.
- Establish clear goals for the meeting.
- Distribute a meeting agenda with time frames that allow for socializing.
- Distribute reading materials in advance.

During the meeting:

- Stay connected to mission.
- Describe the meeting agenda and goals.
- Clarify everyone's role.
- Use consent agendas, where appropriate.
- Encourage participation.
- Stay on task and on time.
- Save the socializing for later.
- Recap the meeting's achievements.

After the meeting:

- Distribute minutes within 2 weeks and include a to-do list.
- Follow up with other promised communications.
- Ask what worked well and what could be improved.
- Send members who were absent a report on the meeting.

Policies That Build, Not Burden

Developing a foundation policy or two is one of the most practical ways for your board to save time and energy, and to prevent misunderstandings. Policies provide direction, generate interesting discussions, promote objective decision making, and are less bureaucratic than you might think. To avoid redundancy, check your bylaws or trust document before you create new policies. The following policies are critical for a smooth-running foundation:

- **Board membership and meetings—**Your bylaws may include criteria for board membership, but a more explicit policy on membership and meetings often emerges at a later stage when the entire board can contribute to its terms. Set policies that will help to maintain a reasonable board size, respond to and set clear expectations for prospective board members, and use an objective standard to address difficult board scenarios.

- **Conflict of interest—**Although federal law does not yet require all foundations to have this policy, it is clearly important for good governance. Conflicts of interest can arise when a foundation board or staff member's role intersects with outside roles, thus creating the potential for benefit from the foundation in a personal, direct, or economic way. The benefit or potential for benefit by board or staff can lead to biased decisions and unethical behavior, or the appearance of such. A conflict of interest policy helps your board and staff to maintain ethical integrity in their decisions by establishing a disclosure and decision-making process that removes potential biases. *See pages 43–45.*

- **Travel and expense reimbursement—**Private foundations are permitted to pay for or reimburse ordinary and necessary expenses of those furthering the foundation's charitable purpose, including the costs of foundation-related travel by board members and staff. The policy should establish what the foundation will and will not reimburse, and what documentation is required for reimbursement.

- **Board compensation—**It is legitimate to compensate board members for routine board service, although the majority of foundations do not do so. Some foundations compensate board members who provide a professional service to the foundation, such as accounting or legal services, or who serve in a staff capacity. A compensation policy should detail which, if any, services will be compensated and how the foundation will seek sufficient data to set reasonable compensation levels.

Board Compensation

Some foundations believe that compensation diminishes the good a foundation can do because it directs financial resources away from grants. They also argue that foundations should hold to the same standard expected of grantees (who have voluntary boards) and that it is difficult for a board to discuss the issue of compensation without a conflict of interest.

Proponents often compensate board members as an incentive for board service and diligent work, and to increase diversity on a board. Doing so may attract younger or less privileged members who would be unable to serve without pay.

Although sound arguments exist for and against compensation, the majority of foundations do not compensate board members for routine board service. According to Exponent Philanthropy's *2016 Foundation Operations and Management Report,* only 35% of foundations compensate board members for routine board service with either an annual or per meeting fee.

If your board decides to compensate its members, the compensation must be reasonable when compared to similar people paid for similar work at similar organizations. Turn to benchmarking data to document what is reasonable for your situation.

Chapter Three

BUILDING TO CODE: TAX AND LEGAL ISSUES

You have defined your purpose and assembled your team. Now it's time to acquire your building permits to ensure compliance with the many codes and regulations—an essential step before moving forward.

What must we do, at a minimum, as a private foundation?

At a minimum, a private foundation must do the following every year to remain a private foundation and stay out of trouble:

- Hold the minimum number of board meetings and keep minutes.
- Pay your annual excise tax of 2% (or 1% in certain cases) of the foundation's net investment income through quarterly estimated payments.
- File your federal tax returns, comply with state filing rules, and pay employment-related taxes.
- Meet your annual minimum distribution requirement (5% payout) through grants and administrative expenses.
- Uphold all state and federal laws relevant to private foundations.

The information in this chapter is for informational purposes only and not as part of an attorney–client relationship. The information is not a substitute for expert legal, tax, or other professional advice tailored to your specific circumstances, and may not be relied on for the purposes of avoiding any penalties that may be imposed under the Internal Revenue Code (IRC).

In This Chapter

- Foundation law is complex and sometimes counterintuitive.
- As fiduciaries, you must be familiar with the basics of foundation law.
- It is crucial to have professional advisors with nonprofit expertise.

Building to code is a necessary part of building and maintaining your foundation. Some private foundation laws are straightforward and logical; others are complicated and even counterintuitive. Don't let fear of the law keep you from enjoying the incredible potential of your foundation. Simply commit to understanding the basics of foundation law and knowing when to engage expert counsel.

This chapter introduces the nonprofit sector, essential legal documents, major federal laws, and tax filing tips. With a thorough read, you'll be well on your way to understanding the basics so you can build to code.

Nonprofit Sector 101

The term *nonprofit sector* collectively describes the institutions and organizations in American society that are neither government nor business. *Nonprofit* is a layperson's term that describes a range of organizations—including private foundations—that contribute to the public good. The nonprofit sector in the United States is vast and diverse, with more than 1.5 million nonprofit organizations.

Because nonprofit organizations offer programs and services that otherwise would have to be provided by the government, the government excuses nonprofits from the taxes that for-profit businesses must pay. A private foundation receives this special tax-exempt classification when created, and with this classification comes a responsibility to act on behalf of and to uphold the public trust.

Section 501(c) of the federal tax code, which outlines the types of organizations eligible for tax exemption, lists more than 25 classifications of nonprofits. The 501(c)(3) classification, which is most relevant to private foundations and their grantmaking, includes organizations “organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes....”

The tax code divides 501(c)(3) organizations into five types. Four have a further designation of 509(a)(1)–(4); and the fifth, private foundations, has no additional designation. The types include:

1.	Traditional public charities	509(a)(1), also known as 170(b)(1)(A)
2.	Gross receipts public charities	509(a)(2)
3.	Supporting organizations	509(a)(3)
4.	Public safety organizations	509(a)(4)
5.	Private foundations	

The first three groups, 509(a)(1)–(3), are broadly categorized as public charities because of their broad-based public support or influence, in contrast to private foundations, which have mostly private support and control. The fourth group, public safety organizations, stands somewhere in between and has characteristics of both.

Although you may hear little about 509(a) organizations, this is the designation that should matter most to you as a grantmaker, because grants to certain types of 509(a) organizations are excluded from counting toward your annual distribution requirement. Don’t settle for simply knowing that an organization is classified as a 501(c)(3).

Traditional and Gross Receipts Public Charities: 509(a)(1) and 509(a)(2)

When someone thinks of a nonprofit, 509(a)(1) and (2) organizations are the types that typically come to mind, including hospitals, museums, schools, and homeless shelters. Classification is based on having a purpose to serve the public or by receiving a third or more of total income from the public. Community foundations also have this designation because of the public support they receive.

Supporting Organizations: 509(a)(3)

Supporting organizations are funding organizations that are closely associated with another public charity. Examples include university or hospital foundations; foundations created to support libraries, elementary schools, or other government units; and personal trusts created to benefit specific public charities. Supporting organizations are further classified into types I, II, or III, depending on the degree of control held by the affiliated public charity over the supporting organization. It is important to know that there are restrictions on grants to certain 509(a)(3) supporting organizations. *See page 57.*

Public Safety Organizations: 509(a)(4)

Few organizations qualify under this designation, but be aware that grants to 509(a)(4) public safety organizations (e.g., American Fireworks Standards Laboratory) require additional paperwork.

Private Foundations

Private foundations are one of the most complex components of the nonprofit sector. Defined in the tax code by what it is not—that is, not a 509(a)(1), (2), (3), or (4)—a private foundation:

- Is a charitable organization
- Typically derives its revenue from investments (i.e., endowment fund)
- Makes grants to other charitable organizations as its main activity, except in the case of private operating foundations, which operate their own programs

Because private foundations are more private in nature than public charities, often with little input or funding from the public, they are subject to more stringent regulation and reporting requirements than public charities. It is important to understand this distinction between private foundations and public charities.

A further designation, although not a legal one, is common. If a family starts a foundation and continues to play a major role in its governance, it is considered a *family foundation. Corporate foundations* are affiliated and funded by a business, and *independent foundations* are those with no particular family or company affiliations.

Private foundations may be standard (nonoperating); conduit (pass-through); or operating foundations.

The Essence of Essential Documents

Private foundations must maintain a variety of documents to establish, protect, and sustain their tax-exempt status.

Founding Documents

Keep the following state and federal documents safe and accessible, comply with their contents, and modify them only when the foundation has a major change (e.g., change in private foundation status):

- **Articles of incorporation—**These documents establish the foundation as a nonprofit corporation in a particular state; private foundations formed as a trust use a trust agreement.

- **Form 1023 (with SS-4)—**This is the mandatory Internal Revenue Service (IRS) application for federal tax-exempt status and employer identification number.

- **IRS determination letter—**This letter is issued upon approval for tax-exempt status.

Guiding Documents and Policies

Guiding documents give direction for daily foundation management. Review them regularly to ensure that your activities are aligned with your guiding documents. Key guiding documents include the following:

- **Bylaws—**These are the operational guidelines created at your foundation's inception (if a nonprofit corporation). They are used and updated throughout the foundation's lifetime because they address issues such as voting rights, meeting guidelines, and board structure. They help to prevent or resolve conflicts by clearly outlining procedures, rights, and powers. Foundations formed as a trust are likely to find such governing rules in the trust agreement. Review bylaws every 3 to 5 years. Make amendments as necessary and file them with the foundation's Form 990-PF tax return.

- **An anti-fraud (whistleblower protection) policy—**This document assists your foundation in following the anti-fraud or "whistleblower" regulations established in federal law. *Exponent Philanthropy members can visit www.exponentphilanthropy.org for a sample.*

- **A conflict of interest policy—**This document, with an annual disclosure, is essential for foundation managers to fulfill the fiduciary duty of loyalty. Although foundations established before 2005 are not legally required to have such a policy, Exponent Philanthropy recommends that every foundation establish and follow one. Even the most conscientious foundation manager will benefit from having a formal process in place to preempt biased decision making. *See page 45 for a sample policy.*

  A comprehensive conflict of interest policy establishes the following:

  - Foundation managers disclose, at the start of the year or as they arise thereafter, their connections to any organization or person under consideration for board involvement or foundation activities.

  - The board determines whether the interest or connection

Don't Find Yourself in the Dark

Trustees have a fiduciary duty to be familiar with:

- Articles of incorporation (or trust agreement), bylaws, and policies
- Foundation history and mission
- Grantmaking guidelines
- Current activities (e.g., meeting minutes, recent grants)
- Federal and state laws governing the foundation
- Recent financial statements and control mechanisms
- Investment policy statement
- Form 990-PF
- Job responsibilities

is actually a conflict, and whether material enough to be of practical importance. After explaining the circumstances of the potential conflict, the interested person should remove himself or herself from the discussion and subsequent vote to decide whether it is an actual conflict.

- The interested person may make presentations to the board regarding decisions that involve organizations or people with whom he or she has a conflict; if deemed helpful to the board, the interested person may even participate in discussion. The interested person should always be excluded from voting, however.

- Financial conflicts should be resolved, when possible, by collecting competitive bids to ensure a fair price for every significant transaction.

- Make a record of the action taken for every conflict of interest that arises.

Each board member should sign the policy document, and the board should review the policy annually. If a board or staff member willingly disregards the policy, the foundation should consider disciplinary steps. Following a conflict of interest policy does not relieve a foundation from following the very detailed self-dealing rules. *See pages 49–52.*

- **A document retention and destruction policy—**This document assists your foundation in following the federal laws that impose criminal liability on any organization that destroys records with the intent to obstruct a federal investigation. Foundations should be sure that the policy follows state guidelines on how long paper and electronic records must be retained. Although the policy is not legally required, it is another way your foundation can display good governance procedures to the IRS. *Exponent Philanthropy members can visit www.exponentphilanthropy.org for a sample.*

Sample Conflict of Interest Policy

The proper governance of The ABC Foundation depends on the active participation of its directors, staff, and committee members. It is important for the foundation directors, staff, and committee members to be aware that the appearance of conflict can be troublesome even though there is, in fact, no conflict. Therefore, the foundation chairperson and the foundation president/CEO must be fully informed at all times of events or circumstances that might create the appearance of conflict.

The board of directors, staff, and committee members of The ABC Foundation are guided by this conflict of interest policy whenever they are carrying out the business of or representing the foundation. In addition, directors, staff, and committee members of the foundation shall avoid acts of self-dealing, which may adversely affect the foundation's tax-exempt status or result in a sanction or penalty by a governmental authority.

Because directors, staff, and committee members may be involved in other organizations that may have business dealings or affiliations with or may seek grants from the foundation, the following general principles have been established:

> Each director, staff member, and committee member shall maintain the highest level of ethical conduct and shall exercise the highest standard of care, diligence, and prudence when conducting any activity on behalf of the foundation.
>
> In the event that a director, staff member, committee member, or a member of her/his immediate family has a personal or business interest in, or is involved in any way with, an organization with which the foundation is considering a grant request or business contract, such interest or involvement shall be disclosed to the foundation. In addition, any other person may raise a question of conflict of interest or possible conflict of interest.
>
> The question of whether an actual conflict exists shall be decided by a majority vote of the board or the committee on which the individual having the conflict or possible conflict of interest is serving. Any other directors or committee members present who already have been disqualified from voting on the issue because of their own similar conflicts of interest shall be excluded from voting on the determination of the existence of any such conflict of interest.
>
> If it is determined that it is an actual conflict of interest, the director, staff, or committee member may answer pertinent questions of other directors, staff, or committee members when knowledge regarding the matter will assist the foundation.
>
> In the case of financial conflicts, the foundation will require competitive bids as a way to ensure a fair price for significant transactions and resolve the conflict of interest.
> The minutes of the meeting shall indicate that the interested director, staff, or committee member disclosed the interest or involvement in the matter being considered by the board and abstained from voting on the matter.

I have read and understand the foregoing conflict of interest policy and agreement. I agree to its terms, and my actions have been and will continue to be guided thereby.

____

Signature

For additional sample conflict of interest policies, Exponent Philanthropy members can visit www.exponentphilanthropy.org.

How to Get Up to Speed on Foundation Law

If you have more money than time:

- Hire an attorney well-versed in foundation law to review the basics with your board—as well as any particular topics relevant to your foundation—at an upcoming meeting.

- Hire a knowledgeable accountant to help you pay your excise tax on investment income and file your Form 990-PF and related filings.

If you have more time than money:

- Download "Legal Essentials for Small Foundations" at www.exponentphilanthropy.org to learn the basics of what you can and cannot do.

- Consult your state attorney general or secretary of state for the specifics of foundation law in your state (e.g., audits, investments, number of meetings).

- Attend Exponent Philanthropy's 990-PF Tax Seminar and learn how to do your own filings.

- Hire an attorney or accountant on an as-needed basis.

An Overview of the Private Foundation Laws

As foundation managers, you need not be nonprofit attorneys, but you do need to know the basic concepts and trouble spots of the main laws governing foundations. This discussion focuses on the following sections of the IRC that outline private foundation law:

• Excise Tax on Net Investment Income	§ 4940
• Self-Dealing	§ 4941
• Annual Distribution Requirement	§ 4942
• Excess Business Holdings	§ 4943
• Jeopardizing Investments	§ 4944
• Taxable Expenditures	§ 4945
• Public Disclosure Rules	§ 6104

When legal questions arise, be sure to secure competent advice from qualified attorneys and accountants who are knowledgeable about private foundations and the intricacies of relevant laws.

How do you know if your advisors are competent?

- **Look to other private foundations for suggestions—**Who do they use?

- **Interview the advisor—**How many private foundations does the advisor work with regularly? Has the advisor worked with private foundations beyond the set-up stage? How often does the advisor file Forms 990-PF (if hiring for that)?

- **Develop your tax and legal radar—**Read this chapter and attend Exponent Philanthropy's educational programs on the Form 990-PF and legal essentials. *See www.exponentphilanthropy.org for a calendar of events.*

- **Turn to Exponent Philanthropy—**We can share names of top advisors recommended by Exponent Philanthropy members. Contact us at info@exponentphilanthropy.org or 202-580-6560.

On the following pages, we outline the basics of relevant federal laws and how they apply to you and your foundation. These pages, though, are intended as an overview and by no means are comprehensive. Remember to also follow your state laws, which, in some cases, are becoming more demanding.

Excise Tax on Net Investment Income (§ 4940)

Foundations are responsible for paying an *excise tax,* a small tax on their net investment income each year. The tax is usually 2% of investment income minus certain expenses. Excluded gains include those from any portion of property used for at least 1 year for the foundation's tax-exempt purpose—if the entire property is immediately exchanged solely for property of "like kind" that also is used primarily for the foundation's tax-exempt purpose.

If the annual estimated tax is expected to be $500 or more, the foundation must pay the excise tax quarterly through the Electronic Federal Tax Payment System on dates set by the IRC corresponding to your fiscal year.

Estimating Excise Tax

Foundations should compute and pay their estimated excise tax payments quarterly—on or before the 15th day of the 5th, 6th, 9th, and 12th months of the tax year. Most foundations calculate their estimated tax payments based on their prior year's tax liability. Provided that they pay each quarter an amount equal to 100% of the prior year's tax liability, no underestimation penalties will be imposed on any balance of tax due at year end. A foundation cannot use this method of estimation if it did not file a tax return showing tax liability for the preceding year, the preceding tax year was fewer than 12 months, or it is a large foundation with taxable income of $1 million or more in one of its three preceding years.

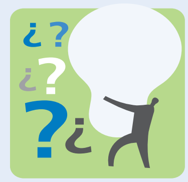
Reducing Excise Tax From 2% to 1%

It is possible for foundations to reduce their excise tax by 50% to allow more funding to go to programming, rather than to taxes. Look at the foundation's average distribution for grants and administration over the past 5 years. If the current year's expenditures exceed this average percentage by 1% of investment income, you're headed for the 1% tax rate.

Foundations in their first year cannot qualify for this reduction; foundations between 2 and 4 years old may qualify and should divide by the number of years in operation, rather than 5 years. *See the next page for a sample calculation.*

It is difficult for private foundations to qualify for the 1% rate every year without forever increasing their annual distributions and depleting their corpus.

Can new foundations qualify for a reduction in the excise tax?



Foundations cannot qualify for a reduction in federal excise tax from 2% to 1% in the 1st year of operation because the reduction is based on exceeding previous expenditures.

Reduce Your Excise Tax

To reduce the excise tax from 2% to 1%, start with the foundation's 5-year average distribution, multiply by the current year's assets, and add 1% of net investment income.

Example

Average distribution percentage for the 5 years preceding the tax year equals 7.5%.

Average value of the foundation's assets for the current tax year equals $4 million.

Average net investment income (i.e., gross income minus all necessary expenses to produce the income) equals 15%.

