

ATLANTIC TRUST
PRIVATE WEALTH MANAGEMENT

In partnership with
FOUNDATION
Source®

HALLMARKS OF A WELL-RUN FOUNDATION

A Guide for Foundation Leaders

Making More Foundations *Great Foundations*™



A well-run foundation employs its resources efficiently and effectively, always in the public interest, to pursue the philanthropic goals of its leadership.

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Overview

A private foundation is a wonderful vehicle for managing your philanthropy. It is a flexible entity that enables you to engage in a variety of innovative charitable strategies.

A private foundation is also a legal entity that is subject to sound governance and business practices and federal and state regulations. More than a hobby, it's often meant to endure for years—if not several generations.

To be successful, to be *well-run*, takes more than a checkbook and a spreadsheet. It takes knowledgeable and responsible leaders, transparent processes for oversight and accountability, documented policies and attention to detail. This sounds daunting, but it does not have to be—especially with help from qualified advisors.

This booklet is intended as a simple guide to setting up a well-run foundation. Most readers will not be familiar with 100% of its content. If you take your role in the foundation seriously, you may want to review these suggestions with your tax preparer, investment advisor, attorney and/or other advisors to be sure that you are fully complying with state and federal requirements.

If you're already a Foundation Source client, you can relax. Many of these tasks are handled by Foundation Source in our role as your administrator (see page 10 for details).

Andrew C. Bangser
Chief Operating Officer

Governance

A foundation may be a corporation or a trust, governed by a board of directors or trustees. This booklet primarily addresses family foundations with a limited number of directors (conceivably only one director as permitted in some states) or trustees and little or no staff.

The same basic principles apply to larger foundations with more board members, officers and/or paid staff positions. **Because large foundations tend to have more complex activities, we have added comments to address their specific needs in blue boxes you will find in each section.**

In many family foundations, the same people—usually the donor(s) and family members—act as both directors and officers. If this is the case for your foundation, then this booklet speaks to you without necessarily distinguishing between these two roles. Nevertheless, it helps to understand the difference:

- Directors are responsible for setting the direction of the foundation and overseeing all aspects of its management and operation. Decisions about the composition and operation of the board can have long-term repercussions. The board of a well-run foundation provides active guidance to foundation officers, including the next generation of family members as they take on more responsible roles.
- Officers, such as the President and Vice Presidents, are responsible for managing day-to-day activities and implementing the policies adopted by the board.

The foundation's charter documents may define the duties and responsibilities of each foundation officer and may also state the foundation's philanthropic mission. These documents typically give guidance as to how the foundation should be governed and how new board members are elected

(or existing members replaced). IRS regulations and one or more state offices (usually the Attorney General and sometimes the Secretary of State) may also have jurisdiction over the foundation.

In substance and spirit, even the small family-controlled board needs to be familiar with its duties of care and loyalty—that the interests of the foundation outweigh personal interests and that directors and officers act in good faith and use reasonable business judgment. They should develop and adopt written policies in the following areas:

- A conflict of interest policy that identifies when professional or personal interests compete and sets rules for managing potential conflicts, i.e., when to disclose, when to abstain from voting, and so on,
- An investment policy that includes investment objectives, benchmarks for assessing investment performance and types of investments that are or are not permissible for the foundation,
- A travel and expense policy that describes the types of expenses that are considered reasonable and necessary for accomplishing the foundation's charitable mission, and
- A document retention policy specifying how long to retain documents and records, especially as it relates to grantmaking and board decision-making.

The board should consider adopting a succession plan. As the foundation may initially have only one director, a succession plan allows the donor to clearly direct future governance by family members or others. Otherwise, governance of the foundation could end up in the judgment of a court.

Finally, hold board meetings at least annually—or as required by regulations in the state where the foundation was formed. Use the meeting to review the foundation's

grantmaking activity (especially as compared to the targeted mission and any budgets), investment strategy and performance. Keep written minutes of all meetings.

Larger Foundations:

If the foundation's board has several members, or has recently added new members, it's good practice to offer orientation and guidance to new board members regarding their duties to the foundation, the history and donor intent behind the foundation, and current procedures and policies.

If the foundation has staff, you may allocate time at board meetings to review their performance annually.

Where directors, officers or any other insiders are to receive compensation, the foundation should comply with its own conflict-of-interest policy (or it may have a separate compensation policy) and maintain appropriate records leading up to and following approval of compensation. Ideally, this process will include a benchmarking analysis, comparing proposed compensation to levels paid by similarly situated foundations.

Where audits are required, such as under the California Nonprofit Integrity Act, the board is advised to rotate independent auditors periodically.

