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FORsights on Foundations

Grantmaking Considerations & Trends

October 25, 2022

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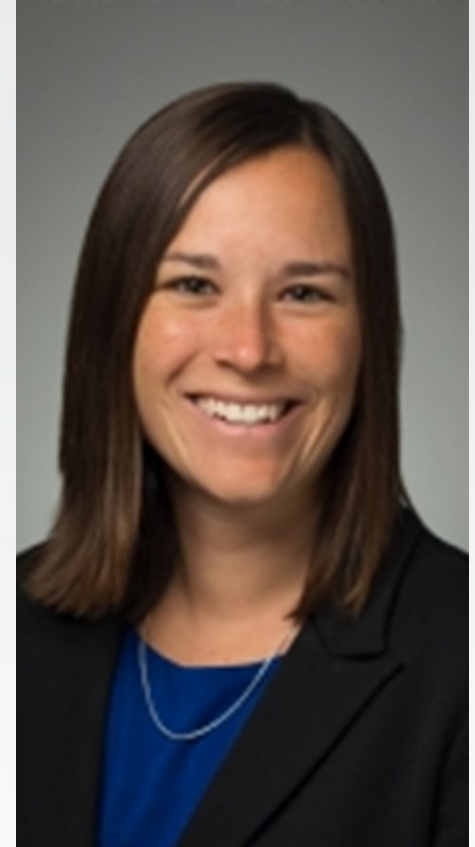
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Introductions



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Please Join Us for Session Three of the Fall FORsights on Foundations Series

**Tax Compliance: Avoiding Pitfalls & Anticipating Potential
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Watch for information on our Spring Series in early 2023

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Agenda

- Introductions
- Current Trends in Grantmaking
- Expenditure Responsibility Considerations
- Assessing Grant Applicants
- Closing Thoughts



Donors represent a private version of the legislative process
– a deliberative process that selects goals, sets values, &
allocates resources ... an alternative vehicle for getting
things done.”

– Paul Ylvisaker

Current Grantmaking Trends

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Current Grantmaking Trends

General Operating Support (GOS) Grants

- Allows more flexibility for organizations to use funds to fulfill mission
- Helps plan for long-term sustainability
 - According to The Center for Effective Philanthropy, 57% of nonprofits were at significant risk of being unable to cover essential operating costs
- Pandemic has accelerated trend toward GOS grants
- Multiyear GOS grants can be beneficial & allow future planning

General Operating Support Grants

- What are the barriers?
 - Lack of trust in nonprofit recipients
 - Desire to maintain control over grant funds
 - Concern about grantee's future financial stability
- Most foundations provide some multiyear GOS, but for few grantees
- Unrestricted support
 - Increased during pandemic & many foundations continuing to provide higher levels

Current Grantmaking Trends

General Operating Support Grants

Diversity, Equity, & Inclusion (DEI)

- Shifts in how grant applicants are identified
- Prioritizing collaboration with leaders in social justice/equity
- More intentional funding of marginalized communities

Current Grantmaking Trends

Impact Investing

- Investment into businesses or organizations with intention of generating social/environmental impact

Challenges to Historical Assumptions

- Payout rate assumptions
- Perpetuity vs. sunseting
- Transition of wealth/business interests from individuals to charitable entities



Giving frees us from the familiar territory of our own needs by opening our mind to the unexplained worlds occupied by the needs of others.”

– Barbara Bush

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Expenditure Responsibility

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Expenditure Responsibility – What Is It?

- Private foundation assets must be used exclusively for charitable purposes
- Grants to non-U.S. public charities must be in compliance with expenditure responsibility to ensure funds are used for charitable purposes
- Failure to comply with requirements can expose foundation & foundation managers to tax penalties

Expenditure Responsibility – What Is It?

- Exercising Expenditure Responsibility may involve one or more of the following
 - Conduct pre-grant inquiry before funds are awarded
 - Execute written agreement that contains required terms & conditions that must be met
 - Receive confirmation from grantee that funds are used for intended purposes
 - Publicly disclose grant amount & purpose on foundation's annual tax return

Expenditure Responsibility – When Is It Required?