Step 1: Multiply average distribution percentage by average value of the current year's assets:
7.5% x $4,000,000 = **$300,000**

Step 2: Calculate 1% of net investment income:
(15% x $4,000,000) x .01 = **$6,000**

Step 3: Add the two resulting figures from steps 1 and 2:
$300,000 + $6,000 = **$306,000**

Therefore, for the tax year in question, qualifying distributions equal to at least $306,000 must be paid out before the end of the tax year to reduce the excise tax payment from 2% to 1%. If this foundation qualifies for the 1% rate, it will pay only $6,000 (i.e., 1% of net investment income) in excise tax, rather than $12,000 at the 2% rate.

Self-Dealing (§ 4941)

The self-dealing rules are complicated and among the easiest of the private foundation rules to violate unwittingly. The basic rule is that any direct or indirect transaction between a private foundation and a disqualified person is prohibited, unless it is permitted under a specific exception. Under the self-dealing rules, it does not matter whether a transaction is fair—or even beneficial—to the foundation.

Because self-dealing is a complicated, ambiguous area with steep penalties, professional counsel is strongly encouraged if contemplating transactions with disqualified persons. In addition to correction of the action, penalties of 10% of the dollar amount involved are imposed on the individual who benefited from the transaction and penalties of 5% are imposed on the foundation manager(s) responsible for the transaction. Additional penalties are imposed if the transactions are not corrected in a timely manner. Whenever you contemplate a transaction or arrangement with a foundation insider, ask three key questions:

1. Does the transaction involve a disqualified person?

2. If so, is the transaction on the list of prohibited self-dealing transactions?

3. If so, is there an exception that applies? *If not, the transaction is prohibited.*

Disqualified Persons

Disqualified persons include:

- A foundation manager, director, trustee, officer, or one with similar authority

- Substantial contributors to the foundation

- An owner of more than 20% of a business that is a substantial contributor to the foundation

- Family members of any such manager/substantial contributor/owner, including ancestors, spouses, children, grandchildren, great-grandchildren, and spouses of the children, grandchildren, and greatgrandchildren

- A corporation with more than 35% of voting power owned by a disqualified person

- Certain government officials

Note: Siblings and stepchildren (unless legally adopted) are *not* disqualified persons.

Prohibited Transactions With Disqualified Persons
Section 4941 of the IRC is designed to prevent most transactions between private foundations and their disqualified persons, regardless of the potential fairness of the transaction to the foundation. These prohibitions often capture transactions in which the participants have no reason to believe that any rules have been violated.

Foundations cannot:

- Engage in the purchase, sale, exchange, or leasing of property with a disqualified person.

- Furnish goods, services, or facilities to (or accept them from) a disqualified person.

- Borrow money from, lend money to, or otherwise extend credit to (or accept it from) a disqualified person.

- Pay compensation to, or pay or reimburse the expenses of, a disqualified person.

- Transfer income or assets to a disqualified person or make income or assets available for the benefit or use of a disqualified person.

- Make or agree to make payments of money or other property to certain government officials.

To avoid the appearance of impropriety, check with legal counsel on proposed transactions that involve disqualified persons to ascertain if self-dealing regulations will apply. The law does allow for specific exceptions to the above prohibitions; *see below.*

Exceptions to the Prohibited Transactions
Some of the most common exceptions are as follows:

- A foundation may compensate disqualified persons (other than certain government officials) for providing services to the foundation if three conditions are met:

    1. The service is a “personal service,” narrowly defined by the IRS as:

        - Routine board service
        - Services considered staff functions
        - Limited professional advisory services, such as legal, accounting, investment, or banking services

    2. The service is necessary to further the foundation's charitable purpose—The extent of services must be reasonable in light of the foundation's specific activities, and the individual providing the services must be qualified to do so.

    3. The compensation is reasonable—To determine if it is reasonable, you should:

        - Determine what similar foundations pay similar persons for similar work. Data are available at www.exponentphilanthropy.org, www.cof.org, and through several regional associations of grantmakers.
        - Consider the total compensation package, not only salary and wages.
        - Document your decisions, including your sources of compensation data.

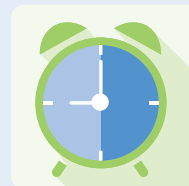
- D&O liability insurance may be purchased for foundation board members.

- A disqualified person or organization may provide office space to a foundation for free.

- A foundation may reimburse disqualified persons for reasonable out-of-pocket travel and other expenses necessary for foundation's operation. Thus, a foundation can reimburse the travel expenses of only the disqualified persons active with the foundation—not spouses—unless such payment is part of a compensation package for the disqualified person active with the foundation and is reported on Form 1099 or W-2 for tax purposes.

- Foundations may purchase tickets for trustees or staff to attend grantees' performance or benefit events, as long as attendance is for evaluating the program or showing support for the charity.

Time-Saver



Whatever your questions, we can help! Exponent Philanthropy members are invited to call or e-mail our **Q&A service—**our most highly rated member benefit. We'll research an answer to your question, or connect you to a peer or advisor who can help.

202-580-6560 or
info@exponentphilanthropy.org

Top Trouble Spots for Self-Dealing

- **A foundation pays rent to a disqualified person—**Any payment of rent to a disqualified person, even at below-market rates, is a form of self-dealing.

- **The foundation holds a 3-day retreat to set direction for the foundation; spouses are invited to attend the dinners—**The foundation may pay the board members' expenses but not the spouses' expenses, unless such payment is part of the board members' compensation packages and reported on Form 1099 or W-2 for tax purposes.

- **Board members use a foundation credit card for personal expenses and later reimburse the expenditures—**Even if the foundation is reimbursed the month immediately following the transaction, this qualifies as a loan and therefore is self-dealing.

- **A family foundation buys a table at a charity's annual fundraiser and invites trustees and their spouses (who are not trustees) to fill the table—**Although the trustees may attend to evaluate the results of a grant, the spouses are receiving a benefit, which is self-dealing. Spouses may pay the full ticket price themselves, or the foundation may consider the ticket price part of the trustees' compensation packages as reported on Form 1099 or W-2 for tax purposes.

- **Board members and staff are paid excessive amounts to serve the foundation—**Although it is legal to compensate disqualified persons for "personal services," amounts must be necessary and reasonable for the duties performed.

- **An individual makes a personal pledge to give to a particular organization and fulfills that pledge with a foundation grant instead—**Even if the individual is a donor to the foundation, it is considered self-dealing.

For more on the tricky issue of self-dealing, see the publication "How to Avoid Self-Dealing" at www.exponentphilanthropy.org.

Annual Distribution Requirement (§ 4942)

A private foundation must make annual charitable expenditures called *qualifying distributions* equal to at least 5% of the fair market value of its previous year's endowment. Thus, a foundation with average assets of $5 million in one fiscal year will need to make $250,000 of qualifying distributions by the end of its next fiscal year. A foundation that has distributed more than its 5% in the past 5 years (and has carryover remaining) may include this excess to meet the 5% payout requirement. Failure to meet the 5% minimum payout subjects a foundation to 30% taxation on the undistributed amount in addition to having to make up the shortfall. Additional penalties are assessed if not corrected in a timely manner.

Although foundations have an additional year to meet the 5% payout requirement, most foundations estimate their year-end assets and make the required payout in the year it is generated. Foundations that wait to make their payout in the subsequent year can be caught off guard by precipitously declining assets. A payout requirement generated by much larger assets in the previous year may force the foundation to sell assets to raise cash or even donate additional funds to the foundation.

Defining Qualifying Distributions

What counts as a qualifying distribution?

- Most grants for charitable purposes to public charities, noncharities, and eligible individuals (e.g., scholarships) as long as the foundation follows specific IRS rules, such as expenditure responsibility; one important exception is the case of certain supporting organizations *(see page 57)*

- Reasonable administrative expenses necessary for conducting a foundation's charitable activities (e.g., staff salaries, training, rent, site visit expenses)

- Direct charitable activities (e.g., providing technical assistance, conducting research, publications)

- Assets used to fulfill charitable purposes (e.g., artwork or a building used for charitable purposes)

- *Program related investments (PRIs),* that is, investments made by a foundation that meet the following criteria: the primary purpose of the investment is to accomplish the foundation's exempt purpose, not the production of income or appreciation of property; and the foundation may not use the investment for lobbying purposes. Examples include below-market loans to an environmental group to purchase scenic spaces or stock investments in a minority-owned bank that supports inner-city businesses.

How do we calculate the fair market value of the foundation's noncharitable-use assets?

Calculate values for each asset class as follows:

- Calculate securities—such as common and preferred stocks, bonds, and mutual funds, which typically have readily available market quotes—on a consistent and reasonable basis. For example, a value for a particular month might be determined by the closing price on the last day of the month or the average of the closing prices on the first and last trading days of the month.

- Compute cash balances by averaging the amount of cash on hand on the first and last days of each month.

- Using an independent appraisal, obtain the fair market value of any real estate, including improvements, every 5 years.

- Determine the fair market value of all other assets annually.

What does not count as a qualifying distribution?

- Investment fees (e.g., management fees, brokerage fees) and portions of salaries or meeting expenses related to overseeing investments are not qualifying distributions. Thus, if 40% of your board meeting is spent discussing investments, only 60% of meeting expenses can be counted as qualifying distributions.

- In addition, legislation prohibits foundations from counting grants to certain supporting organizations. *See page 57.* Although these grants are allowed if foundations exercise expenditure responsibility, they will not count as qualifying distributions under any circumstances.

Calculating the Distribution Requirement

1. Determine the market value of the foundation's noncharitable-use assets. *See sidebar.*

2. Deduct 1.5% of total noncharitable-use assets. The IRS allows foundations to exempt 1.5% of the fair market value of all assets under the assumption that foundations need to hold some assets (usually cash) for short-term grants or administrative expenses.

3. After deducting 1.5% of total assets, calculate 5% of this new total.

4. Subtract the amount paid in excise tax on investments for that year.

5. This final number is your required distribution.

If you have not made sufficient qualifying distributions to reach the required payout and you have distributed an excess of the required 5% at some point in the previous 5 years, you may use this excess as a credit toward your shortfall. Any shortfall that still remains must be met within the 12 months following the end of that particular tax year.

Excess Business Holdings (§ 4943)

The IRC prohibits private foundations from owning more than a small portion of any business enterprise to prevent abuses that could stem from a nonprofit's controlling a for-profit enterprise. A foundation and disqualified person(s) cannot collectively own more than 20% of any business enterprise, whether incorporated or unincorporated. If someone else (not classified as a disqualified person) has demonstrably effective control of the business, the foundation, collectively with its disqualified person(s), may own a stake not to exceed 35% of the enterprise. *De minimis* rules provide that a foundation, together with its related foundations, may own up to 2% of voting shares or beneficial interests in a business enterprise, regardless of how much stock the disqualified person(s) own.

If stock is gifted to the foundation, which causes its ownership position to exceed permitted holdings, the foundation has 5 years in which to dispose of the excess stock. In certain cases, a foundation may request an additional 5 years.

If a violation occurs, an excise tax of 10% of the foundation's excess business holdings may be imposed.

Jeopardizing Investments (§ 4944)

A foundation may not invest its income or principal in a manner that may jeopardize its ability to carry out its charitable purpose. Since these rules were written, significant changes have been made in the field of investments, and an exception is made for PRIs, for example, which may assume substantial risk because their main purpose is to be charitable rather than to produce income. The IRS is unlikely to impose penalties unless the foundation has clearly squandered its assets, especially when due to self-dealing.

You can find further guidance and oversight within state law with the Prudent Investor Rule and usually some adaptation of the Uniform Prudent Management of Institutional Funds Act, which focus on a portfolio's total return and its overall investment strategy. Instead of evaluating the appropriateness of each asset in isolation, investment decisions are considered in context of the entire portfolio. As a result, investments that were considered risky are now much more acceptable.

If a foundation is investing in jeopardizing investments, an initial excise tax of 10% of the amount of the jeopardizing investment may be imposed.

Donating Appreciated Stock

Private foundations often overlook a valuable tax planning vehicle: using appreciated stock as the grant to an organization. A grantee that is a public charity will incur no tax on the sale of donated stock. The foundation avoids paying tax on the increased value of the stock, which it would have incurred upon selling the stock to realize cash to award the same grant.

The only real associated risk is that the cash value of the stock may fluctuate downward from the time of the grant decision to the time ownership is transferred. You can mitigate this situation with either cash supplements to make up the downward price movement or through a carefully coordinated delivery date to ensure that the stock price remains secure during the course of the transaction.

Taxable Expenditures (§ 4945)

Taxable expenditures are grants or expenditures made by a private foundation that are either prohibited or in an IRS-specified area without following respective IRS rules. Generally, an initial excise tax of 20% is imposed on each taxable expenditure; additional levies may be made against individual foundation managers for approving such expenditures. The latter excise tax generally will not exceed $10,000.

The following expenditures are prohibited:

- **Noncharitable activities—**A grant or questionable administrative expenditure for noncharitable purposes by a private foundation may subject the organization to penalties.

- **Partisan political activity—**Private foundations cannot engage in or fund political campaign activity that has the intent of influencing the outcome of a public election. Such activities include making direct contributions to a candidate, endorsing a candidate, paying the salaries of campaign workers, funding partisan or area-specific voter registration, or paying for the publication of written materials that speak for or against a candidate. Foundations are likely to face significant penalties for this type of activity—possibly even revocation of the foundation's tax-exempt status.

- **Lobbying and grants earmarked for lobbying—**Foundations may try to influence public policy but must avoid what is narrowly defined as *lobbying.* The two types of lobbying are direct and grassroots. *Direct lobbying* is communication with a legislator to express a view about specific legislation. *Grassroots lobbying* is asking the public to communicate with legislators to express a view about specific legislation. The laws define *legislation* broadly to include any action by Congress, state legislatures, local councils, and the public (with respect to a referendum, initiative, constitutional amendment, or similar procedure). The only exception is for "self-defense" lobbying related to private foundations.

- **Grants to organizations or people involved in terrorism—**If a potential risk exists that a domestic or international charity, together with its associated individuals, is involved in terrorism, the foundation—before funding—must review the government's Specially Designated Nationals (SDN) list. GuideStar regularly updates information on blocking orders applied to U.S. charities within the description of suspected organizations. *See www.guidestar.org.*

The following expenditures are allowed, but you must comply with specific IRS rules when making grants to:

- Certain supporting organizations (509(a)(3) public charities)
- Individuals
- Non-U.S. organizations
- Noncharities
- Private foundations
- Organizations that lobby

Grants to Supporting Organizations
Because of concerns about abuses among supporting organizations, the U.S. Congress put regulations into place in 2006 to limit grants to *supporting organizations,* legitimate public charities with a 501(c)(3) designation and a further classification of 509(a)(3). Their legal structure is formed with a certain relationship with one or more other public charities—the "supported" organization(s). Supporting organizations are one of three types (I, II, or III) relating to the degree of control a supported organization has over the supporting organization.

Regulations now require a private foundation to exercise expenditure responsibility *(see page 62)* over grants to some, but not all, supporting organizations. Specifically, private foundations must exercise expenditure responsibility over grants to a supporting organization if any foundation insiders directly or indirectly control either the supporting organization or its supported organization, and to type III supporting organizations that are not "functionally integrated."

If expenditure responsibility rules are not followed, the grant will be considered a taxable expenditure and will be subject to a penalty tax. A private foundation cannot, under any circumstances, count grants to these supporting organizations toward the foundation's annual distribution requirement.

Although these new regulations may apply to only a few of your grantees, it is critical that you know which organizations fall into this category because taxable expenditures can be a costly mistake for a foundation.

Grants to Individuals
A private foundation may make grants to individuals. Different rules apply based on the purpose of the grant:

- **Grants to individuals for travel, study, or similar purposes—** Such grants require prior written approval from the IRS for the procedure you will use to make such grants. If a third party, such as a community foundation or university, selects grant recipients and your foundation simply supplies the funding, IRS approval is unnecessary.

- **Grants to individuals for disaster relief, economic distress, or similar purposes—**Grants to individuals in poverty or in need of assistance because of circumstances such as natural disaster do not require prior approval from the IRS. Be sure to make objective and nondiscriminatory awards to a "charitable class." Detailed recordkeeping is critical, including written proof (e.g., grant application) of the recipient's charitable need and inability to presently meet that need. We recommend that you seek legal counsel.

- **Grants to individuals for artistic achievement or similar purposes—**Similar to grants for economic distress or disaster relief, foundations may give grants for artistic or literary achievement without prior approval from the IRS. Seek legal counsel to ensure that the grants are objective and nondiscriminatory by IRS standards.

Grants to Non-U.S. Organizations

Private foundations may give to non-U.S. (foreign) organizations for charitable purposes by practicing expenditure responsibility (*see page 62*) or making an equivalency determination. Although it often is easier to simply practice expenditure responsibility, an equivalency determination is more efficient if making repeated grants to the same foreign organization.

If you choose to make an equivalency determination, your foundation will make a good-faith determination that the recipient organization is the equivalent of a U.S. public charity based on an affidavit from the recipient organization or an opinion of counsel. The affidavit or opinion must set forth sufficient facts concerning the recipient organization's operations and support to enable the IRS to determine that it would likely qualify as a public charity if based in the United States. *Exponent Philanthropy members qualify for discounts on NGOsource, an online equivalency determination service; see www.exponentphilanthropy.org.*

In addition, foundations must follow Anti-Terrorist Financing Guidelines. U.S. government Executive Order 13224 and The Patriot Act bar transactions with persons considered to be terrorists. Such transactions include both domestic and international charitable contributions to organizations or persons on the government's SDN list. GuideStar regularly updates information on blocking orders applied to U.S. charities within the description of suspected organizations. *See www.guidestar.org.*

Time- and Money-Saver

Exponent Philanthropy members can save money and stay compliant with **discounts on software and services,** including:

- GuideStar Charity Check, Pro Search, and FinSCAN
- NGOsource, an online equivalency determination service for global funders

www.exponentphilanthropy.org

What types of grants can we make easily?

You can easily make grants to a public charity classified as a 501(c)(3) with a further designation of 509(a)(1) or (2), as well as certain 509(a)(3) organizations as long as no foundation insiders directly or indirectly control either the supporting organization or its supported organization.

You also can fund the charitable activities of government agencies; units of government (e.g., public libraries, fire departments); and religious organizations. In the case of a government entity, your foundation should request a copy of the document (e.g., legislative action) that shows the grantee's governmental status. Be sure the grant agreement states that the grant is earmarked for a specific charitable purpose.

You can determine an organization's status via two easy methods:

1. Link to the IRS Exempt Organizations Select Check online tool.

    - 509(a)(1) or (2) organizations will receive a deductibility status of "PC."

    - 509(a)(3) organizations that are easy to fund if no foundation insiders are involved will receive a deductibility status of "SO."

    Be sure to document the results of your search. Although not required by law, some auditors are interested in seeing the original IRS determination letter in the grant file; do not rely on the original determination letter, however, for current tax-exempt status. In an effort to reduce the burden of paperwork, some foundations only request letters of first-time grant recipients or forgo the letter.