Investments

Private foundations have tremendous control and discretion over the investment of their assets. They are free to invest in a broad range of investment vehicles including publicly traded securities, private stock, real estate, artwork or other personal property—with few restrictions as long as they exercise fiduciary stewardship and accountability.

Because a foundation holds funds in public trust, it would be prudent for the foundation to adopt an investment policy that places a reasonably high priority on protecting principal and earning enough income (with sufficient liquidity) to meet the annual five percent minimum distribution requirement. The IRS prohibits no single asset class per se, but frowns upon any investment strategy that carries a high degree of risk (i.e., “jeopardizing” investments) and will scrutinize certain investments such as large uncovered option

positions. Board members should determine what constitutes an acceptable level of risk, taking into account whether the foundation plans to exist in perpetuity or spend down its endowment over a certain number of years.

- In a well-run foundation, officers responsible for investments should be financially savvy themselves or delegate investment management to financial experts.
- The foundation should manage its investments according to its investment policy.
- If foundation investments extend beyond the realm of cash, stocks, bonds and mutual funds into limited partnerships, hedge funds, real estate and other “alternative assets,” the foundation should consult an advisor with a working knowledge of the Internal Revenue Code and Treasury Regulations so as to avoid unfavorable tax treatment and potential violations.
- The foundation should also plan activities so as to reduce its excise tax rate from 2% to 1% in years when it realizes significant investment income, such as from large capital gains.

Larger Foundations:

Many larger foundations are now expanding into the realm of “mission-related investing.” They develop a working knowledge of investment vehicles that further the foundation’s own mission, as well as program-related investments (PRIs)—loans, loan guarantees and other investments for charitable purposes—that count toward satisfying the foundation’s annual minimum distribution requirement.

Operations and Administration

Like any organization, a foundation must set up accounting, bookkeeping and recordkeeping systems to function properly. Solid financial controls provide the basis for accurate and complete tax returns, efficient operations, compliance with IRS (and self-imposed) guidelines, and minimizing taxes.

- The foundation should maintain records of its charter documents, governing instruments, its application for recognition of exemption and IRS determination letter, past tax returns, and other significant correspondence.
- The foundation should monitor for satisfaction of the annual five percent minimum distribution requirement. Some foundations also have special distribution requirements, such as for out-of-corporis distributions.
- The foundation should maintain a list of substantial contributors (who are automatically categorized as insiders) along with records of all contributions made to the foundation. Note that all foundation transactions with insiders are tightly regulated by the IRS, so knowing exactly who they are helps the foundation avoid self-dealing violations.
- For the tax return and estimated tax calculations, the foundation needs to maintain accurate records of the cost basis (usually the donor's cost basis) and fair market value of securities and other assets on the date they were contributed to the foundation.
- The foundation should prepare and file its annual return (Form 990-PF and where applicable, Form 990-T) with the IRS, and keep current with all state filings, which vary from state to state.
- Each January, the foundation should provide tax receipts to donors for contributions that exceed \$250.

- Finally, if the foundation's excise tax is estimated to be in excess of \$500, the foundation should make quarterly estimated excise tax payments throughout the year—ideally using a method of calculation that will shield the foundation from penalties in the event of an underpayment.

Larger Foundations:

Larger foundations typically establish an operating budget and obtain and retain detailed written records of expenses and reimbursements. Expenditures should be approved by the treasurer or another designated individual.

During the calendar year, the foundation should obtain a W-9 from any independent contractors (including attorneys) who are paid for services. In January (regardless of the foundation's fiscal year-end), the foundation should provide a Form 1099 to each independent contractor.

Mission and Grantmaking Activities

There are many different grantmaking strategies, and all of them can be appropriate in the right situations. Most family foundations, for example, have an informal grantmaking process. Giving decisions are based on direct experiences, personal relationships and first-hand knowledge of the charities they support.

In time, foundation members may find that they gravitate toward specific issues or that they enjoy being involved in some projects more than others. Or they may feel overwhelmed with unsolicited requests as the nonprofit community becomes aware of the foundation as a source for funding.

When these things happen, foundations become more focused with their giving. They develop a written mission statement that they may share with the public. They define guidelines that help narrow the field of potential grantees down to a manageable number.

Regardless of the foundation's grantmaking strategy, the following are sound practices for awarding grants:

- The foundation should prepare a grant letter with clear and appropriate terms and conditions. Although many donors feel a very personal connection with their grantees and are uncomfortable with the formality of a written agreement, it is all too easy for a conflict to arise later. Having a written agreement that spells out the obligations of both parties makes it much easier to part amicably if something changes along the way.
- The foundation should maintain records of each grant, including the amount and purpose, and the specific evidence of the current tax status of each grantee. See "Compliance" for more details on documenting tax status.
- The foundation should monitor grantees' use of funds—at least to an extent appropriate to the size of the gifts. Larger gifts demand more frequent and comprehensive follow up.