- Grants made to a nonpublic charity
 - 501(c)(4)s, 501(c)(6)s
 - For-profit entities
 - Other private foundations
 - Foreign organizations
 - Equivalency Determination is permitted under Rev. Proc 2017-53

Expenditure Responsibility – Taxable Expenditures

- Grants that fail to meet requirements of IRC § 4945 are taxable expenditures
 - Initial tax is 20% of the expenditure
 - Second tier tax is additional 100% of the expenditure
 - A 5% tax is imposed on foundation manager who knowingly agreed to the expenditure
 - A 50% tax is imposed on foundation manager who refuses to correct the expenditure



Expenditure Responsibility – Best Practices

- Carefully screen grant applicants
 - GuideStar/Charity Check/Charity Navigator – resources to confirm public charity status
 - Identify any grants that require expenditure responsibility
 - Coordinate with grantee
 - Documentation should be retained for Form 990-PF reporting
 - Additional recordkeeping/due diligence can discourage some foundations from making these grants



There is no substitute for rolling up your sleeves & working with the people who can make a difference. They get the benefit of your participation & you gain a direct understanding of the real problems & potential solutions, which makes you a more informed giver.”

– Michael Milken

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Assessing Grant Applicants

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Assessing Grant Applicants

- Nonfinancial Considerations
- Financial Considerations
 - Balance Sheet Ratios
 - Expense ratios
 - Resources for benchmarking
- Tools to Help Assess
- Next Steps

Important Factors to Consider – Nonfinancial

- History of the Grantee
 - New or existing organization
 - Community reputation
- Requested Funds
 - New program or recurring program
 - G&A costs
 - Other funders
- Related Parties
- Fiscal Sponsor or Fiscal Agent Agreement

Fiscal Sponsor

A fiscal sponsor is a nonprofit organization that **provides fiduciary oversight, financial management, & other administrative services** to help build the capacity of charitable projects

- Often used by newly formed nonprofits to attract donors before they are a 501c3
- New initiative to use a fiscal sponsor to “test drive” ideas before they form a 501c3
- The sponsor maintains control over donated funds
- No separate 990, instead finances roll into sponsor’s 990



Fiscal Agent

A fiscal agent is a nonprofit organization that **acts as a legal agent** for a project but **does not retain control** over the activities

- Often used by new or small 501c3 that wants to use another organization to perform back-office functions
- The 501c3 will have their own 990



Important Factors to Consider – Financial

- Form 990
 - Type of 990 they filed – dependent on revenue (990-N, 990-EZ, 990, 990PF)
 - Is there a recent filing available?
- Financial Reporting & Assurance
 - Audit report
 - Review report
 - Compilation
 - Internal financials
- Financial Ratios & Metrics



Ratios – Financial Management



$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

- Measures organization's ability to pay obligations over the next year
- Need classified balance sheet (separates current vs. long term). Can't be calculated from 990 alone



$$\text{Operating Reserve Ratio} = \frac{\text{Unrestricted Net Assets} - (\text{Fixed Assets} - \text{Debt on Fixed Assets})}{\text{Annual Expenses} - \text{Depr. \& Amort. Expense}}$$

- How long (in years) an entity can continue with their unrestricted assets

Ratios – Functional Expense



$$\text{Program Expense Ratio} = \frac{\text{Program Expenses}}{\text{Total Expenses}}$$

- % of expenses spent on Program vs. Fundraising & G&A
- Consider looking at this as a pie chart, where Program, Fundraising, & G&A are the three pieces that make up all expenses