2. Subscribe to Charity Check at www.guidestar.org for up-to-date information on a nonprofit. *Exponent Philanthropy members qualify for discounts on annual or monthly subscriptions; see www.exponentphilanthropy.org.*

Grants to Noncharities

As long as your foundation exercises expenditure responsibility *(see page 62),* it may make grants for charitable purposes directly to organizations not classified as public charities (without a 509(a)(1)–(3) designation), including fraternal orders, trade associations, labor unions, chambers of commerce, and start-up organizations without an IRS designation.

Trouble With Tipping

Organizations that qualify for public charity status usually want to keep that status. Use caution if considering a grant to a public charity that is comparatively larger than the recipient's overall base of public financial support because a generous grant can force or "tip" a public charity into private foundation status.

To remain a public charity, the organization must meet a test that shows a substantial percentage (usually one-third) of its funding comes from a broad cross-section of the public. If you wish to make a large grant to a small organization, seek the help of counsel to structure the grant in a way that avoids tipping.

For example, social welfare organizations—such as the National Rifle Association, or NRA; National Association for the Advancement of Colored People, or NAACP; and AARP—are classified as 501(c)(4) organizations and permitted to lobby. Foundation grants to these noncharities count as qualifying distributions as long as the grants are for charitable purposes and the foundation exercises expenditure responsibility.

Rather than exercise expenditure responsibility, private foundations may wish to use a fiscal sponsor/agent that qualifies as a public charity and passes the grant to the noncharity. This arrangement is permissible, as long as no oral or written agreement exists between the foundation and fiscal sponsor directing the grant funds to a specific third party (i.e., no earmarking). We recommend that you seek legal counsel when pursuing this type of funding arrangement because a fiscal sponsorship can be structured in different ways: Some are fully legitimate; others lead to taxable expenditures.

Grants to Private Foundations

Your foundation may make a grant for charitable purposes to another private foundation, and your foundation must take several steps for the grant to count as a qualifying distribution. First, the grantor must practice expenditure responsibility *(see page 62),* excluding the final step of establishing a separate bank account. Second, the recipient must meet its annual distribution requirement for the year in which the grant was received and the preceding year. After meeting these two requirements, the recipient then must expend an additional amount equal to the total grant award from the private foundation within 12 months after the end of the tax year in which it was received. It is important to consult your attorney when making a grant to another private foundation.

Grants to Organizations That Lobby

Foundations often avoid advocacy because it is confused with lobbying, which is just one type of advocacy. To clarify, *advocacy* includes any activity that supports or opposes a cause or issue, whereas *lobbying* is narrowly defined to include only communications intended to influence specific legislation.

With exception of prohibited partisan political activity and most lobbying (including grants earmarked for lobbying), foundations should not shy away from advocacy. Instead, advocacy may be the most effective way for your foundation to accomplish its charitable goals. By following a few special requirements, foundations can safely:

- Make general support grants to organizations that engage in advocacy, including lobbying.

- Make project grants for specific advocacy activities. For example, you can specifically fund a public education campaign, a litigation effort, publication of a research report, or a candidate debate.

- Fund and engage in voter education efforts if you follow specific rules.

- Fund or conduct studies of broad social, economic, or policy issues as long as the discussion does not address specific legislation.

- Educate the public on issues by writing letters to the editor, putting information on your website, hosting a public forum, or taking out ads, for example.

- Respond to a request from a legislative body for technical assistance on pending legislation.

- Engage in self-defense lobbying concerning legislation that affects the foundation's existence, powers and duties, or tax-exempt status.

Foundation managers also may engage in lobbying on their own behalf, on their own time, and at their own expense. Be sure to know the legal guidelines before doing so.

Expenditure Responsibility Explained

The steps of expenditure responsibility allow private foundations to make grants to nearly any U.S. or international entity, as long as the grant is for charitable purposes and follows all other legal guidelines (e.g., no self-dealing, lobbying). The steps are doable—even for small foundations—so don't shy away from grants that require it.

Expenditure responsibility cannot be used to avoid the IRS pre-approval process for grants to individuals. The steps include:

- **Pre-grant inquiry—**Take reasonable steps to investigate a potential grantee's capability of, and commitment to, executing the charitable activity.

- **Written grant agreement—**A written grant agreement must clearly specify the charitable purposes of the grant, require annual grant reports, maintain sufficient records, and limit all lobbying (or otherwise prohibited) activities.

- **Grantee reports and grantor recordkeeping—**The grantee must provide regular reports of the grant's financial status and progress toward achieving the intended charitable purposes. The grantor must keep these reports on file.

- **Reporting the grant to the IRS—**Expenditure responsibility grants must be reported on the Form 990-PF in the year they are made and in each year in which they are outstanding. The statement must include grant recipient information and grant amount, purpose, description, and current status.

- **Financial precautions—**Grantees, except for private foundations, are required to set up a separate account for the grant funds to prevent the commingling of charitable and noncharitable funds.

Public Disclosure Rules (§ 6104)

Public disclosure rules are set by Congress to ensure that private foundations make certain tax information available to the general public. It is important that you comply with these requirements, or penalties of $20 per day per infraction may be levied against an officer, trustee, employee, or other individual who is under a duty to allow inspection or provide copies.

Private foundations are required to make the following documents available to anyone who makes a request:

- **Form 990-PF—**The annual information return filed with the IRS; the foundation must provide the form for the 3 most recent years

- **Form 1023—**The application for federal tax-exempt status (and all related correspondence with the IRS)

- **Form 990-T—**The unrelated business income tax return

To be technically "complete," these documents must be provided exactly as filed with the IRS, including all signatures. Also check your state laws because some states impose further disclosure requirements.

To comply with the preceding requirements, foundations must provide:

- **Copies for inspection—**Foundations must provide copies of the preceding documents for inspection during normal business hours at their offices or at an alternate location if the foundation has no office—within 30 days of receipt of a written request.

- **Photocopies or Web postings—**If requested, foundations must also provide photocopies or Web access to the preceding documents—within 30 days of receipt of a request.

Tax Filing Requirements

It's critical that you know what to file with the IRS and your state. This section addresses the main forms. Given that regulators have claimed that at least 25% of foundations file incorrect returns, be sure to work with a competent accountant or other knowledgeable individuals.

Time-Saver

Don't be among the 25% of foundations that file annual returns with errors; we have **publications** and **educational programs** to help. Download our 50-page publication "Filing the Form 990-PF," or register for an upcoming 990-PF Tax Seminar.

www.exponentphilanthropy.org

Form 990-PF

This is the foundation's annual information return that details its financial activity. The foundation must file this form on the 15th day of the 5th month following the end of your fiscal year. Although most activities of private foundations are tax-exempt, this form provides the IRS with enough information to determine if the foundation is operated properly as an institution for the public good.

Just about everyone, including the IRS, acknowledges that the Form 990-PF is a complex one to file. Below you'll find tips—thanks to Tom Blaney, CPA, CFE of O'Connor Davies—to help your foundation avoid the most common mistakes. How does your latest Form 990-PF compare?

Note: The following tips are based on the 2015 Form 990-PF. Page, part, and line numbers may differ in more recent versions. Be sure to consult your accountant or contact Exponent Philanthropy with questions.

Part I Errors to Avoid

- Check the correct accounting method (page 1, question J). If using cash basis accounting, as most small foundations do, you will have no accounts, prepaid expenses, buildings and equipment, or accounts payable on page 2, part II. These items exist only when using accrual or modified cash basis accounting.

- Leave page 1, part I, column c blank unless a foundation is an operating foundation or a nonoperating foundation that has income from charitable activities.

- Foundations that are not required to attach Schedule B (Schedule of Contributions) should check the box on page 1, part I, line 2. Leaving this box blank could result in return of the filing.

- The gross sales price for all investment assets sold should be reflected on page 1, part I, line 6b. At times, this field is mistakenly left blank.

- The foundation's share of payroll taxes (e.g., Social Security, Medicare, state unemployment) should be reflected on page 1, part I, line 15 (i.e., pension plans, employee benefits) and not on line 18 (i.e., taxes).

- Excise tax paid on net investment income for nonoperating foundations should be reflected on page 1, part I, line 18 and solely in column a. Some foundations mistakenly allocate the excise tax to columns b and d.

- Electricity, telephone, and janitorial expenses should be reflected on page 1, part I, line 20 (i.e., occupancy) and not line 23 (i.e., other expenses).

Part IV Error to Avoid
When completing the Capital Gains and Losses Schedule (page 3, part IV), indicate whether each security sold was purchased or donated.

Part VII-B Error to Avoid
On page 5, part VII-B, line 1a, foundations that pay compensation, furnish facilities, reimburse expenses, or engage in other transactions with disqualified persons must check "Yes" to lines 1a (3) and (4). As long as the expenditures were "necessary and reasonable" under IRS guidelines, check "No" for 1b. *See pages 50–51 for permissible transactions with disqualified persons.*

Part VIII Error to Avoid
When listing the addresses of officers, directors, and trustees, do not use home addresses or other personal contact information. The IRS accepts a preferred address, such as the foundation's business address or a P.O. box.

Income- and Investment-Related Filings

Form 990-T
Your foundation must file a Form 990-T if it receives $1,000 or more in gross income from an unrelated trade or business that is regularly carried on, but not substantially related to, the charitable, educational, or other purpose that is the basis of the foundation's exemption. The foundation must pay estimated taxes if it expects its tax for the year to be $500 or more. Be aware that some hedge funds generate unrelated business income.

Form 8109
IRC section 4940 imposes an excise tax of 2% on the net investment income of private foundations. In certain cases, the tax can be reduced to 1%. *See pages 47–48.* You must file Form 8109 with quarterly tax payments for the excise tax on investment income. Only file if paying annual tax of more than $500.

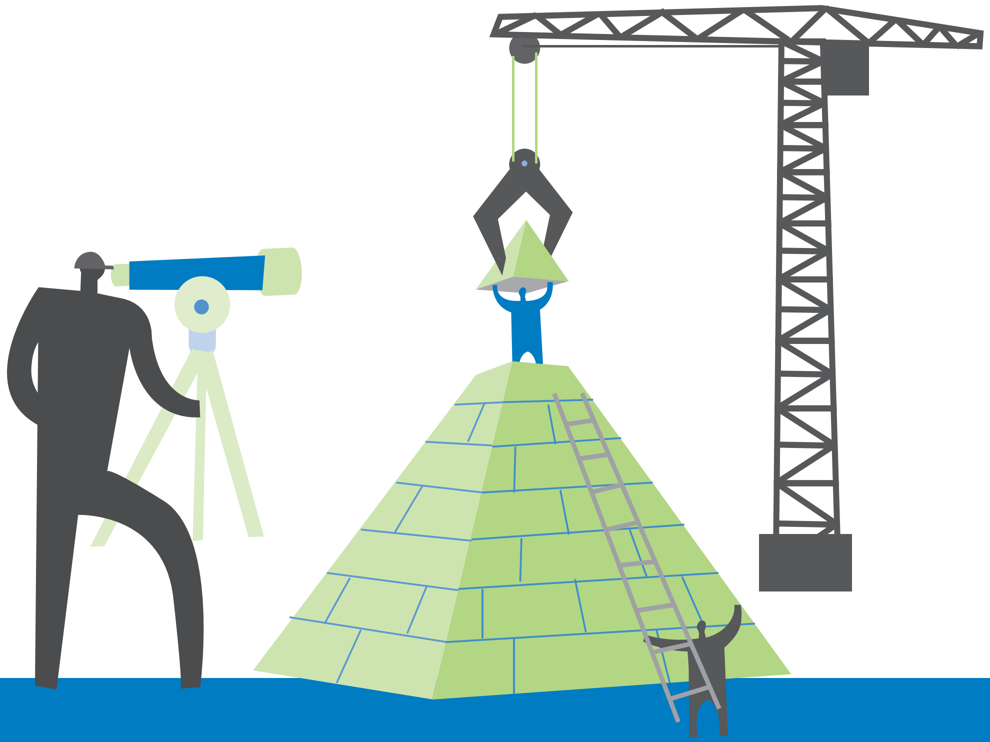
Forms 926, 5471, or 8865
Foundations invested in foreign corporations or partnerships may need to file additional forms to report such activity. Speak with a knowledgeable accountant for more information.

Employment-Related Filings
Foundations with staff must file quarterly forms related to employment withholdings, pension fund accounts, and nonemployee compensation. Small foundations with employees may find it simplest to engage a payroll service to handle the details.

State-Level Filings
Many states have additional filing requirements. Be sure you know the requirements for any state where the foundation was founded or has an office.

Protect Your Personal Information

A public database of nonprofit information is available at www.guidestar.org, including your foundation's three most recent Forms 990-PF. Foundations should not list on the Form 990-PF, for any reason, home addresses or Social Security numbers of trustees, employees, or grantees. In the case of foundation trustees or employees, use the foundation address or a P.O. box.

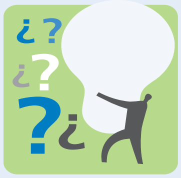


Chapter Four

LAYING THE GROUNDWORK: INVESTMENTS

With building permits in hand, it's time to lay the groundwork of your foundation. Good builders know to build on solid ground with materials that endure—only then will the capital investment remain strong and secure when stormy winds blow.

Where can I learn the language of investors?



Is investment terminology a foreign language to you? Try the following: www.finance-glossary.com, www.investopedia.com/dictionary, www.investorwords.com, or other resources listed at www.exponentphilanthropy.org.

This chapter is adapted from text by Albert Keith Whitaker, director of family dynamics at Calibre Advisory Services and former president of The Morton Foundation, Inc., and Paul A. Ehrhardt, managing member of Investment Business Advisors LLC. Our thanks to Deborah D. Weiss, CFA, managing director of Okabena Advisors, and Ben Valore Caplan of Syntrinsic Investment Counsel, LLC, for their review.

In This Chapter

- Investment oversight is a key legal responsibility of foundation board members.
- Regardless of whether you outsource the management and oversight of your investments, use an outsourced chief investment officer (OCIO), or have the competence to handle those roles in-house, board members still have a fiduciary responsibility and must provide oversight.
- A thoughtfully crafted and frequently reviewed investment policy statement (IPS) is your road map to success.

The ultimate goal for a foundation board is a prudent investment process: a thoughtful, disciplined approach to investments that is aligned with the foundation's purpose and goals. Over the long haul, good investment decisions lead to more grants and greater impact. Moreover, state law requires board members to act as prudent fiduciaries in caring for the foundation's assets.

Starting With Strategic Board Decisions

As *fiduciaries,* that is, anyone with the legal and ethical duties and responsibilities of caring for someone else's property, it is critical that your board members make strategic decisions related to investments, even if an investment committee exists.

All states have adopted some form of the Uniform Prudent Management of Institutional Funds Act, or UPMIFA, which requires fiduciaries to make decisions with "reasonable care, skill, and caution." This act is complemented by the Prudent Investor Rule, which requires fiduciaries to consider an entire portfolio, rather than individual securities; seek to balance risk and return; achieve this balance through appropriate diversification; and, if necessary, delegate investment functions to appropriate experts.

Your board's strategic decisions will form the basis of your foundation's investment policy statement (IPS) and will connect your investments to your purpose and goals. Although your board may not have specific answers to the strategic questions that follow, you will accomplish future investment-related tasks more easily if you establish a general direction in the following areas:

- **Foundation mission—**What do you want to accomplish with your foundation? What are your focus, intended impact, and strategies for achieving your goals? What is the foundation's mission or program goals? The answers will influence your spending policy and required return. *See Chapter 1.*

- **Investment time horizon—**Will you have the greatest impact by existing in perpetuity or giving heavily to make a significant change now and spending down by a certain date? If you do intend to close shop, when is the target date? The answers will begin to define your investment time horizon and asset allocation policy.

- **Spending policy—**Does your foundation plan to make the minimum annual qualifying distributions (5% of its net investment assets) or does it plan to spend more? Does it expect to make large capital expenditures in the next 5 years? Does the foundation expect capital inflows—either continuing gifts or bequests? The answers will help to determine your foundation's required return and asset allocation policy.

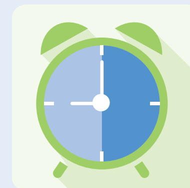
- **Risk tolerance—**How comfortable is your board with variability in a portfolio's return from year to year? Has the foundation made long-term or multiyear pledges to support specific programs, and will market fluctuations upset those pledges? The answers will help to identify your risk tolerance and asset allocation policy.

- **Diversifying assets—**Does your foundation hold or expect to hold special assets, such as closely held business interests or limited partnership interests? If so, do you have plans to diversify those assets or to justify not diversifying them? The answers will affect your asset allocation and guidelines for diversifying investments.

- **Aligning investments with impact—**Does the foundation's mission or do the board's values indicate that you should avoid certain stocks, sectors, or asset classes when constructing the foundation's portfolio? Does the foundation want to invest in companies that generate social and financial returns? The answers will determine your engagement in impact investing.

- **Oversight and management—**Who will develop the IPS and implement your foundation's investment policy? Will the full board or an investment committee—with or without a professional advisor's help—create the IPS? Will you allow board members to manage foundation assets—either *pro bono* or with compensation? What is your foundation's statement on conflicts of interest? The answers will launch your exploration of investment oversight and management.

Time-Saver

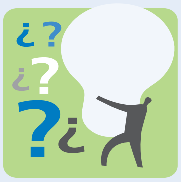


Exponent Philanthropy members can download **sample documents** to reproduce or adapt, including:

- Investment policy statements
- Investment consultant letters of agreement
- Investment return calculations and templates

www.exponentphilanthropy.org

What investment documents are necessary for tax and audit purposes?



Foundations should request and keep the following documents on file:

- Monthly investment reports
- Year-end summary of capital gains and holdings (which may be split into two reports)
- Any K-1 reports (commonly issued by alternative investment vehicles)

Your board should review the preceding questions at least once every year to clarify your investment policy and strengthen your sense of purpose.

Choosing an Oversight Structure

After making strategic decisions, it is time to decide how your foundation will establish and implement its investment policy. Before jumping to conclusions about who will take the helm, take time to understand the responsibilities and tasks you'll need to accomplish, even if you end up hiring staff to assist you with investment oversight and management.

Investment responsibilities include:

- Creating an IPS for the foundation that includes foundation background and mission, investment objectives, time horizon, spending policy, statement of risk tolerance, asset allocation policy, asset guidelines, responsibilities of those overseeing and managing the investments, guidelines for selecting managers, and standards for monitoring and evaluating investment performance
- Selecting appropriate individuals to manage the foundation's investments
- Monitoring and evaluating investments and those managing them
- Keeping your IPS relevant and board members educated

As you can see from this list, being prudent in your investments takes work. But such work is not necessarily best accomplished by the entire board. Even foundations with small boards can benefit from developing an investment committee with a few members to lead the charge.

Start setting up an investment committee for success by putting the right people on the committee and electing them to certain—preferably staggered—terms. Although board members who understand investing are natural choices, they should serve alongside less experienced board members. The committee will serve the foundation better if investment expertise is balanced by members whose affinity is to support the foundation's mission. The investment committee is also less likely to become distant from the full board and may help the board to deal more swiftly with conflicts of interest around investments.

