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WHERE FOUNDATION MISSION MEETS MONEY

Translate the Big Picture to Action

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INVESTMENTS & WEALTH INSTITUTE®
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A spending plan isn't a grant-making budget—but it's a good start. First and foremost, it's a plan. Many foundation boards have difficulty translating their big-picture goals into smaller, achievable steps that will move them forward. A spending plan, which budgets for each area of interest, helps to narrow the universe of funding possibilities and guide decision-making. So, how can you help your clients create a spending plan for their private foundation?

BEGIN WITH THE 5-PERCENT MINIMUM DISTRIBUTION REQUIREMENT

Before you discuss what your client wants a spending plan to accomplish, you might want to address what it must accomplish. As you're probably aware, the Internal Revenue Service requires private foundations to distribute a minimum of 5 percent of the previous year's net average assets annually. This is colloquially known as the minimum distribution requirement (MDR). Although there is no limit to how much a foundation can give, it must distribute at least the MDR in order to avoid penalties.

In developing a spending policy, it makes sense to start with the MDR because many of your clients' decisions will stem from whether they want to meet or exceed it, what they will count toward satisfying it, and even whether it pertains to their foundation.

For a foundation in its initial year, no amount is required to be distributed by year end because there were no prior-year assets. And foundations that have exceeded the MDR in previous years may be entitled to carry over the surplus distribution and count it toward satisfaction of future years.

If the foundation does have a payout requirement, it will need to be fulfilled with qualifying distributions.

Examples of qualifying distributions include the following:

- Grants to public charities, nonprofits, and individuals (including scholarships or emergency aid)
- Non-investment-related administrative expenses that help achieve the foundation's charitable purpose (for example, Foundation Source fees fall into this category)
- Equipment that helps the foundation achieve its charitable purpose
- Direct charitable activities (e.g., research, publications, technical assistance, running conferences, communications)
- Program-related investments (loans, loan guarantees, or equity investments made to an organization for projects related to the foundation's philanthropic purposes)

To determine the foundation's annual budget for distribution, the board must weight both philanthropic objectives and fiscal realities. Some of the questions you might want your clients to consider include the following:

- Is the foundation fully funded or will additional assets be received in the future?
- Does the foundation plan to meet or exceed the 5-percent minimum distribution requirement?
- Does the foundation need to remain in existence for future generations or does the board intend to spend down its endowment?
- Do you want to grow the foundation's endowment or are you satisfied to keep up with inflation?
- What returns can you expect on your investments and will they keep up with your distributions?
- Does the foundation have cash flow and cash reserved to meet operational needs?

FROM POOLS TO BUCKETS

Determining whether your clients are going to meet or exceed the MDR has probably helped them determine how much their foundation plans to disburse. The next step is to take this pool of funds and apportion it to various buckets that correspond to interest areas and priority needs. How much will the foundation budget for the nonprofits that board members always have supported—their historical interests? How much should they set aside for targeted programs that the board undertakes collectively and how much do they want to hold in reserve for special opportunities that might present themselves? Do they want to establish a discretionary fund that enables board members to fund their favorite causes and projects?

We suggest that the board define its anticipated funding categories and then divide the MDR among them. Deciding how to apportion funds will help the board collectively determine its grant-making priorities. Although making these decisions now may require some tough decisions, it can help prevent conflict later when board members make their final grant choices.

For example, let's imagine that your client's foundation mission is devoted to reducing childhood obesity. Over the years, however, the foundation also has supported a local art museum, and a few board members have expressed interest in funding projects of personal interest, including an animal shelter and a food pantry. How might the foundation's spending plan reflect its mission and account for unrelated side projects?

BUCKET 1: MISSION PROGRAMS

This bucket represents the main area of funding—the foundation's mission—which is for the bulk of your client's charitable dollars. In this example, the foundation is dedicated to reducing childhood obesity, and the board wants to put most of its funding into this one area. Therefore, let's say that 53 percent of the foundation's spending plan will be poured into this first bucket. If your client's foundation has more than one area of interest, funds for those interests should be allocated to this bucket. Although deciding what percentage of funds should be apportioned to each might require some tough decisions now, it can help prevent conflict later when the foundation considers specific grantmaking decisions.

BUCKET 2: HISTORICAL INTERESTS

Many foundations, such as the one in our example, are associated with organizations that the founder, board, or family have supported previously. These historical interests may no longer be relevant to the foundation's mission, but foundation members still may want to honor the legacy of the founder through continuing support. Alternatively, if the foundation is just getting started, this bucket may comprise organizations that the family supported in the past and wants to continue to support. If so, your client's spending plan still should account for them. For our example foundation, let's allocate 12 percent of the spending plan for historical interests.

BUCKET 3: DISCRETIONARY FUNDING

Not every grant your client's foundation makes has to be made as a team. To keep everyone engaged and to prevent individual pet projects from derailing progress on the defined mission, some foundations find it helpful to give individual members a small portion of funds to donate as individuals. This practice, called discretionary funding, is invaluable because foundation members don't always share the same convictions, political ideology, or priorities. Giving everyone some funds to distribute individually can help keep the peace and preserve collective decision-making by providing an escape valve for personal priorities. Our example foundation might allocate 15 percent to this bucket for individual giving.

BUCKET 4: OPPORTUNITY FUND

Members of our example foundation are keenly aware that the only way they can attain appreciable results is to stay laser-focused on their mission. But what will foundation members do when and if they are presented with a completely unexpected funding opportunity that they absolutely positively can't pass up? For our example foundation focused on childhood obesity, let's say that the foundation wants to provide immediate relief funding for a natural disaster in its home community. An opportunity or venture fund, as its name suggests, is a "coins under the couch" cache that can be tapped when an unforeseen need or can't-miss opportunity arises. Our clients find that having this kind of fund keeps their options open, which enables them to stay focused on their mission. Let's put 12 percent in this bucket.

BUCKET 5: OPERATING EXPENSES

Expenses aren't just the day-to-day costs of administering a foundation or meeting in-person to discuss foundation business. This category also represents the foundation's research and development expenditures, the funds the foundation dedicates to hiring issue experts for research or consultation, attending conferences and workshops, and conducting site visits to assess programs and grantees. Other possible expenses include joining donor networks to better understand the needs in the field, meet the players, and become more effective philanthropists. Our example foundation anticipates spending 8 percent on these expenses.

TIPS FOR USING YOUR SPENDING PLAN

It can be helpful to remember that a foundation spending plan isn't much use without an income plan. Your clients will need a corresponding investment policy that will enable them to earn sufficient funds to enact their spending plan. We recommend that foundation boards document both their investment and spending plans in writing, adopt them, and revisit them yearly to align them with their actual earnings and expenditures.

We have a host of useful resources to help you and your clients monitor their financials and keep their spending plan on track. Foundation Source Online features real-time information about investment account balances, progress toward fulfilling the foundation's MDR, granting history, and expenses. Customizable reports enable your clients to easily monitor their expenditures across the same categories their foundation uses for its spending plan, so they will be able to make informed decisions about pending disbursements and avoid surprises about under- or overdistributions.

Although writing and living by a spending plan does take some effort, a thoughtful spending plan can be an invaluable tool. A spending plan budgets for each area of interest and keeps a foundation on track toward its philanthropic objectives. And should the foundation's needs or objectives change along the way, the plan always can be tweaked to reflect changing circumstances. Ultimately, a good pie chart is worth the effort it takes to bake it.

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