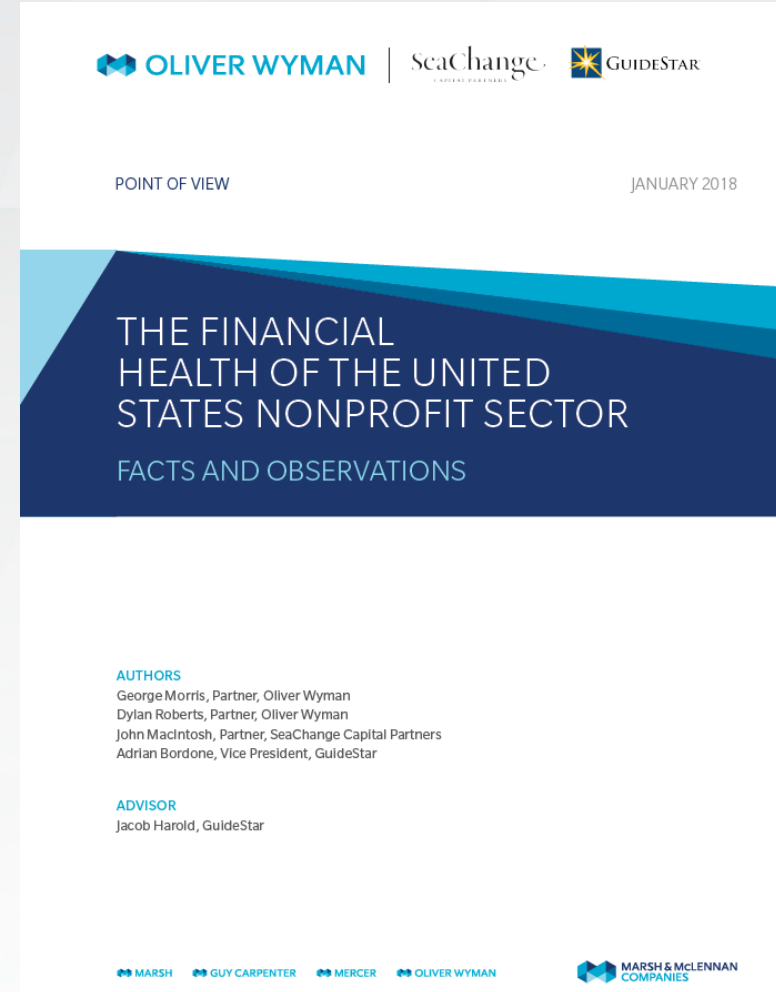


$$\text{Fundraising Efficiency} = \frac{\text{Unrestricted Contributions}}{\text{Fundraising Expenses}}$$

- Cost to raise \$1
- How efficient the organization is at raising funds

Resources for Benchmarking

- Charity Navigator Scoring Methodology – A rating system from 0–10 for many metrics published on their website
- GuideStar – Published report in 2018 with metric benchmarks
- Year-over-year comparison
- Compare similar organizations (size & nonprofit sector)





Next Steps

- Are your grant applications thorough?
 - Request financial reports
 - Grant budget detailed by line item
 - Related Party Inquiry
 - Scale your application & internal review appropriate for various sizes of grants
- Dashboard or tools to aid in assessment

Grantee Financial Health Tool – Example

Organization Information

Organization Name & Mission	Example Org	Total Revenue - Prior Year	\$100,000
<i>Mission Example</i>		Current Year Operating Budget	\$155,000
		Years Financial Data Analyzed	4

Grant Request Information

Description of Grant Request	Project Example	Amount of Grant Request	\$30,000
Amount of Prior Year Grant Awarded	\$30,000	% of Total Operating Budget	19%
Type of Grant Request	Combination		

Related Parties Information

Related Parties Exist?	Yes (explained below)
<i>List of Related Parties</i>	<input type="text"/>

Financial Reporting

Type of Financial Reports - Measures reliability and accuracy of financial reporting						
Current year	Review Report	1	2	3	4	5

Financial Management

Working Capital Days - Number of days expenses can be paid with current assets						
Current year	126	1	2	3	4	5
Historical Average	162	1	2	3	4	5
Unrestricted Operating Reserve Days - Number of days expenses can be paid using unrestricted assets						
Current year	-82	1	2	3	4	5
Historical Average	-34	1	2	3	4	5
Net Income as a % of Revenues - Ability to cover expenses with revenue in a single year						
Current year	3%	1	2	3	4	5
Historical Average	0%	1	2	3	4	5



If life happens to bless you with talent or treasure, you have a responsibility to use those gifts as well & as wisely as you possibly can.”

– Bill & Melinda Gates

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QUESTIONS



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