Developing and Implementing an IPS

Once an oversight structure is in place, your board or investment committee can begin the critical task of developing the foundation's IPS. A good IPS is a plan: It states in writing the board's attitudes, expectations, objectives, and guidelines for investing. It sets forth an asset allocation and diversification plan for the foundation's assets, encourages effective communication between the board and investment professionals, and establishes criteria to monitor, evaluate, and compare the performance of those investment professionals.

It is no small task to create a useful IPS, yet it is one task with big implications for your efficiency in managing money, confidence about the foundation's financial health, and even investment returns. Your board or investment committee may have the expertise to develop a prudent IPS; if not, an investment consultant can be of great help.

Your IPS doesn't need to be long; most are somewhere between 3 and 10 pages. It also doesn't need to speak in exacting terms about which stocks to buy or managers to hire, but it shouldn't speak in generalities either.

Below are common components of an IPS; choose those that apply to you and leave the rest!

- **Foundation background and mission—**Describe the foundation's history and its intended impact. Incorporate your answers to the strategic questions on page 69 about time horizon, capital inflows and outflows, and special assets.

- **Investment objectives—**Describe generally how your investment approach will help to fulfill your foundation's mission and goals. Your objectives are unique to your foundation and depend on your focus or intended impact, time horizon, spending policy, and risk tolerance (described later in your IPS). Although objectives vary among foundations, every foundation's IPS should include these objectives: diversification and a prudent balance of risk and return.

- **Time horizon—**Document your foundation's time horizon for investments. Many foundations with long life spans choose a time horizon in the 5- to 10-year range. This period allows the foundation to set specific, measurable goals yet view interim fluctuations and volatility in markets with an appropriate long-term perspective.

- **Spending policy—**Summarize your *spending policy,* the percentage of assets you plan to spend annually on grantmaking and other expenses related to fulfilling your mission. Also state your *required return:* the sum of your spending rate, the inflation rate expected over your time horizon, and all expected investment fees.

- **Statement of risk tolerance—**Because the entire board—not just the investment committee—must be able to tolerate fluctuations in the foundation's assets, recap your collective attitude toward risk. Consider whether your foundation has made or will make long-term or multiyear commitments to projects or grantees that could be disrupted by volatility in the foundation's assets.

- **Asset allocation policy—**Be deeply thoughtful about your asset allocation policy; it is the centerpiece of your IPS. Define rough targets and a range of permissible limits for each of the major asset classes, and define how you will diversify each investment type. Include in the IPS a modeled annual return or expected return based on that information.

Putting Your Money Where Your Mission Is

Impact investing, often called mission investing or socially responsible investing, describes the intentional deployment of capital to generate positive financial and social returns. It involves proactively investing in enterprises or activities that will result in a positive community or environmental benefit. Individuals and foundations of all types and sizes make impact investments, which include investments across all asset classes and along the entire spectrum of risk and return—from program related investments, or PRIs, to market-rate investments that yield competitive rates of return.

By pursuing these activities and more, you can break down the barriers—and often the contradictions—between your philanthropy and your investing. You can put more of your resources to work toward your mission and maximize your impact.

To start a conversation about impact investing with your board, start out small and do your homework. When you examine not only the rate of return but the manner in which the money was made, you may find yourself able to advance your mission without ever writing a check.

For much more on impact investing, including the complimentary guide "Essentials of Impact Investing: A Guide for Small-Staffed Foundations," see www.exponentphilanthropy.org.

- **Asset guidelines—**When appropriate, provide guidelines to complement your asset allocation policy by laying out the kinds of investments you allow, favor, or prohibit, such as preferences for investments that are aligned with the foundation's mission and alternative investment limitations and securities guidelines.

- **Guidelines for monitoring and evaluating investments—** Describe the controls in place to move and invest your foundation's funds, guidelines for rebalancing the portfolio, and performance benchmarks.

- **Oversight and management responsibilities—**Identify who will oversee implementation of your investment policy, who will manage the investments, and who will monitor and evaluate them. List the main tasks involved.

- **Criteria for selecting investment consultants or managers—** Document the most important criteria for selecting an investment consultant or manager.

- **Guidelines for monitoring and evaluating investment consultants or managers—**Document how and how often you will review the performance of consultants and managers. Establish a written process for monitoring and evaluating to set clear expectations. Encourage regular communication among the board, investment committee, and consultants and managers. Promote accountability and specify grounds for termination of the relationship with outside advisors.

After creating your IPS, be sure to implement the plan. Don't make the mistake that many foundations do: creating a great IPS and never looking at it again. Your IPS is an essential foundation document, so the board or investment committee and all trustees should review it annually. In addition, share your IPS with outside professionals you engage (e.g., consultants, investment managers). *For sample investment policy statements, Exponent Philanthropy members can visit www.exponentphilanthropy.org.*

Deciding Who Will Oversee and Manage Investments

The development of the IPS will allow your board or investment committee to have greater insight into the skills required to implement your foundation's investment strategy. Two distinct roles must be filled:

1. *Managing* foundation investments involves buying and selling assets according to the plan outlined in the IPS. A paid investment manager or knowledgeable foundation manager can fulfill this role.

Foundation Snapshot: Do You Know What's In Your IPS? | The Morton Foundation, Inc.

Location: East Greenwich, Rhode Island
Assets: $1 million

Number of board members: 4
Number of full-time staff: 0
Number of part-time staff: 0

"For a long time," wrote Keith Whitaker, then of The Morton Foundation, Inc., "I paid attention only to our charitable expenditures, assuming that our investment consultant was doing his job. When I did raise concerns about our lagging investment performance, our consultant spent 30 minutes with me drawing up an investment policy statement (IPS).

I didn't pay much attention to our IPS until I began working in the investment industry. When I did look, I was embarrassed. Frankly, our 'IPS' was just an exercise in massaging the client. Our new IPS is not only longer than our old one, it has become the focal point for our approach to stewarding the foundation's assets. Creating it offered our board an education—not just about investments but also about our mission. There's still plenty that we don't know, but our new IPS prompts us to ask the right questions."

Time-Saver

Let Exponent Philanthropy research, sift, and summarize for you! Download or order helpful **publications,** including these investment-related titles:

- Creating a Strategy and Plan for Your Foundation's Investing: Developing and Using an Investment Policy Statement
- Essentials of Impact Investing: A Guide for Small-Staffed Foundations
- Getting It Done: The Who and How of Small Foundation Investing

www.exponentphilanthropy.org

2. *Overseeing* foundation investments involves selecting, monitoring, and evaluating the investment managers, as needed, as well as the investments themselves. An investment consultant who also helps to develop an IPS or a knowledgeable foundation manager can fulfill this role.

Foundations typically fill the roles of managing and overseeing investments in one of the following four ways:

1. **Outsourced chief investment officer (OCIO)—**In this model, the OCIO offers a high level of service by acting as a partner and co-fiduciary to the organization—essentially serving as the foundation's investment office staff and consultant. The OCIO implements the investment policy, handles manager decisions, assesses the managers' performance, reviews asset allocation, assesses risk, and reports regularly to the board, whose members maintain fiduciary responsibility.

2. **Investment consultant model—**The board hires an investment consultant who, in turn, recommends managers to buy and sell assets in accordance with the foundation's investment policy. The consultant helps the board monitor the performance of the portfolio. The consultant manages most of the weekly and monthly interactions within the parameters of the IPS. When strategic decisions are required, the investment consultant makes recommendations that the board chooses to accept or reject.

3. **Investment manager model—**The board selects and hires investment managers to buy and sell assets in accordance with the foundation's investment policy, and it oversees those managers directly. The board monitors performance of the portfolio and communicates directly with managers about ongoing tasks (e.g., rebalancing).

4. **"Board does it all" model—**The board does it all: develops the IPS, researches and selects assets, ensures proper custody of assets and necessary recordkeeping, evaluates and reports performance accurately, monitors assets and adjusts course, rebalances, and completes other tasks.

Foundations often hire one or more investment managers who rely on the board or investment committee for investment oversight. Although this approach may be the most common, it is not without problems. Investment oversight is no small task. It includes consideration of economic and market conditions; the possible effects of inflation or deflation; expected tax consequences, if any, of investment decisions or strategies; the role that each investment or course of action plays within the overall investment portfolio; the expected total return from income and the appreciations of investments; other foundation resources; the needs of the foundation to make distributions and to preserve capital; and an asset's special relationship or special value, if any, to the foundation's charitable purposes.

Investment oversight also includes rigorous investment research, tactical asset allocation, periodic rebalancing, the use of generally accepted methodologies to report performance, and ongoing evaluation of investment managers and their absolute and relative performance.

Unfortunately, many investment committees or boards neglect those responsibilities and ultimately expose the foundation to increased risk. It is critical that the individual or group responsible for oversight be prepared to fully assume the oversight tasks.

Filling the Role of OCIO, Investment Consultant, or Investment Manager

If your foundation chooses to engage an OCIO, investment consultant, or investment manager, you will have to decide whether to fill the role(s) internally or externally. For all positions, be sure to create job descriptions, gather referrals, and perform detailed interviews. Ask to see representative statements before making a hiring decision. You will rely on them to provide you with regular statements of investment performance, at least on a quarterly basis. These reports should be easy to understand, or the advisor should be willing to educate you on how to make sense of them.

Hiring From Within

If considering an individual from your board or staff to fill the role of investment consultant or manager, the foundation should address the following questions:

- Is someone on the board competent to consult or manage the foundation's assets?

- If a board member has the expertise, does he or she actually have the time to consult or manage effectively?

- What are the advantages and disadvantages of having an insider fill the role of consultant or manager versus someone else?

- If someone is competent, does foundation policy allow him or her to be paid for the work? Whereas federal law allows disqualified persons to be compensated for "personal services," such as investment advisory services, some foundation bylaws prohibit insiders from being paid.

- If considering a board member for the position of consultant or manager, how will the board respond if performance does not meet expectations? Even if services are offered *pro bono,* is the board resolved to use the same due diligence and documentation as it would for an outside advisor and hold the individual to a reasonable standard?

- Does the foundation have a conflict of interest policy to ensure that all interests are disclosed and monitored? Is the board or investment committee prepared to manage conflicts? Competitive bids should be sought, and the interested party should not participate in voting related to the position.

If your board cannot answer the preceding questions to its satisfaction, the foundation should probably not hire an insider, no matter how great the financial savings. Don't underestimate the human tendency to be sentimental with an insider or the consequences of poor investment decisions for a foundation's endowment.

Hiring Investment Consultants

If your foundation chooses to hire an investment consultant, you generally will want to hire that consultant before choosing investment managers. Don't look for a consultant who concentrates on offering the latest "hot stocks" or market insights; that's the concern of an investment manager.

As you conduct your search, ask:

- Does the investment consultant listen carefully to you? Take the time to understand the foundation's background, mission and goals, and needs?

- Does the consultant have experience advising foundations or other charitable entities?

- Does he or she promise to meet with you regularly and with attention to your concerns?

- Does the investment consultant have experience with a broad range of asset classes?

- Is the consultant committed to finding the best managers within each asset class?

- Does the investment consultant provide advice and manage money? That generally is *not* a best practice because the consultant is likely to be biased toward using his or her investment management services.

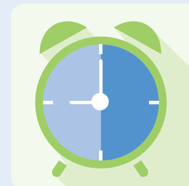
Be sure to ask how the consultant is compensated. If a consultant makes money from trading securities or recommending certain managers, for example, he or she has an incentive to trade securities or recommend certain managers that may not be in your foundation's best interest. Keep in mind that negotiating a low fee may have its costs. If you negotiate your consultant into an unprofitable relationship, you may forgo the attention you deserve.

Hiring Investment Managers

Consider the following questions if hiring investment managers directly:

- What is the manager's investment philosophy? Does the manager try to help you understand the philosophy or just use terms meant to put off your questions?
- Does the manager pick securities from a preapproved list? If so, what is the justification or strategy for doing so? Can the manager reasonably assure you that this constraint will not sacrifice returns in the short term or long term?
- Does the manager know what is in his or her fund? Can the manager explain clearly why he or she holds a particular stock?
- Can the manager describe cases in which the market punished an investment style, yet he or she stuck by it? If so, what did the manager learn from the experience?
- How is the manager compensated?
- Does the manager have a track record of success? How is that measured?
- Does the performance record comply with Global Investment Performance Standards, or GIPS®?
- Is the manager registered as a Registered Investment Advisor, or RIA, with the Securities and Exchange Commission?
- What is the firm's history? What is the longevity of the portfolio manager with this strategy?

Time-Saver



Exponent Philanthropy gathers annual **benchmarking data** from foundation members on these investment-related topics and more:

- Investment returns
- Investment portfolio allocation
- Use of investment consultants
- Investment management fees and expenses

Download a complimentary *Foundation Operations and Management Report* (Exponent Philanthropy members) or purchase one (non-members).

www.exponentphilanthropy.org

Controlling Fees

Investment performance isn't only about picking the right investment; it's also about controlling costs. As you'll see in the following list that was created by Tony Oppenheimer of Oppenheimer Brothers Foundation and Marshall & Ilsley Wealth Management, the possible investment fees are many and the ranges are considerable.

Investment management fees are almost always quoted in basis points (bps), or in hundredths of a percent, so 50 bps equals .50%.

- **Custodial fees—**These are paid to an institution to hold your foundation's assets and to settle trades—but generally not to manage them. Typical fees can range from 1 bps to 5 bps, depending on asset size, and even more, if the assets include foreign securities.

- **Trading costs—**These costs are generated by buying and selling securities. Commissions can range up to 5–6 cents per share traded. For large trades of common securities by institutional clients, a brokerage house might charge a flat fee of $10–$50. For more thinly traded stocks, clients may pay a *spread,* the difference between the bid and ask prices. Brokerages often embed these fees in the trade itself, so be sure to find out how much you are paying.

- **Professional manager fees—**People or institutions that manage your assets, whether in mutual funds or in separately managed accounts, levy these fees, which depend on the asset class; type of management (passive or active); sector; and size of assets. They can range from 5 bps to more than 200 bps. Management fees may be levied quarterly on the account or paid through an upfront or back-end charge (in the case of certain mutual funds).

- **Investment consulting fees—**These fees are paid to an independent consultant who proposes an asset allocation plan for your foundation and then objectively recommends the managers or funds to manage the foundation's assets. Consulting fees can range from 10 bps to 100 bps, depending on size of the foundation and range of the services provided, and they come on top of professional managers' fees.

If you're not sure about your fees, get a ballpark figure by looking at direct management costs (what you pay your advisors or consultants in direct fees and commissions) or by calculating the difference between your gross and net rates of return.

Evaluating Your Investment Professionals

Evaluating OCIOs and Investment Consultants

In your IPS, be sure to document your evaluation guidelines, including how often you will evaluate your OCIO or investment consultant (usually annually) and what metrics you will use. Be sure to measure the entire portfolio's performance while under the consultant's advisement and create a composite benchmark comprising benchmarks for all asset classes in the consultant's asset allocation plan. Your consultant should help you to create this composite benchmark; once created, stick to it. In addition, consider whether the consultant meets with the board regularly and executes the IPS consistently and accurately. If an insider is filling this role, evaluate him or her under the same standards. Outline activities that will result in termination.

Evaluating Investment Managers

Follow the evaluation guidelines specified in your IPS as to how and how often (usually quarterly or at least annually) you will monitor the performance of your investment managers. You may measure performance on an absolute basis (e.g. inflation plus a spread) or on a relative basis against benchmarks, such as indexes or composites of multiple indexes. Choose appropriate indexes that include securities in the same asset class as the manager being judged. Communicate that choice to the manager and stick to your benchmark.

Keep in mind that return is only half of performance; the other half is risk. When evaluating a manager against a benchmark, compare the manager's risk to the benchmark's volatility. Document the factors that would put a manager on watch and the time frame or criteria that would result in termination, such as a change in the manager's style (e.g., from value to growth); personnel turnover (e.g., if the top manager of a mutual fund leaves to start his or her own hedge fund); or performance that lags the manager's peer group or index, usually over a market cycle.

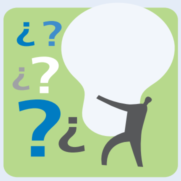
Keeping Your IPS Relevant and Your Board Educated

Once a foundation establishes its IPS and implements its plan, a significant amount of the work is done. It is critical, however, that both your IPS and your board of directors stay up-to-date. Toward this end:

- **Review your IPS annually—**Review the key strategy decisions on which the IPS is built. Make changes as needed.

- **Meet regularly to monitor investments—**Foundation boards that meet regularly (quarterly or semiannually) rather than annually or irregularly position themselves to better oversee

Do investment expenses count toward the 5% payout?



No. Expenses incurred for the production of income, including investment management and consultant fees, do not count as qualifying distributions. Likewise, portions of board meetings or staff salaries spent on investments are excluded from calculations of qualifying distributions.

their investment performance. Decisions about changes to investments do not need to be made each time the board meets; rather, patience can be a skill that is rewarded. Attention to the investments instills good governance practice; consider using your regular board meetings as a time to learn about one of the many asset classes and its impact on your foundation's portfolio. Cash, for example, may seem like a bland asset class until you begin to discuss whether your spending policy requires that you keep a large cash reserve, and what effect such a reserve has on your portfolio's performance.

- **Take advantage of your investment professionals' expertise—** Invite them to at least one board meeting per year to educate the board and give an update on their areas of expertise or the foundation's portfolio. If you've hired an investment consultant, be sure to consider the ways he or she can help to educate the full board, such as customizing an educational program for your board or recommending conferences to attend.

Keep in mind: Although the law allows board members to delegate specialized investment decisions to "experts," each board member, as a fiduciary, is responsible for making prudent and robust investment decisions. Board members don't need to be experts, but they do need to establish and implement a prudent policy. The rewards—in terms of investment performance, board cohesion, and support of your foundation's mission—are well worth it.

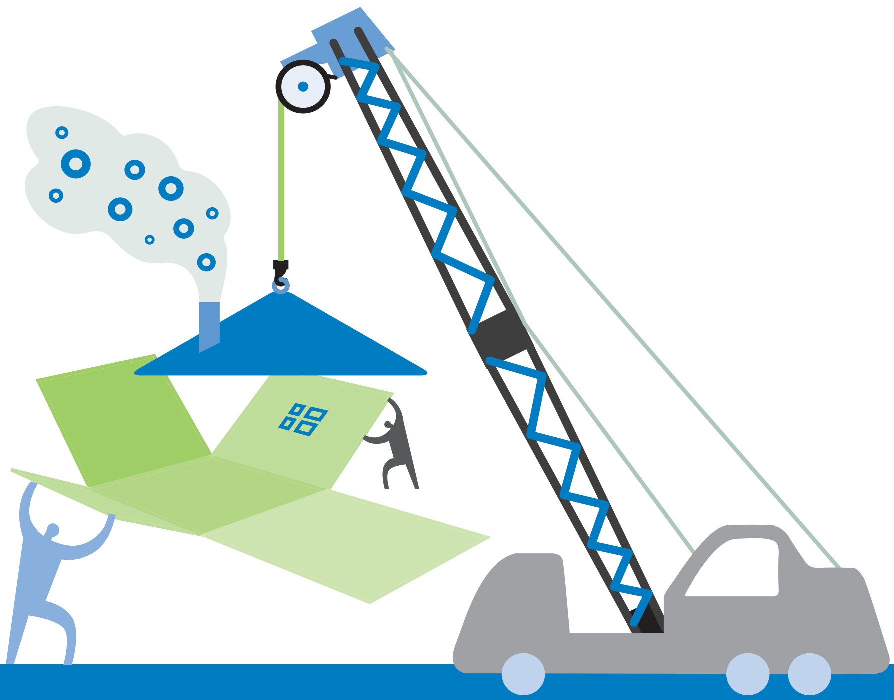
Staying Legal With Your Investments

It is critical that you know—and follow—the few laws in place related to foundation investments: *See Chapter 3 for all major private foundation laws.*

- **Be a prudent fiduciary—**Foundation board members have the legal responsibility to manage the foundation's assets by establishing and following prudent processes and practices. Investment decisions are governed by the Internal Revenue Code that addresses jeopardizing investments and also governed by some adaptation of the Uniform Prudent Management of Institutional Funds Act, or UPMIFA, or a similar act. *See page 55*.

- **Pay your excise tax—**Foundations must pay excise tax on their net investment income and usually in quarterly estimated payments. *See pages 47–48*.

- **Avoid excess business holdings—**Be sure the foundation and its disqualified persons do not collectively own more than 20% (or 35% in some cases) of a business enterprise. *See page 55*.



Chapter Five

PUTTING THE STRUCTURE IN PLACE: ADMINISTRATION

With the groundwork laid, it's time to build the framework of your foundation. Although putting a structure in place takes time and can be the least glamorous part of building, it is essential to opening the doors of the structure you have created—and keeping the doors open for years to come.

In This Chapter

- Your foundation can be managed and administered by volunteers, staff, consultants, or a mix of the three—each with its own benefits.
- Administrative expenses count toward your annual distribution requirement and may help you to fulfill your mission.
- Tech savvy or not, incorporating technology into your foundation management will save you huge amounts of time and possibly even money.
- Thoughtful setup of financial, filing, and other systems will make foundation operations run much more smoothly, thus freeing you to focus on the more enjoyable aspects of grantmaking.

Whether volunteers or paid staff run your foundation, a few administrative matters are necessary for you to conduct business. This chapter helps you put the right people on the right tasks, determine the right compensation level, put your finances in order, and keep good records—and do it all as efficiently as possible.

When we asked Exponent Philanthropy members how they get everything done at their foundations, here's what we learned:

- "Having a clear focus and guidelines saves us and our grantees' time."
- "Having a website has been a tremendous help. The foundation's guidelines, application, and report form are all on the website."
- "We try to get to know our grantees on a personal level—eliminating the need for much paperwork, an aspect greatly appreciated by our grantees."
- "We use grantmaking software, and that reduces the administrative burden significantly. I encourage folks to call me to discuss proposals. A short phone conversation means less wasted time because we receive far fewer proposals that are out of guidelines."

Putting the Right People on the Right Tasks

A private foundation has the freedom to shape how it will accomplish its work. Start by defining the tasks at hand; from there, determine the best way to accomplish them. The categories that follow include the most common and basic activities in running a foundation. Some are managerial, some are administrative, and some are a combination of the two. Determine which are relevant to your foundation.

Setting Direction
See Chapter 1.
- Define a focus and intended impact.
- Capture donor intent.

Governance
See Chapter 2.
- Plan and hold meetings.
- Prepare meeting materials and keep minutes.
- Keep the foundation oriented to mission.
- Create policies.
- Plan for succession.
- Recruit and train new board members.

Tax and Legal
See Chapter 3.
- Stay familiar and compliant with state and federal laws.
- Pay your excise tax quarterly.
- Meet your annual distribution requirement.
- File a Form 990-PF with the Internal Revenue Service (IRS) and state annually (and other reports required by the state).
- Stay compliant with employment-related taxes and filings.

Investments
See Chapter 4.
- Create a prudent investment process and policy.
- Oversee implementation of the policy.
- Monitor investment performance.

Administration
See more in this chapter.
- Read and respond to mail and e-mails, and respond to phone calls.
- Manage files and keep records.
- Invest in necessary technology.
- Mitigate risk with insurance.
- Plan and implement basic financial systems.
- Pay bills.
- Handle employment-related issues, if staffed.

Grantmaking
See Chapter 6.
- Establish and communicate an application process.
- Make and communicate grant decisions.
- Write checks and monitor grant progress.
- Comply with legal requirements for special grants.

Cheaper Isn't Always Better

Be willing to invest money in your own capacity if it will increase your impact. Funders have a tendency to be super economical, even when carefully chosen expenditures can have a big payoff in efficiency or effectiveness. Thought leader Kris Putnam-Walkerly calls this a "poverty mentality." Investments that can pay off big include staffing, office space, equipment, technology, site visits, board and staff training, consultants to research an issue in-depth, and communications.

Once you have outlined the work to be accomplished at your foundation, consider how you will get it done. Foundations have several options: relying on volunteers (e.g., board members); hiring staff; engaging consultants or firms; or any combination of the three. Here are some common models:

- **Volunteer management and administration—**The founder(s) manage and administer many first-generation foundations. The workload is often manageable in the foundation's early stages, particularly for those with fewer assets and simple grantmaking processes. In certain cases, the entire board may share responsibilities. If a foundation has a primary volunteer, he or she may assume the title of executive director, even if unpaid.

- **Volunteer management or paid administration—**Other foundations rely on volunteers to accomplish management-related activities, paying only for discrete tasks that are administrative in nature or require a specific skill. For example, some foundations hire full- or part-time administrative staff, consultants, or firms for bookkeeping, investments, or grants management. Some foundations rely on administrative staff from a family office to assist with foundation administration (with costs usually covered by the family business).

- **Paid management or paid administration—**Foundations with larger assets or more complex grantmaking processes often hire someone to manage the foundation as executive director or CEO. The executive director typically shapes the foundation's grantmaking program, recommends projects worthy of the board's consideration, conducts or coordinates meetings and site visits, and prepares materials for board meetings. The executive director or CEO may assume all administrative duties, or an administrative assistant may be hired to assist with those tasks.

With the preceding models in mind, consider the following questions to help you with decisions about hiring:

- Would one model serve the foundation's mission best? Although foundations are often cautious of spending money on administration rather than grants, your foundation may become even more effective if it hires staff.

- Do board members (or other available individuals) have the time and inclination to help with the work of the foundation for the long term and without pay? If so, which tasks could such individuals handle?

- Do any tasks require expertise not currently available (e.g., bookkeeping, filing tax returns) that a professional could handle?

- If you need management or administrative help, would it be best to hire staff, hire a consultant, or engage a firm that provides back office support? Consider your options because each has unique advantages.

- Is an insider or family member competent and willing to serve in a staff capacity? To fully understand the pros and cons, talk to other foundations that have hired insiders.

It is important to define the role of each person—even a volunteer—who is engaged in the foundation's work. Detailed, written position descriptions go a long way toward outlining expectations, clarifying duties and responsibilities, establishing accountability, increasing efficiency, and avoiding misunderstandings.

Exponent Philanthropy members can download sample position descriptions at www.exponentphilanthropy.org.

Determining the Right Compensation Level

Once you've placed the right people on the right tasks, it's important to be thoughtful about their compensation levels. Excessive compensation is on the IRS radar because it is a key way that private foundations violate the self-dealing rules. To be sure that you are compensating individuals appropriately, follow these steps:

- Check your governing documents and state laws to be sure that they allow the individuals in question to be compensated. For example, some founders dissuade the foundation from hiring family members with provisions that prevent them from being compensated.

- Be sure that individuals are providing services for which they can be compensated. Disqualified persons can only be compensated for "personal services" narrowly defined by the IRS as:

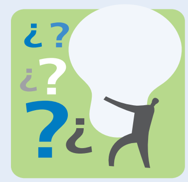
    - Routine board service

    - Services considered staff functions

    - Limited professional advisory services, such as legal, accounting, investment, or banking services

- Assess whether the services are necessary to further the foundation's charitable purpose. The extent of services must be reasonable in light of the foundation's specific activities, and the individual to be compensated must be qualified to perform those services.

What services do consultants offer to foundations?



Board members and staff sometimes find themselves wishing for extra time or another pair of hands. Consultants can help foundations with every aspect of foundation management and administration, and most small foundations use consultants at one time or another. For example, you might hire a consultant to design your grant program, manage your investments, or prepare your tax returns. A consultant also might respond to grantseeker inquiries, facilitate a retreat, or evaluate your grantmaking program.

For a sampling of consultants who work with Exponent Philanthropy members, visit www.exponentphilanthropy.org.

- Set reasonable compensation. To determine if it is reasonable, you should:
  - Assess the duties to be performed, along with the level of expertise required and the time needed to accomplish the work. Develop a job description.
  - Know what similar foundations pay similar persons for similar work. *See www.exponentphilanthropy.org for benchmarking data.*
  - Consider the total compensation package. Keep in mind that total compensation includes not only salary and wages but also bonuses; health care, retirement, and other fringe benefits; housing and automobile allowances; and club memberships. If the foundation incurs lavish expenditures that include benefits to board members or staff, those benefits also may need to be included in calculations of compensation.
  - Be sure to document your decisions, including your sources of compensation data.
  - Remember that salaries are disclosed on the foundation's Form 990-PF and made public at www.guidestar.org. Don't compensate at a rate that you are uncomfortable sharing.

Choosing a Work Location

Foundations have the luxury of being as formal or informal as they like, including choosing where to get their work done. Consider the pros and cons of the options that follow to help you make the best decision for your foundation.

Location	Pros	Cons	Tips
Home office	• Is convenient • Is economical	• No space for larger meetings • The space is not "official" • It's harder to maintain work-life boundaries • It can be isolating	• Get a separate phone line • Use a nearby P.O. box for foundation mail
Leased space	• Have an "official" space • Can accommodate grantee and board meetings	• It can be costly • It may be isolating	• Be sure to have legal counsel review the lease

Shared office	• Is economical and often free • May allow for sharing of utilities, equipment, and staff • Prevents isolation	• This space can easily become self-dealing if not careful • Challenges that accompany sharing the space can be greater than the benefits	• Clarify details upfront and in writing • Be sure to have legal counsel review the terms, especially if sharing the space with a disqualified person

Note: Trustees or family members cannot rent space to the foundation. A rental is considered to be self-dealing, unless the space is leased to the foundation for free.

Managing Your Foundation's Financials

Foundations handle money matters in different ways, depending on asset size, board and staff structure, and grantmaking program. Yet most would agree on general practices that keep a foundation financially healthy, whether or not you hire an accountant to help. For starters, establish procedures in writing to:

- Stay current on basic finances, such as investment assets and income, grants made, and expenses incurred, so that you can make timely adjustments.
- Provide your board with data to fulfill annual legal requirements, invest assets prudently, distribute 5% of net investment assets in qualifying expenses, file the IRS Form 990-PF, and pay your excise tax.
- Protect your assets.
- Set the stage for future planning.

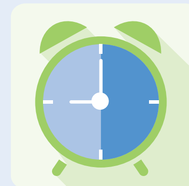
Be sure to note who is responsible for which tasks and who provides oversight on each task.

Handling Money

When handling money, use good practices that work for many foundations, including:

- **Open a single foundation bank account—**Foundations that make grants only one to two times per year or those with minimal operating expenses simplify recordkeeping by making most transactions from one account. Some also use a money market account.
- **Keep up with cash flow needs—**Some foundations set up automatic monthly asset transfers from their investment accounts; others transfer funds just once or twice a year before a grant distribution.

Time- and Money-Saver



Exponent Philanthropy members can save money and stay compliant with **discounts on software and services,** including:

- D&O liability insurance
- Grants management tools
- GuideStar products
- NGOsource
- And more!

www.exponentphilanthropy.org

How can our foundation offer health insurance to employees?

Among Exponent Philanthropy members, 69% offer health insurance to their full-time paid employees; 23% offer health insurance to part-time paid employees. Consider the following resources in your state or region for affordable group health insurance:

Associations
Inquire about group health insurance policies available through state, trade, or regional associations. *For a list of state nonprofit associations, visit the National Council of Nonprofits at www.ncna.org.*

Nonprofit Outsourcing Firms
Nonprofit outsourcing firms offer human resources solutions to other nonprofits.

Group Employers
For-profit group employers allow employees of small-staffed businesses and nonprofits to become leased employees for the purposes of obtaining human resources benefits, such as health insurance. Search online for "local group employers," "group employment," or "employment services."

Exponent Philanthropy does not offer a group health insurance policy at this time because current state-specific regulations make it difficult to negotiate a policy for our national membership.

- **Create policies to monitor check writing—**Account for and protect your assets with a policy stating who can sign checks (and for what amount). Many foundations require two signatures for checks over a specific amount; some use banking services that prevent unauthorized withdrawals.

- **Use caution with credit cards and petty cash—**Many small foundations pay for everything with business checks, whereas others find it convenient to use a credit card or petty cash, especially when traveling for foundation business. If your foundation chooses to use a credit card or petty cash, establish a policy authorizing who can use it; for what types of expenses (only foundation expenses; otherwise, self-dealing is likely to occur); and up to what amount.

Establishing a Financial Tracking System

We recommend you follow these procedures to keep tabs on your basic financial information:

- **Establish a fiscal year—**A *fiscal year* is the 12-month period in which a foundation tracks expenses and income. Many foundations establish a fiscal year that follows the calendar year from January 1 through December 31. Others establish fiscal years to follow grant cycles, board/staff availability, or the practices of hired accounting services. Whatever you choose, describe your fiscal year in your bylaws.

- **Check on your distribution requirement—**Early in your fiscal year, calculate the qualifying expenses you'll need to make by year's end. Include grants, administrative expenses, equipment, and other expenses related to fulfilling your charitable mission. *See page 54.*

- **Establish files for your financial documents—**For each fiscal year, establish files for your financial documents, including investment statements, bank account statements, grant award letters, regular monthly expenses, and other expenses.

- **Track expenses and grants monthly—**Use a spreadsheet, even a simple one, or an online system or software, to track your monthly expenses and grants. This recordkeeping will allow you to track progress toward fulfilling your annual distribution requirement and to make budget projections.

- **Assess your expenses and grants each quarter—**Stay current with your financial tracking system to maintain an accurate picture of your resources and how you're spending your money. To keep your board members informed, send them copies of the spreadsheet. Are you spending as planned and on track for meeting your distribution requirement and your operating

Liability Issues for Foundations

In today's litigious society, even your foundation may become the target of a lawsuit. Although state and federal laws may provide some protection for your board members and volunteers, such laws rarely protect the foundation or provide for legal expenses, often the most costly components in litigation.

Consider the following types of insurance to protect the foundation and those involved in its work:

- **D&O liability insurance—**A D&O liability policy will protect your directors and officers against a variety of claims alleging mismanagement that are not covered under the foundation's general liability policy. Such claims include harassment, wrongful termination, employment discrimination, conflicts of interest, libel, slander, breach of contract, and violations of tax laws.

  Among other provisions, a good D&O policy should contain:

  - A *duty to defend* provision that offers full defense coverage, even if allegations are found to be groundless or false
  - Unlimited coverage for legal expenses (i.e., legal expenses do not count toward the policy's coverage limit), with such expenses to be paid as incurred
  - Coverage for allegations of antitrust violations or mismanagement of funds
  - Full employment liability coverage
  - Coverage for accusations of harassment by a third party
  - Protection for assets of a director held in a spouse's name

- **General liability insurance—**All private foundations with office space should consider this insurance—typically thought of as "slip and fall" insurance—to cover personal injury and property damage. If the foundation operates out of your home, contact your homeowner's insurance company to update your policy to include coverage for office equipment and business liability. This coverage is not automatically included in a standard homeowner's policy, and certain losses could be excluded.

- **Business property insurance—**This insurance protects the contents of your foundation from fire, theft, or other risks, and is key for any foundation with property or equipment of value. Many different types of property insurance and varying levels of coverage are available. It's important to determine the property you need to insure for the continuation of your operations and the level of insurance you need to replace or rebuild your assets.

- **Employee dishonesty policy—**This type of insurance covers a foundation in cases of fraud. No one ever expects the people they hire to be dishonest, so the decision to select this insurance should not be based on whether a foundation believes its current employees might be dishonest. Consider purchasing this insurance: Policies are rather inexpensive and the payoff can be large.

- **Cyber insurance—**This type of insurance protects the foundation against hacking and the theft or revelation of confidential information. As foundation assets grow, foundations are at increased risk for these problems.

Exponent Philanthropy members qualify for discounted and comprehensive coverage through our insurance program. For more details, visit www.exponentphilanthropy.org.

Time-Saver

Exponent Philanthropy members can download **sample documents** to reproduce or adapt, including:

- Budgets
- Consultant contracts
- Interview questions
- Position descriptions for executive, program, and administrative staff

www.exponentphilanthropy.org

budget? This information is invaluable as you assess your initial decisions about where and how to operate.

- **Use your spreadsheet and files to prepare the Form 990-PF at year's end—**Because investment-related expenses, including fees paid to investment consultants or managers, do not count toward your annual distribution requirement, list them separately on your spreadsheet.

Creating a First Budget

After a few years of operation, some foundations create simple budgets based on expenses they're tracking or financial plans for the coming year(s). To create a budget, look at your spreadsheet, assess how much was spent in different categories, and decide whether you will spend the same, less, or more in the future. Add a column to your spreadsheet for the amount you plan to spend in each category during the upcoming fiscal year. Then compare your actual expenses against your budgeted amounts throughout the year. Think about which aspects of your administration are running smoothly, those you might live without, and any new expenses that would allow for more efficient, effective grantmaking (e.g., more meeting space, a new computer, a change in investment strategy).

Exponent Philanthropy members can find sample spreadsheets and budgets at www.exponentphilanthropy.org.

Keeping Reasonable Records

Whether you choose to keep hard copies or manage everything digitally, good recordkeeping takes time and thought. If you put the proper systems in place, you'll be able to find what you need when you need it, fulfill your legal requirements, and save time.

Some foundations delegate their recordkeeping to accountants, custodians, or consultants. If your foundation outsources its recordkeeping, be sure trustees understand that the board—not the hired recordkeeper—ultimately is responsible to make sure records are in good order. Also be sure to clearly outline the scope of work; the fees and payment schedule; and your expectations (including where the records will be stored and how your foundation will access them).

What to Keep and for How Long

The IRS offers only general recordkeeping guidance to nonprofits. The following best practices, which apply to both paper and electronic files, have been established over the years. State laws may influence how long to retain documents, especially personnel records.

Founding Documents
Permanently

Examples: articles of incorporation, bylaws, IRS determination letter

Legal and Accounting Records
Permanently

Examples: Form 990-PF, major correspondence with attorneys, records of contributions to the foundation

Board Records
Permanently

Examples: signed board meeting minutes, committee actions, annual reports

Program Records
7 years

Examples: grantee records, including grant applications (keep only for 4 years) and verification of grantee federal tax status; grant reports; canceled checks

Personnel Records
7 years after termination

Examples: personnel records, including applications, personnel files, and W-2 forms; foundation's payment to employees; workers' compensation policies and reports

Financial Records
7 years

Examples: contracts, leases, and mortgages (7 years after expiration); bank statements and reconciliations; check requests and invoices; audit reports

Putting a Records Management System in Place

Now that you know what records to keep, you can establish a records management system to reap the benefits of good recordkeeping, including increased efficiency, ease of legal compliance, and the ability to track progress toward your mission.

Keep in mind that a system that works in year 1 might not work in year 5. Be sure that your systems work for you, and refine them if they don't.

Records Retention Policy

Create a *records retention policy,* a one- or two-page written document that summarizes your procedures for storing, organizing, purging, archiving, and protecting foundation documents and fulfilling public reporting requirements. Documenting your procedures helps your foundation keep good records over time, thus letting you reap the benefits of compact, organized, and secure files.

A records management system consists of the following tasks:

- **Sort documents into categories—**Start by sorting your documents into major categories that fit the operations of your foundation (e.g., founding documents, board records, personnel records). Ways to organize foundation files include: alphabetically; numerically; by year; by program area; or by region or neighborhood.

  Different ways of organizing documents have different advantages. Organizing alphabetically might make retrieval easier, but organizing by year may make for a smoother transition when purging and archiving materials. In addition, different file categories might call for different ways of organizing.

  Most foundations keep separate files for grantseekers and grantees. You might decide that grantseeker records are easier to access if organized by program area, whereas grantee records are best organized alphabetically, by organization.

- **Set up files so you can retrieve documents easily—**Within each category, how will you need to access the information? Most categories will need additional structure (and thus additional files) beyond the major category. For example, you could organize board records into the following subtopics: board lists, board meeting minutes, board planning. Within these, you could order documents by date, with a separate file for each year.

  Once you have decided on a filing system, explain it in writing, save the explanation in your administrative files, and put the explanation in a public place. That way, trustees and staff can refer to that explanation when filing and retrieving documents.

- **Purge inactive documents regularly—**As part of your records management system, decide which files (including e-mails) you will purge (i.e., destroy) regularly, and how often you will purge them. Purging every 3–6 months (and at least once a year) keeps your files clean and compact, and saves you space and money.

- **Archive documents regularly—**Like purging, archiving keeps your files clean and compact. Archive documents that you no longer wish to use but wish to keep for historical purposes; archived documents become part of your foundation's long-term repository.

- **Protect your records—**No one likes to think about disaster, yet the risk is there. Fires, floods, or even the occasional employee or trustee snafu can spell disaster if it results in the loss or deletion of important records. Be prepared by photocopying or scanning your vital records, and storing the originals offsite in a fireproof location; backing up computer files every 1–2 weeks on a separate hard drive or disk; and updating your virus and spyware protection.

However you choose to maintain your records, it is critical that you stay current with technology so that your records remain accessible. The IRS does not require that tax documents be stored in a particular way, but it does require that requested documents be available and ready to be shared in a legible, readable format.

Using Technology to Lighten the Load

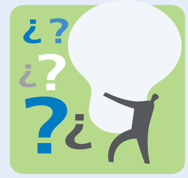
Whether you thrive on the newest gadgets or have Luddite tendencies, technology is key to your efficiency as a grantmaker. Exponent Philanthropy encourages you to use technology in a few strategic places.

Websites

Developing a website does not need to be intimidating or expensive. A website can be straightforward to set up, even without dedicated information technology staff, and a number of tools are available to help simplify the process. The benefits of a website are many. It can be used to:

- Communicate your mission and guidelines to potential grantees quickly, widely, clearly, and cheaply.
- Outline your grantmaking process and time line.
- Make your grant application and reporting forms available to grantees to download, or to provide an online grant application process.
- Highlight your grantees' achievements and publicize their work.
- Inform the public about your organization's values and its history.
- Share internal documents, such as board books, meeting minutes, and grant proposals with your board of directors, committee members, and staff.

Are online storage services secure enough for sensitive information?



Online or cloud storage services are secure, but they rely on individual users to supplement their security. Protect your documents and computer by following safe browsing guidelines, such as creating passwords that combine letters, numbers, and symbols. Also keep your virus protection, firewall, and other software up to date.

As with any kind of files, it is important to regularly back up electronic files: those stored on your computer's hard drive and those stored in the cloud. Print hard copies of critical documents to store securely. Be sure that everyone who has access to sensitive files knows the protocols for keeping them secure.

Grants Management Software

Grants management software can significantly ease a foundation's administrative burden. For many foundations, such software is as essential as a computer.

On the most basic level, software can streamline the creation of letters and e-mails to grant applicants. Most software also offers an online application and grant review process that allows geographically scattered board members and staff to view applications and make comments; it also allows them to create reports, schedule and track payments, and monitor and analyze grants programs.

For foundations that make relatively few grants, however, most grants management software is too complex and too costly for their needs. For these foundations, a simple spreadsheet often is sufficient.

Conferencing

Many foundations find audio- and video-conferencing to be effective alternatives to in-person meetings—and time- and money-saving too, especially because many such services are free. Although audio-conferencing is sufficient in many instances, long conference calls with multiple participants can be challenging and may limit participation. In such cases, do not hesitate to use video-conferencing services, which allow small group discussions, sharing and reviewing documents together, and more. Once people are used to the technology, it significantly improves the experience, and it is still inexpensive compared to an in-person meeting.

Electronic board books

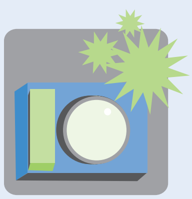
Several options allow your foundation to share board books electronically:

- **Online or cloud storage services—**These services allow users to store files online. Typically low cost, they also are easier to set up than many other options. The most popular online storage services allow users to share files with access levels that allow for viewing and editing.

- **Board websites—**This password-protected section of your website is secure and easy to access, providing another good option for sharing and reviewing documents. The site allows board members to communicate and share feedback as they review materials.

- **Board portals—**Although the priciest of the electronic sharing options, board portals tend to have lots of useful functionality. Within most portals, users can create board books and meeting agendas. They generally also have built-in voting and polling functions, calendar tools, and e-mail alerts, and they allow individual board members to review and add notes to their own board books.

Foundation Snapshot: Putting Technology to Work for You | The 1772 Foundation, Inc.



Location: Pomfret Center, Connecticut
Assets: $78 million
Number of board members: 7
Number of full-time staff: 1
Number of part-time staff: 0

"The most important factor in our ability to get work done with a one-person staff is the use of an online grant review/rating system," said Executive Director Mary Anthony. "This allows 80% of the grants discussion to take place before the board meeting. It also gives board members more flexibility in how and when they do their review work. If questions come up before the meeting, it gives us time to contact the applicant for clarification. It also takes a lot of stress out of the decisions and requires board members to be thoughtful and accountable in their reviews because they are done in writing and are visible to other board and staff members. It has really streamlined our quarterly meetings and made for some constructive online discussions."

Chapter Six

PUTTING OUT THE WELCOME MAT: GRANTMAKING

You're in the final stage of building. Everything is in place except for finishing touches that will define your role in the community and make the project worthwhile. Don't delay—there's a positive impact to be made.

What's in a name?

Used throughout this book, the term "grantee" is familiar to most everyone. Increasingly, however, funders are experimenting with other terminology, such as "grant partner," to elevate the critical on-the-ground role nonprofits play in achieving success. "Grant partner" also challenges the inherent power imbalance at play when only one party has the money. Ultimately, how a funder treats the nonprofits that receive grants makes the biggest difference, but you might want to discuss the terminology with your board and staff.

In This Chapter

- Seeing the impact of a thoughtful grant makes all other foundation tasks worthwhile.
- Defining a grantmaking strategy and communicating it clearly will serve you and the community well.
- A process to collect and review proposals, however informal, will save you time in the end.
- Require only what you will use. Everyone will benefit, as will the environment.
- Always look for opportunities to learn.

Nothing is more central to a foundation's existence than grants that make a difference, whether to revitalize a neighborhood, strengthen a family, or keep a struggling but high-impact nonprofit in business. Grantmaking is the end result of your hard work in establishing a smooth-running foundation.

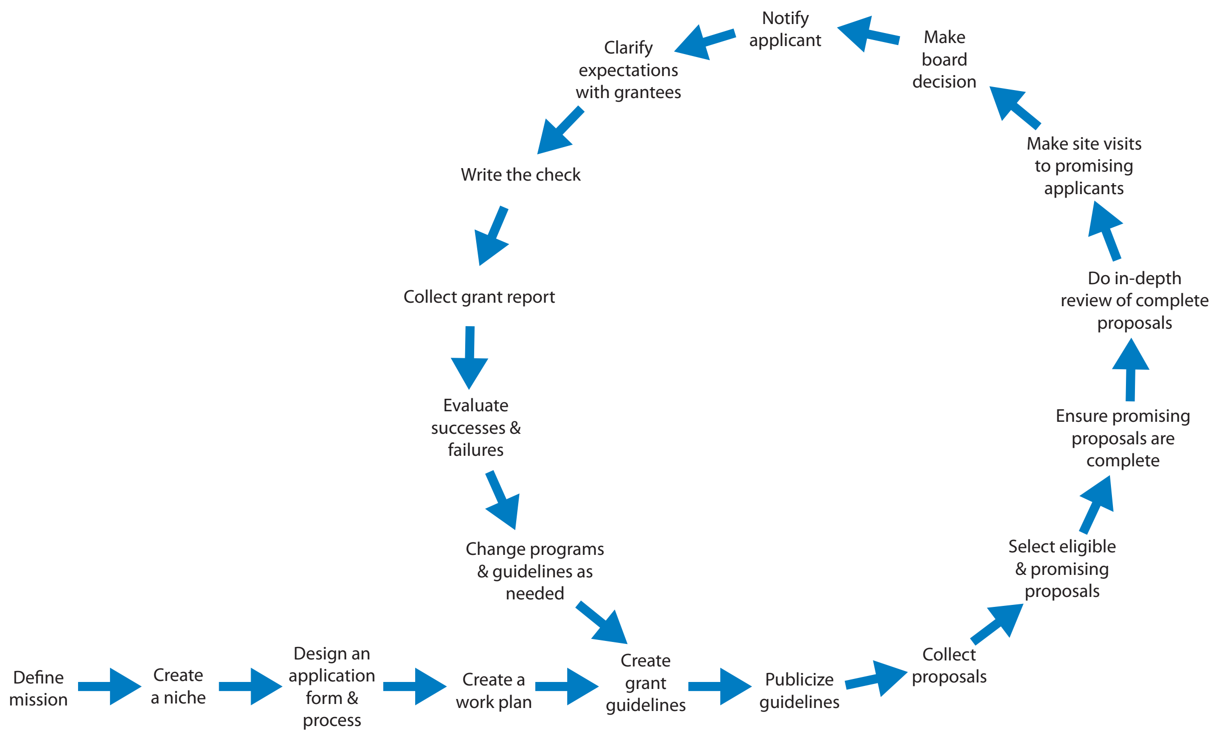
This chapter addresses the main components of a grantmaking program: defining a strategy, designing an application process, creating a work plan and guidelines, making and communicating grant decisions, and monitoring and evaluating grants. Although the chapter outlines a broad spectrum of decisions and activities within the field, the most effective path and process will be the one that works for you, the particular stage of your foundation, and the impact you desire.

The figure on the next page diagrams the process that many foundations use to make good grants efficiently. If you're just starting out, some of the components are more than you need. Pick and choose what works for you now and make adjustments over time.

Defining Your Grantmaking Strategy

A *grantmaking strategy* is a plan that details how your foundation will make its impact together with the organizations and people you fund. Foundations that craft even a simple strategy are better able to focus, prioritize, assess their impact, and use their time and resources effectively.

Before you define your strategy, though, it's critical that you learn about your chosen focus area. It is better to do this task beyond your desk or boardroom table. Just as a company would not develop a strategy without doing a SWOT (i.e., strengths, weaknesses, opportunities, and threats) analysis, foundations seeking an effective route to significant change will want to know a several things about a field. In philanthropy, this step often is called a *landscape scan.*



Through scanning, you can identify essential information, such as barriers to progress in your chosen focus area; strategies that have or have not worked; effective agencies and programs; public funding streams; potential collaborators; the various social, economic, and political forces at play; and opportunities for your foundation to make a difference. Scans also can jump-start coalitions of funders in a community. Just be clear about your intentions from the beginning of the conversation so that no one misconstrues the purpose.

You can do the scanning on your own time line, budget, and operating style, and it need not take a long time. Methods for scanning include the following:

- Talk with anyone who touches your focus area in some way: staff of nonprofits, such as the United Way; government officials; social workers; researchers; business leaders; teachers; local community foundations; parents; students; volunteers; recipients of social services; and others.

- Call or meet with Exponent Philanthropy members and other funders in your focus area to find out what strategies they use and why, and what they've learned along the way.

- Survey your grantees and organizations seeking grants from you about how they think your foundation is addressing current needs and whether your foundation could play other roles.

- Invest in a community needs assessment or commission a study of issues in your focus area to identify current challenges, gaps in services, barriers, effective strategies, and potential funding partners and grantees.

- Read materials about your focus area produced by other larger funders and affinity groups, such as Grantmakers in Health and Grantmakers for Education, to learn more about these topical areas and how other funders are approaching those issues.

Whichever method(s) you choose, you'll need to set aside enough time to make sense of what you learn. You might do so in stages, ensuring that you keep the board informed along the way so that interim feedback can shape the next stage of your scan. Out of the scan, you'll begin to see paths for making change.

It is out of these various pathways for change that the board and staff can begin to define the path they'd like to pursue. For example, if focusing on childhood obesity, you might decide that healthier school lunch programs are critical to decreasing the rates of childhood obesity. This decision then will begin to shape the types of grants you'll make, the organizations in which you'll invest, the amount of time you'll invest, the geographic confines, and so forth. If you can establish even a broad goal upfront, you can then align all other decisions to support that goal, rather than set up procedures and methods that might inadvertently be at cross-purposes. If your board prefers, you can test different strategies to see which is most effective before settling in on a longer-term plan.

Once you have clarity about where you're headed, you can define the following elements more easily:

Geographic Focus

Consider what you want to achieve and whether you will be more or less successful within a particular geography. Being specific will go a long way toward reducing the number of ineligible grant proposals.

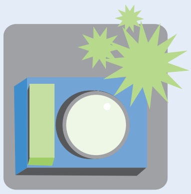
Grant Types

Foundations often choose a primary grant type and award other types as circumstances warrant. Consider how various grant types might advance your mission. For example, if you're interested in shoring up young organizations in your community, you might offer a series of general operating support grants to stabilize and build those organizations. If you're interested in expanding affordable housing in your community, you might consider loans, loan guarantees, or another form of program related investment, or PRI.

Consider the following grant types:

- **General operating support—**This increasingly popular grant type allows a grantee to decide how funds are used, although most foundations and grantees have conversations about expectations and intended outcomes.

Foundation Snapshot: The Power of Taking Time to Learn | Sauer Children's Renew Foundation



Location: St. Paul, Minnesota
Assets: $6 million
Number of board members: 8
Number of full-time staff: 1
Number of part-time staff: 0

"Taking the time to really understand the landscape in which we were funding was critical," said Colleen O'Keefe, executive director of the Sauer Children's Renew Foundation. "I felt like we were using a Band-Aid approach, rather than helping to create better outcomes. Taking the time to scan helped me truly understand our grantees' realities, not just the picture they thought I wanted to see. I wanted to come alongside them so I could make better decisions, to get around the typical grantor–grantee power dynamics and create authentic relationships.

Equally powerful was the desire to be on the ground, learning about the experiences of children who land in foster care—both what happens when they grow up in care and what happens when they age out of the system. Scanning gave me a window into the whole picture, from the inside, before we created our funding strategies. And, maybe most important, I knew our current strategies weren't changing children's outcomes. I felt desperate to figure out how to be more effective, and I knew I didn't have the answers. Only after interviewing individuals from every angle in the system could we start to have a sense of the leverage points where our small foundation could make a difference."

- **Capacity building grant—**This type funds core organizational skills and capabilities, such as leadership, fundraising, and management.

- **Project support grant—**This grant type funds a particular program or project—with expected outcomes.

- **Advocacy—**This type supports the public policy work of nonprofits to further your mission. Funders can use this type of grantmaking to have huge impact; they only must avoid a small list of activities that qualify as lobbying.

Time-Saver

Exponent Philanthropy members can use the **Member Directory** or **Member Discussion Groups** to find fellow members with expertise to share. Members are ready to talk with you about the following topics and much more:

- What to know when getting started in grantmaking
- Grantmaking without staff
- Proposal review processes
- Communicating with grantees
- Measuring foundation effectiveness

www.exponentphilanthropy.org

- **Scholarship—**This grant type typically funds individuals for a particular purpose, usually for travel or study. Special approval from the Internal Revenue Service (IRS) is necessary for this type of program, unless a third party, such as a community foundation or university, selects grant recipients and your foundation simply supplies the funding.
- **Seed grant—**This type provides start-up funds for a new organization or program.
- **Challenge/matching grant—**This type provides funds to an organization with the expectation—or on the condition—that other sources will raise additional funds.
- **Program related investment—**This is a low-interest loan, loan guarantee, or other investment in a nonprofit.
- **Capital campaign—**This grant type funds the purchase or construction of a building, land, or major equipment.
- **Endowment fund—**This type builds an organization's endowment fund, which can help a grantee to achieve financial stability.
- **Innovation grant—**This type funds projects that experiment with new solutions to social problems—a key role for foundations because few organizations have the same luxury of funding projects that are perceived as risky.

Grant Sizes

Foundations give grants of all sizes. Consider how grant size fits into your overall grantmaking strategy:

- What are your community's needs? Will a few large grants have a greater impact than several small ones? If your foundation funds in a new area with only a few effective organizations, a few large grants may be the right fit.
- Considering your foundation's resources and time, what would be the best grant size? Who will manage the process of reviewing grant requests, making recommendations, communicating with grantees, and monitoring grants? How much time can be allotted to that work? Many small grants will take more time to review, administer, and monitor than a few larger grants. For grantees you intend to fund over time, large, multiyear grants can reduce the administrative burden significantly for you and the grantee.

Remember that a disproportionately large grant to a small public charity can actually force or tip the public charity into private foundation status, a disservice for most public charities. *See page 60.*

Grant Restrictions

If you wish to limit your funding in some way, be explicit about it. For example:

- **Size of organization—**Some foundations limit their giving to organizations below a particular annual operating budget (e.g., $2 million) because they expect to have greater impact when partnering with smaller nonprofits.

- **Funding uses—**In addition to outlining what they fund, some foundations delineate what they do not fund. For example, a foundation may state that it funds capital projects but not conferences.

Consistency of Grants

Some foundations fund the same organizations year after year; others seek new organizations and programs after a few years. Neither approach is right nor wrong; seek one that best fits your strategy. You'll want to choose based on your overall goals and pathways to change, and on your time horizon for achieving your goals. For many funders, achieving a particular impact takes several years, a decade, or more. The time horizon will help you decide whether to make annual or multiyear grants, or invest in helping grantees to be strong and self-sustaining. If your foundation decides to redirect its funding, grantees will benefit from help during the transition (e.g., introductions to other funders, challenge grants).

Nongrant Assets

With their board and staff, foundations bring much more than money to the table. Those resources even might be more valuable than the grant. Consider your expertise and skills, and how you might use those assets to achieve the foundation's goals. Do not underestimate the value of listening well with a bird's-eye view, strategizing, thinking critically, convening, communicating, providing technical assistance, and leveraging your connections. As you meet with nonprofits, ways to use the full spectrum of your assets will become clear.

Relationship With Grantees

Even though a strategy for relationships with grantees is difficult to outline and implement, it is essential. Good relationships engender openness, honest feedback, better problem solving, and fewer mysterious dynamics. A respectful relationship also can lead to better funding ideas and programming, and a more effective nonprofit community. One of the most critical decisions you can make is to schedule time to listen to the challenges of your nonprofit partners. For example, taking time to understand a grantee's income streams and how they are affected by government cuts makes it possible to be proactive about the shortfalls and to support the organization in the most strategic way possible.

Grantees say the best parts of their relationships with grantmakers include mutual respect, a funder's genuine interest in the grantee's mission, a commitment to learning together, clear expectations, and appropriate use of power. Consider the following:

- What kind of relationship with grantees will help your foundation to achieve its mission?

- How will your relationship with grantees affect your grantmaking strategy and application process? For example, will it be better for you or the grantseeker to initiate the application process?

- Can the foundation put in place the personnel (volunteer or paid) and operational capacities (e.g., website, grants management software) to relate to grantees in the way it wants?

Partnerships, Collaborations, and Affiliations

Although partnerships and collaborations can take time to develop, your foundation may greatly enhance its effectiveness by engaging in strategic partnerships. Consider the following:

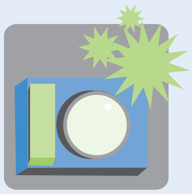
- Do other foundations fund similar activities and have experience from which you can benefit (or vice versa)?

- Do key projects need significantly more funds than you can provide? Might these projects be of interest to other foundations?

- Can you join affiliations to help you better understand the key issues, challenges, and opportunities in the field in which you fund?

Once you have decided on a grantmaking strategy, stick with it long enough to see if it really works—usually 3 years or so—before making significant changes. Remember that your grantmaking strategy is only a guide. Circumstances will arise that are best handled by veering beyond your strategy.

Foundation Snapshot: Being a Good Grant Partner Requires Flexibility | Dresher Foundation



Location: Baltimore, Maryland
Assets: $48 million
Number of board members: 12
Number of full-time staff: 1
Number of part-time staff: 0

"In collaboration with two nonprofit partners," said Executive Director Robin Platts, "the Dresher Foundation funded two multiyear projects that provide transportation and child care to families living in transitional housing. The 3-year plan was well developed and thoughtful, but, like most grants and most plans, reality is more complicated than the plans in our heads. And we, as a funder, needed to be flexible.

For example, it could take a year or more for families to even be able to qualify for a car purchase. Many people didn't have licenses and didn't have access to a car for practicing their driving skills. Therefore, although not originally budgeted, it was critical that a portion of the grant be used to buy a vehicle that could be used for practicing driving, as well as shuttling people to work until they could get their licenses and own vehicles.

The viability of the project depends on open communication among all of the partners, to fix what is not working, expand what is, and know that the best end result is that families will have a permanent home."

Being Approached for Foundation Support—in Public

It's bound to happen. You serve on the board of a well-known (even locally renowned) foundation, and someone approaches you for funding at a party, a wedding, the theater—even at a funeral. What to do? First, emphasize that no one makes individual decisions. At best, you can suggest that the individual contact the foundation office or consult the foundation's website for grant guidelines. Stress that following those guidelines is more important than any other consideration. This information will allow you to deflect requests until the proper time and place.

Designing an Application Process and Form

Now that you have a grantmaking strategy in place, the next step is to design an application process. There is no right or wrong process; follow a process that works best for your foundation and grantseekers.

Choosing to be Receptive or Proactive

Your method for engaging grant applicants will play a major role in how your grantmaking program functions and how you achieve your impact. When a grantseeker initiates, the onus is on that grantseeker to engage with the foundation. Although foundations widely practice an open-door policy, which has many benefits, it is critical that you also have clear, accessible guidelines and a process that encourages full proposals from only those grantseekers most likely to get funding.

Streamline Your Application and Reporting Processes

A common trap is for foundations to design overly elaborate or sophisticated grantmaking processes. Streamlining your application and reporting processes is valuable to both funders and nonprofits. Here are some tips:

- Know the minimum legal requirements for making grants to public charities.
- Learn to use a cost–benefit approach in designing your processes.
- Consider asking applicants only for what you really need to make a grant decision.
- Get additional tips to help you streamline at www.gmnetwork.org/projectstreamline.

When a foundation initiates, it is responsible for finding those organizations and programs that will help it achieve its intended impact. The search will be effective particularly if a foundation has a clear focus and knowledge of the field in which it funds or has the time to gain such knowledge and access to a network that provides it. Although this approach allows a funder to better manage the number of proposals it receives, the foundation may miss some excellent ideas. Foundations that choose this route typically will use the phrase "no unsolicited proposals" in their grant applications. Some foundations do the majority of their grantmaking proactively but allot a small portion of funds for other ideas.

Screening Processes

Exponent Philanthropy encourages you to put a screening process in place that gives the foundation and grantseeker an early indication of whether there's a possible fit or not. This process saves both the foundation and grantseekers time because full proposals are requested only of those that have a real possibility of receiving a grant. Some foundations have established a grants committee to review the initial inquiries. Your screening process might involve:

- **Letters of inquiry—**For most small foundations that do not have an office or staff, a letter of inquiry (or letter of intent) is the best way to get an initial sense of the possibility of funding. Letters of inquiry are typically no more than one or two pages and include the organization's mission, a brief description of the program, the needs addressed, the desired outcomes, and the dollar amount requested. Letters of inquiry should receive a response, even a simple e-mail stating that other programs were more in line with the foundation's interests.
- **Conversations with grantseekers—**An exploratory call or meeting can help a grantseeker to better understand a foundation's interests and to express its own program ideas. Be sure to gather enough information to assess whether a chance of funding exists.

Documentation Requirements

Foundations vary in the amount of information they require from grant applicants. Before assuming that more documentation leads to better grants, consider asking only for those documents absolutely necessary to determine—based on your goals and strategy—if a grant will be a good investment. Because few to no legal requirements exist for straightforward grants—other than knowing a grantee's tax status—your foundation has flexibility in deciding which documents to require. If you use a letter of inquiry process, you might find that's all you need, especially for repeat grants or those below $5,000.

You might start by asking, What does our foundation need to know to fund an organization or project? You can easily find on a grantee's website the types of things that funders in the past have requested. Also, if you have a preliminary screening process, be sure to eliminate items you already requested in the letter of inquiry. Choose from the following those items that will be most useful:

General Organizational Information
- Contact information
- Organizational history, mission, goals
- List of board of directors
- Financial information: budgets, financial statements, Form 990
- IRS determination letter: Consider requesting it only once; in subsequent years, you can verify that the status has remained the same by using the online IRS Exempt Organizations Select Check tool

Program Information
- Program description, needs addressed, staffing, timing, goals
- Ways to measure program effectiveness
- Other organizations doing similar work
- Ways in which the program is innovative
- Other funding sources and ways to sustain the program
- Program budget

Whatever you choose to request, be specific and clear—even down to a page limit.

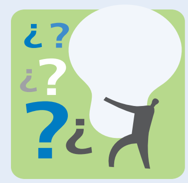
Application Type

Depending on how specialized your funding strategy is, you might consider accepting a common grant application used by other foundations in your state or region. Be sure to check whether grantees have found the local common grant application to be a time-saver.

Whether a foundation has an online application process or not, be aware that prospective grantseekers increasingly are submitting applications electronically. Ensure that any downloadable form is easy to complete and that applicants can save and revisit it without losing information between breaks. Many foundations have found that grantmaking software has significantly improved their grants management process.

See page 109 for a sample grant application.

Must all grantseekers complete a grant application?



The law does not require foundations to collect grant applications. Although many foundations find applications helpful to their decision-making processes, many also find value in the flexibility to make grants to organizations they know and trust—simply by verifying the organization's tax status. Some foundations even set up procedures to make emergency grants quickly.

Grant Cycle

Most foundations establish quarterly or 6-month grant cycles. They specify corresponding deadlines for submitting proposals and an internal schedule for reviewing proposals, making grant decisions, drafting grant agreements, and writing checks. Those cycles can help you bundle tasks and save time. They also allow you to look at a group of proposals and compare them in terms of quality and relevance to your program goals.

Easy Ways to Make Grants in Your Early Years

You have so much to learn and do when starting a grantmaking program. Here are ideas to make it all more manageable:

- **Narrow your focus—**It's tempting to keep one's focus broad to avoid missing out on something. Experienced funders, though, tout the virtues of narrowing your focus because the challenges facing communities are so complex. For example, if your foundation focuses on education, you may want to specify a particular age group (e.g., Pre-K). To determine a niche, connect with affinity groups that fund in that field (e.g., Grantmakers for Education); community leaders (e.g., United Way); or other foundations.

- **Define geographic limitations—**Many foundations choose to focus on one or more geographic locations. The focus could be solely in the donor's immediate community or region, within the various states board members reside in, or beyond.

- **Make multiyear grants—**Once you find an organization that you like, consider making a larger grant that is spread over multiple years (although typically no more than 3 years). The foundation may still pay out a portion of the grant each year, but the paperwork is reduced significantly.

- **Make fewer and larger grants—**More grants equal more time. Foundations often develop more effective relationships with grantees by limiting the number of grants they make.

Sample Grant Application

Before considering a proposal, please check that your project fits within the mission of the foundation. You can do so by contacting *Name, Title.*

1. Project title

2. Name and address of the organization submitting the proposal

3. Project manager and his or her contact information

4. Statement attesting to current status as a 501(a)(1) or (2) public charity; attach IRS determination letter

5. Narrative:
   (A) Description of the project
   (B) Background of the project's origin, including relevant previous experience
   (C) Description of how the project meets the foundation's purpose
   (D) Identification of the population to be served and, if appropriate, how participants will be selected
   (E) Duration and time line for the project
   (F) Definition of "success" in three measureable goals

6. Personnel: List key personnel involved in the project and share their experience

7. Collaborators: List any organizations and/or personnel who will be collaborating on this project; outline their financial and in-kind contributions to this project

8. Budget: As an attachment, provide a budget for the project; include any in-kind contributions

Adapted from original provided by The John & Sophie Ottens Foundation.

Creating a Work Plan and Time Line

Setting a realistic time line for grant decisions, clearly communicating it to prospective grantees, and holding to your schedule will go a long way in establishing an effective relationship with your grantees. A work plan and a time line are especially useful for foundations that only meet a few times each year to make grant decisions.

Determine first who will be responsible for which tasks, the time needed to accomplish those tasks, and the date by which the work will be accomplished. The chart that follows can help your foundation to think through the timing of grantmaking activities and to craft a work plan specific to your needs.

Note that:

- For most foundations, the grant process revolves around the board meeting schedule. You may want to start with the dates of your board meetings and work backward.
- If you are unsure about how much time you'll need for a particular activity, check with other grantmakers and continue reading this chapter for more details on the final steps in the application process.

Sample Work Plan and Timeline

The ABC Foundation has two board meetings each year (May and December) and makes grant decisions at both meetings. Any grantseeker may apply for a grant, though the organization must submit a letter of inquiry first before being invited to submit a full proposal. Grantseekers may submit letters of inquiry throughout the year, but if there is a particular project a board member would like to consider at a particular time, it is important that the letter of inquiry be received by the dates outlined below.

	Who at Foundation	Time to Complete	Completion Date	
Write and submit letters of inquiry	n/a	Grantseeker: 1 month	Jan. 9	Aug. 10
Review letters of inquiry	Jane/Tom	Foundation: 1 week	Jan. 16	Aug. 17
Solicit proposals	Jane	Foundation: 1 day	Jan. 16	Aug. 17
Write and submit proposals	n/a	Grantseeker: 2 months	Mar. 16	Oct. 17
Sort, review, attend site visits, and summarize proposals	Jane/Tom/Sam	Foundation: 4-5 weeks	Apr. 20	Nov. 16
Send documents to board	Jane	Foundation: 2 days	Apr. 25	Nov. 19
Board decision	all	Foundation: 3 weeks	May 16	Dec. 10
Notify grant applicants	Jane	Foundation: 1 week	May 23	Dec. 17

Communicating It All in Grant Guidelines

You won't offend grantseekers by solidifying your focus and intentions in clear grant guidelines. The clearer you can be in your guidelines, the less time a wayward grantseeker from Walla Walla, WA, will spend pursuing funding from a foundation that only makes grants in Santa Clara County, CA.

Grant guidelines communicate your chosen grantmaking strategy, making it clear what, how, and where you fund; and how to apply. Be sure to keep your guidelines current. Communicating the specifics of your grantmaking program will decrease the number of proposals outside your program interests and will improve the quality of the proposals you will receive, even if your policy is "no unsolicited proposals."

Only useful if kept current, guidelines still are just guidelines. If you want to make a grant outside of your stated guidelines, you can certainly do so.

What to Include

Although your grant guidelines will not communicate the details of your strategy and application process, each of those items will contribute to creating good grant guidelines. The following components are common:

- Mission, vision, and values statements
- Brief history of the foundation
- List of current board members and staff
- Clear statement of focus and program interests (i.e., program type, geography)
- Grant restrictions (i.e., who and what you do not fund)
- Type, size, and consistency of grants
- Application process and how to access necessary forms
- Application deadlines (if any) and decision-making time line
- Who to contact with questions

Once you've created the guidelines, you'll want to consider how you will make them public. Many foundations post them on simple websites. Some foundations send out their guidelines to nonprofits that fit within their funding interests to ensure they receive a sufficient number of good proposals.

See page 113 for sample grant guidelines.

Using Discretionary Grants

Board meetings are certainly more challenging when disagreements arise. It is particularly difficult, however, when the rest of the board rejects a board member's favorite grant proposal. Discretionary grants are one method of easing this difficulty by allowing board members to direct a small portion of funds to organizations of their choice. Wisdom from the field advises that discretionary grants compose no more than 20% of the foundation's total giving. They may be just the cure for any board meeting blues.

Financial Documents for the Application Process

It is important for foundations to know an organization's financial health before making a grant. The following list includes the full range of financial documents that foundations review. Keep in mind that most foundations use only one or two of these documents. Because grantseekers spend many hours tailoring budgets and financial documents to the requirements of different funders, an increasing number of foundations are accepting off-the-shelf formats.

Grant Budget
The *grant budget* is useful in accounting for exactly how the foundation will spend its funds on a particular project. It gives little or no sense of the overall project budget.

Project Budget
The *project budget* expands the grant budget to cover the full range of expenses and revenues associated with a particular project. It should outline other funding sources, in-kind contributions, and costs covered by other parts of the organization. A project budget allows you to assess whether the size and timing of costs and revenues are reasonable, and if any funds are restricted for specific purposes.

Current or Compiled Financial Statements
Financial statements communicate an organization's financial health. An organization's bookkeeper or accountant periodically will prepare a balance sheet and income statement based on records at hand. A common addendum is an *actual-to-budget performance statement,* which shows those areas in which actual expenditures varied from the approved budget, including explanations of variances.

IRS Form 990 and Schedule A
All nonprofits are required to file these forms annually with the IRS. The forms show components of the organization's financial statements (i.e., balance sheet, income statement) and costs for programs, administration, staff salaries, fundraising, and so on.

Audit
An *audit* can give a good overall picture of the organization's past financial practices, although many smaller nonprofits forgo annual audits because of the cost. If an audit is available, be certain that the audit is recent, and read the notes carefully, especially the auditor's cover letter, in which warning flags often appear.

Balance Sheet or Statement of Financial Position
The *balance sheet* lists the grantee's assets and liabilities at a specific moment in time; it discloses readily available resources—and the claims against those resources. The balance of assets after liabilities is the client's current *net worth* in cash, cash equivalents, and receivables. Investments, such as securities and bonds, are listed at market value; fixed assets, such as real estate or equipment, are listed at cost.

Income Statement or Statement of Activity
An *income statement* records the organization's financial activity over the course of a year; it identifies revenue sources and expenditures and overall operating profit or deficit. It also pinpoints the funding sources and respective expenditures to allow for an assessment of whether the applicant has used resources prudently.

Cash Flow Statement
A *cash flow statement* indicates the grantee's current cash position and where the grantee has spent cash. It also indicates the grantee's ability to generate cash and pay obligations in a timely fashion.

Adapted from "Some Common Financial Reports" by Tim Walter, Association of Small Foundations, and "How to Read Potential Grantees' Financial Statements" by Mike Fontanello, CPA, and Carol Duffield, CPA, Fontanello, Duffield & Otake, LLP.

Sample Grant Guidelines

The Fitzpatrick Foundation was established by Michael J. and Patricia W. Fitzpatrick, incorporated as a private foundation in the State of California on December 11, 1999, and awarded tax-exempt status in October 2000.

The broad purpose of the foundation is to support elementary and secondary school programs for students and educators, with a particular emphasis on serving economically disadvantaged youths in the San Francisco Bay Area.

The Fitzpatrick Foundation supports in-school and after-school programs that enhance academic achievement, provide arts education, provide recreation and athletic activities, and develop technology skills. The foundation also supports professional development programs for educators, with an emphasis on providing and applying technology skills in the classroom.

Limited grants may be made to projects and programs of special interest to the Fitzpatrick family. In general, The Fitzpatrick Foundation does not make grants to endowments, annual fund appeals, political campaigns, religious organizations, or programs outside of Northern California.

Application Procedure
Grant applicants must submit a letter of inquiry (no more than 2 pages) that contains the following:

- Purpose and history of the organization
- Goals, objectives, and the population served by the project for which funding is being sought
- Current status of the project (i.e., date established and anticipated duration)
- Organization's annual budget and detailed project budget, with amount requested

Letters of inquiry should be submitted on the organization's letterhead to: The Fitzpatrick Foundation, [Street Address], [City, State] Zip Code; or by e-mail to [e-mail address].

Letters of inquiry will be reviewed within 30 days of receipt. If the project falls within the interests of the foundation, the applicant will be advised to submit a complete proposal. For proposal requirements, see [URL of website].

Review Process
Completed applications will be discussed at the next scheduled board of directors quarterly meeting providing that all of the above is received at least 8 weeks before the meeting. Applicants will be notified of the disposition of the request within 2 weeks after the board meeting.

Board Meeting Calendar
March 28, June 18, September 26, December 19

Further Information
For further information about the foundation or its policies, please contact us at [e-mail address].

Source: The Fitzpatrick Foundation, CA.

Making Grant Decisions

Each foundation needs to create a system that works for it and its grantees based on the impact the foundation wants to achieve. This section offers several ideas about process, some which may or may not apply to your foundation. You're likely to make changes along the way, but being thoughtful about the process from the beginning will help you and the nonprofit community tremendously.

First, consider your goal. If the foundation's minimum required distribution for the year is $100,000, and the foundation tends to award $10,000 grants, the board needs to approve 10 proposals or so. To arrive at 10 proposals, you'll likely want to have 15 to 20 letters of inquiry that fit your guidelines and will move forward to the full proposal stage. Then, you'll likely want to advance about 12 of those for site visits and choose the 10 for funding from this smaller group. You may need to vary these numbers, but it's good to have a sense of what you're aiming for to avoid wasting the foundation and grant applicants' time.

Review Letters of Inquiry for Eligibility and Promise

Let's assume you're using a letter of inquiry process or some other means of screening grant ideas before nonprofits submit full proposals. Although some foundations include the full board in the entire process, many of them delegate this early screening work to a committee or staff member—and allow the full board to focus on more promising proposals. Involve more than one person in the early stages to diminish bias.

Once your foundation has reviewed the initial ideas, you'll want to inform grant applicants of the outcome of that review. For those that fit your guidelines and seem promising, be sure to give them sufficient time to submit the additional documentation you require for a full proposal. For those that do not fit the guidelines or do not seem promising, send them an e-mail or letter informing them of your decision. *See the sample correspondence below.*

Sample Declination E-Mail

Dear Mr. Thomas,

The ABC Foundation appreciates the opportunity to consider your request for funding. Unfortunately, we are unable to support your effort at this time.

The foundation receives a large number of requests for assistance, and we regretfully have to decline many commendable applications. Our decision in no way indicates a negative assessment of your organization or proposal. It merely speaks to the overwhelming needs of our community.

On behalf of our foundation, we wish you continued success.

Sincerely,
Benjamin Smith, Executive Director
The ABC Foundation

Conduct In-Depth Review of Full Proposals

Your screening process should help to ensure that the proposals you receive fit your guidelines, are promising, and are complete. You can have a single person confirm that the proposal documentation is complete. Contact the organization if you need more information.

If the proposal is complete, consider sending an e-mail to let the grantseeker know that you have received the application and will respond with a decision by a specific date.

It's a good idea to guide your review with a proposal review form. Using the same form for all applicants helps you to make fair assessments based on consistent review methods. *See pages 116–117 for a sample proposal review form and financial review checklist.* Be sure to adjust the depth of review according to the grant size.

Engage a few people in the in-depth review, if possible. You'll want to allow for plenty of quiet, uninterrupted time to carefully read each proposal, make notes, and jot down questions. Concentrate your energy on new applicants and those with larger requests.

Keep in mind: Great ideas sometimes are presented in rough or incoherent ways. Try your best to get to the heart of a proposal. Also keep in mind that the best proposals will convey energy, expertise, commitment, collaboration, and effectiveness—things that go well beyond a checklist.

If you are interested in a proposal but have additional questions, ask the grantseeker for more information. It can be helpful, in some cases, to provide specific feedback and ask a grantseeker to resubmit the proposal, especially when the grantseeker clearly is competent and minor changes will greatly increase efficiency or effectiveness of the proposed project.

When the reviews are complete, compare your responses to those of your fellow reviewers to determine which proposals should move on to the next stage.

A Common Myth: Grantees With the Lowest Overhead Are the Best

Recently, leaders at GuideStar, Charity Navigator, and BBB Wise Giving Alliance, the leading sources of information on nonprofits, sought to correct the misconception that overhead can stand on its own as an effective measure of performance. In an open letter to the public, those leaders shared data that reveal this: Organizations considered to be the most effective often have higher overhead ratios. Findings show that a lack of investment in core operating support can have several negative consequences that reduce a nonprofit's quality and sustainability.

Sample Proposal Review Form

Name of Organization:

Amount Requested:

Completeness					
Has the organization submitted all required documents: • Organizational history, mission, goals • Specific statement of amount and objectives • Statement of need, target population, and support data • Timetable for the project (including start and end dates) • Staff qualifications • Budget and other financial information	Yes			No	
Programmatic Fit			**Score**		
Will this program fill a need within the community not currently or adequately addressed?	1 *Poor*	5	10	15	20 *Excellent*
Is the organization financially sound?	1 *Poor*	5	10	15	20 *Excellent*
Is the organization capable of implementing and sustaining the program (e.g., adequate funding, staff, community support)?	1 *Poor*	5	10	15	20 *Excellent*
Merit					
Do we have the ability to make an impact with this grant?	1 *Poor*	5	10	15	20 *Excellent*
Does the request stand out?	1 *Poor*	5	10	15	20 *Excellent*
Are there any opportunities to match or leverage the foundation's funds?	1 *Poor*	5	10	15	20 *Excellent*
	TOTAL SCORE:				

Sample Financial Review Checklist

For larger or multiyear grants, the following list can be useful in determining a nonprofit's financial health. If you uncover trouble spots, don't automatically forgo funding. Follow up with questions and fund the organization only on receiving a satisfactory explanation.

Warning Signs in an Independent Auditor's Report or Auditor's Opinion

- Late audited financial statements (more than 5 months after fiscal year end)
- Outstanding litigation
- Inability of the organization to continue in business
- Inadequate recordkeeping or internal controls
- Uncertainties pertaining to Internal Revenue Service or state audit adjustments
- Management omitting required disclosures
- Auditor's inability to render an opinion
- An adverse (i.e., unfavorable) opinion by the auditor

Warning Signs in a Balance Sheet and Income Statement

- Continual operating losses or fund deficits
- Excessive payables and other liabilities with minor or no cash
- Erosion of endowment and reserves to fund operations
- Excessive cash and investments
- Large amounts in miscellaneous expense categories
- Excessive administrative or payroll expenses
- Reliance on only one or two funding sources
- Poor yields on investments

Signs of Financial Health

- Operating profits
- Building up of endowments and reserves
- Increases in pledges
- Ability to add new programs and projects
- Attractive yields on investments
- Ability to answer questions about the organization's financial status

Good Site Visit Questions

It can be useful to ask a standard set of questions of every applicant during a site visit, such as:

- What is satisfying about your work?
- What success story can you share about the project or your organization?
- What challenges do you foresee in executing the project?
- How will your organization know if the project is succeeding?
- Is there a better way for our foundation to help, apart from the request as it stands?
- What questions do you have about the foundation and its grantmaking processes?

Conduct Site Visits

Site visits can help you make grant decisions, monitor progress during the grant period, or evaluate outcomes at the end of a grant. Longtime board members and staff can vouch for the value of site visits, no matter what timing you choose. The visits help your foundation to stay passionate about its mission, understand the issues at play, and build rapport with grantees. Engage a few people in this stage of the process.

As a rule, only advance proposals to the site visit stage if they have an excellent chance of funding. Site visits are time-consuming for you and grantseekers. A site visit, though, can:

- Provide valuable information that you cannot obtain from a written proposal.
- Deepen your understanding of the community, need, and project.
- Provide person-to-person contact with the nonprofit's leadership.
- Help you to compare similar projects of differently sized organizations by giving smaller nonprofits a chance to showcase their work.
- Indicate the seriousness with which you make decisions.

To Plan for the Visit

- Define what information you need from the site visit to make a grant decision.
- Arrange a mutually convenient time to visit and let the applicant know you don't want or expect anything out of the ordinary.
- Plan to stay for a reasonable amount of time: 1 hour or 2 hours. The length of the visit should depend on the size of the potential grant and whether the proposal is for operating or project support.
- Clearly and honestly communicate that a site visit does not automatically signal a forthcoming grant. Site visits immediately raise an applicant's expectations.
- Be specific about who you want to meet, what you want to see, and what you'd like to learn. Generally, it's helpful to meet with the executive director and a seasoned board member.

- Get basic information, such as directions, parking information, or cab availability.

- Let the applicant know who will represent the foundation and be considerate about how many people you bring. Bringing your entire board to a tiny nonprofit is probably overkill.

- Reread the proposal and develop thoughtful questions.

On the Day of the Visit

- Call if you will be late.

- Treat everyone with respect.

- Obtain the names and positions of those with whom you are meeting.

- Start discussions with: "Tell me about the program and how it fits into your overall mission" or "Tell me about your various programs."

- Ask questions that reveal whether a grant to the organization will further the foundation's mission and strategy.

- Take notes. It's better to take too many notes rather than too few.

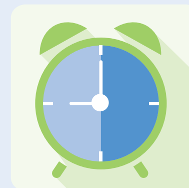
- Write up a report immediately following the site visit while your impressions are still vivid. Don't rely on your memory.

After the Visit

- Consider the facts you learned, how you feel about the organization and the program, how the site visit compares to others, and how a grant would fulfill the foundation's mission. Incorporate this information into your overall summary of the proposal.

- Make your funding recommendation.

Time-Saver



Whatever your questions, we can help! Exponent Philanthropy members are invited to call or e-mail our **Q&A service—**our most highly rated member benefit. We'll research an answer to your question, or connect you to a peer or advisor who can help.

202-580-6560 or
info@exponentphilanthropy.org

Foundation Snapshot: Site Visits Make Good Business Sense | John Gogian Family Foundation

Location: Torrance, California
Assets: $12 million
Number of board members: 8
Number of full-time staff: 1
Number of part-time staff: 1

"I can't emphasize enough how important it is to make personal contact with your grantees," says Executive Director Lindsey Stammerjohn. "On so many levels, it just makes good business sense. Site visits help tap into the passion and commitment of an organization. They can show and tell why the grantees are doing what they do and reveal more than a grant application. It is important to understand your grantee's management style, recognize strengths and weaknesses, and see the commitment from the staff and board.

Make personal contact with your grantees, build trust in time, and your grantees will be more willing to share their challenges as well as successes. A lot can be accomplished if we are all on the same team."

Make the Final Board Decision

Determine which information will help your board to make the best decisions most efficiently. Consider the amount of time board members have to review proposals and their experience with proposal review.

Some boards review every proposal, whereas others rely on the recommendations of another person. The best and most efficient decisions often are made by reviewing proposal summaries and site visit notes, although board members have the option to review a full proposal, if desired. If your board sees only a fraction of the proposals, it is a good policy to require a review and approval of the list of applicants to be declined.

Whatever your process, boards usually appreciate having up to 1 month to review the docket, depending on the number of proposals and length and complexity of each. Be sure to have a decision-making policy in place related to proposals (e.g., majority voting).

At this point, dive in! Plenty of great proposals are awaiting review.

Documenting Your Process to Make Grant Decisions

To follow the steps outlined in this chapter and design a process that works for you, consider the following items. Be sure to revisit and adjust your process over time as needed.

Review Letters of Inquiry for Eligibility and Promise
At this stage, decide and document:

- The indicators of an eligible and promising proposal
- Who will be responsible for the quick review
- Who will send out declinations and requests for full proposals
- The number of proposals to send to the next stage

Conduct In-Depth Reviews of Full Proposals
At this stage, decide and document:

- Who will check for completeness, request missing materials from grant applicants, and incorporate new information into the proposals once they arrive
- Who will be involved in reviewing for programmatic fit and merit
- The questions to help in assessing which proposals are best
- The documentation to accompany each decision (e.g., notes on why a proposal was moved to the next stage or declined)
- The number of proposals to send to the next stage

Conduct Site Visits
At this stage, decide and document:

- Which grant applicants require site visits (e.g., only new applicants, applicants that have not received a site visit in 2 or 3 years)
- Who will make the site visits
- Whether site visit attendees will make funding recommendations
- Who will write up summaries of the site visits and incorporate them into the overall proposal summary

Make the Final Board Decision
At this stage, decide and document:

- The information (e.g., full proposals, summaries, recommendations from reviewers) that will help the board to make the best decisions most efficiently
- Which proposals (or summaries of proposals) the board will see (e.g., all complete proposals that fit the guidelines or only those that are recommended by the reviewers)
- If the board will review and approve all declined proposals
- How decisions will be made (e.g., majority vote)

Time-Saver

Exponent Philanthropy members can download **sample documents** to reproduce or adapt, including:

- Grant guidelines
- Grant applications
- Grant award letters
- Declination letters
- Grant agreements
- Site visit checklists

www.exponentphilanthropy.org

Communicating With Grantees

Communicating a "yes" decision to grantseekers is a wonderful privilege; communicating a "no" decision is a challenging responsibility. Regardless of your decision, be sure to communicate with grantseekers in a timely manner.

How to Say 'No'

Foundations vary in how much information they give when declining a full proposal, but most keep the letter general. On a case-by-case basis, you may decide to give more details, especially to applicants that have been grantees in the past or are likely to be in the future. It is best to convey the details by telephone. Grantseekers also appreciate an indication of whether they should submit a similar proposal again.

After receiving a declination letter, grantseekers often follow up with grantmakers. Don't be surprised—and try not to be bothered—by this follow-up. Even if you choose not to provide additional information, it is important to respond to the calls. When you do respond, as difficult as it may be, refrain from encouraging a grantseeker to apply again if you know the organization will never receive funding.

How to Communicate 'Yes' and Establish Mutual Expectations

Although communicating "yes" is much less challenging than saying "no," it is important to establish mutual expectations with your chosen grantees. The best approach is through a grant agreement with an officer of the grantee organization, especially if the grant is large.

A grant agreement is helpful when a grant goes well, and even more helpful when it does not. With a grant agreement in place, it is easier to hold grantees accountable for reports, anticipated outcomes, and proper use of funds. If the grantee does not use the grant funds for proper purposes, it is far easier to rescind the grant and recover the funds.

Generally, a sound grant agreement includes the following:

- A statement of the amount and purposes of the grant
- A payment schedule (if payable in more than one installment) and grant report schedule
- A provision that no changes will be made to the project budget without foundation approval and that funds not spent in accordance with the budget will be returned to the foundation
- A provision that, if the IRS or a state attorney general changes

or revokes the grantee's tax-exempt status, the grantee will notify the foundation immediately and the grant can be terminated

- A provision that any major staff change that affects the project will be reported to the foundation so it can determine the impact on the successful completion of the project
- An agreement that the foundation may terminate the grant and recover unspent or improperly spent grant funds if the grantee fails to abide by terms of the grant agreement

Read on for a sample award letter and grant agreement.

Sample Award Letter

September 7, 2016
Louisa Brighton
Applegate School
123 Anywhere Street
Anywhere, State 00000

Dear Ms. Brighton,

We are pleased to inform you that the directors of The ABC Foundation reviewed your recent grant request and have awarded a grant in the amount of $15,000 (see Grant Agreement for payment schedule). It is the intention of the board that the grant be used toward the purchase of playground equipment.

Enclosed you will find a Grant Agreement that explains the responsibilities and expectations of both parties in our grant relationship. Please sign the Grant Agreement and return the original to me within 10 days of receipt. Please keep a copy for your records. Once the Grant Agreement is received in our office, the grant monies will be disbursed.

As the Grant Agreement indicates, the foundation requests a final written report when your project is complete. For your information and guidance, I have included a copy of our Grant Evaluation Report. Please use this copy as a reference in preparing your report. The foundation requests that, to the extent possible, you follow the format and questions asked when developing your grant report. Thank you for your cooperation. If you have any questions, please do not hesitate to call.

On behalf of the board and staff of the foundation, please know that we are happy to support the important work you are doing. We wish you much success in your efforts as you undertake the responsibilities of this grant.

Sincerely,

Jane Steele, Trustee
The ABC Foundation

Sample Grant Agreement

Conditions

1. The grant is to be used solely for the purchase of playground equipment as described in the proposal of May 15, 2016.

2. Grantee is described by the Internal Revenue Service as a 501(c)(3) organization with a 509(a)(1) or (2) designation.

3. Grantee warrants and represents that its receipt of this grant will not adversely affect grantee's status as other than a private foundation within the meaning of § 509(a) of the Internal Revenue Code of 1986.

4. Grantee will furnish to The ABC Foundation any information concerning a change or a proposed change in grantee's exempt status.

5. If grantee's exempt status changes, The ABC Foundation reserves the right to have all remaining grant funds immediately returned.

6. Any funds not used or committed for the specific purpose of the grant within the specified term must be returned to The ABC Foundation, unless otherwise authorized in writing.

7. Grantee must provide a written grant evaluation report as soon as possible after close of the grant period. The report must describe conclusions, progress toward the three measureable goals defined in the application, and how funds were expended to attain the objectives.

8. The ABC Foundation desires that all resources of the grantee be dedicated to accomplishing its charitable purposes. Accordingly, grantee agrees not to recognize the Foundation, its board members or staff, or this grant with certificates, plaques, or similar mementos.

Please signify your agreement to the foregoing terms and conditions by having a duly authorized officer sign and return a copy of this letter.

Organization's Name:
Name:
Title:
Date:

Monitoring and Evaluating Your Grants

Monitoring

Now that you have awarded your grants, what's next? As part of the monitoring process, some foundations require nonprofits to submit a grant report at the end of the funding period. This report is not obligatory unless you are engaging in expenditure responsibility. Exponent Philanthropy recommends that you consider asking for a report only if you intend to read it and learn from it.

If you collect a report, the most useful information is usually an accounting of how the grantee spent the money and what progress the grantee has made toward the grant goals. To improve your chances of receiving a useful report on progress, be sure to let your grantee know at the beginning of the grant that it will need to provide specifics about progress at the end of the grant. Consider forgoing grant reports for grants under $5,000.

Another way to get up to speed on the results of a grant is to take your grant partners to lunch. Not only is this a great way to build relationships, but you'll be able to learn about the organization's successes, challenges, and lessons learned. The more you can encourage and reward honest dialogue, the better your relationships will be and the greater your impact will be.

Keep in mind that not all projects will succeed. Some will fail miserably, even with a competent grantee and grantmaking process. This is par for the course, especially when you try something new or tackle difficult issues, as do many foundations. What is important is that you learn what did and did not work—and that you make necessary adjustments next time.

Evaluation

If your foundation has clearly defined a niche and is working closely with its grant partners to achieve a particular goal with a significant investment of resources over multiple years, evaluation is likely a critical part of that process. This evaluation process is one that can:

- Identify successes and challenges that only reflection will reveal.

- Help your grant partners and your foundation make minor changes midstream to improve outcomes.

- Give your foundation an opportunity to learn what is most effective over time.

If you are interested in this type of evaluation, you can learn more at www.exponentphilanthropy.org. Evaluation can be a burdensome process for nonprofits unless done effectively—with proper support from funders.

More than anything, Exponent Philanthropy encourages you to be a learning organization. By approaching your work with an attitude of always wanting to learn more, you will become increasingly effective at what you do.

Exponent Philanthropy

1720 N Street NW
Washington, DC 20036
www.exponentphilanthropy.org
@exponentphil