Larger Foundations:

If the foundation invites charities to submit grant requests, it should have clear guidelines for informing grantseekers about funding priorities, eligibility requirements and restrictions, and about its application process, deadlines and selection criteria.

Those foundations should also have an effective process for receiving requests from grantseekers, and for reviewing and responding to those requests in a timely manner.

Foundation members may also need a working knowledge of how and when grants may be made to non-public entities and to individuals for scholarships, prizes, awards or hardship assistance.

If the foundation provides funds overseas, the foundation should be familiar with cross-border grantmaking, Principles of International Charity, and USA PATRIOT Act requirements. Officers should know when to make an equivalency determination or exercise expenditure responsibility, procedures required by the IRS when a foundation grants to organizations not classified as public charities.

Compliance

All private foundations must operate according to the legal and fiduciary requirements of federal and state governments. These rules and regulations are primarily intended to ensure that foundation assets are in fact used for charitable purposes and not for the benefit of foundation insiders. Officers of well-run foundations should be familiar with these concepts or retain knowledgeable advisors. Unlike some of the earlier suggestions, these items are not optional or “best practices”—they are required by law.

- The foundation must confirm that intended grantees are public charities currently in good standing with the IRS. They may not simply rely on the charity’s original IRS letter of determination. In addition, they should collect all information necessary to document the public charity status of churches and government instrumentalities.
- The foundation must comply with the special requirements for grants to supporting organizations. Supporting organizations appear to be typical 501(c)(3) public charities, but they are further classified as 509(a)(3) organizations. The Pension Protection Act of 2006 includes significant restrictions on grants to these organizations.
- The foundation should review all grants and expense payments to avoid self-dealing violations (where foundation insiders receive some benefit as a result of their association with the foundation) and to ensure grants are not made to influence legislation or elect government officials.

Larger Foundations:

If the foundation has any “direct charitable programs,” each program should be reviewed in advance with qualified advisors or with the IRS to obtain third-party verification of its charitable nature. Direct charitable programs are those where the foundation actually carries out a charitable purpose, such as buying food and distributing it to the homeless. Seeking independent verification of the charitable purpose of the program reduces the risk of an IRS challenge and potential penalties if program expenses are found to be “taxable expenditures.”

Where to start?

If you have any questions about your responsibilities as a board member, consider dedicating part of your next board meeting (or convening a special meeting) for a board orientation session with a lawyer or another expert. Foundation Source staff members are available to assist your board upon request and can perform organizational reviews to help you evaluate the current state of your foundation.

There are many different approaches to managing a private foundation. It takes sound governance, a reasoned strategy and considerable administrative expertise and oversight to be truly well-run. The largest foundations in the country hire staff to do these things. Private foundations with few or no staff can do them just as well by engaging the services of Foundation Source.

Governance: The team at Foundation Source is available to donors and foundation boards who wish to be briefed on their fiduciary responsibilities, who need to adopt written policies as cited earlier, or who require assistance planning for a board meeting. We can also help you turn board notes into official minutes.

Investments: While Foundation Source does not manage assets or provide investment advice, we do provide each new foundation with a customizable investment policy that conforms to the Prudent Investor Rules. As administrator for our client foundations, we track investment activity for certain possible violations. We also act as a resource for financial, legal and tax advisors contemplating transactions that require specialized expertise.

Administration: The know-how built into *Foundation Source Back-Office*[®] and available to clients via the *Foundation Source Online*[®] web site has been developed over years of service to hundreds of private foundations, often in

conjunction with the nation's leading legal and accounting firms and with the IRS. We process all grants, fees, taxes, expenses and other disbursements. Grant checks and customizable grant letters are sent to the charity or directly to you. We keep detailed records of every transaction (contributions, investment earnings, grants, fees, expenses and tax payments) and reconcile all foundation bank and investment accounts.

Taxes: Foundation Source performs a full suite of tax services for its foundation clients, including preparation and filing of the annual 990-PF return and related state filings. When you make a grant, we validate the tax status of each grantee in advance. We calculate your remaining minimum distribution requirement daily, prepare and file quarterly excise taxes, and send year-end substantiation receipts to foundation donors.

Mission and Grantmaking Activities: Foundation Source's Client Services team works to make the full range of grantmaking possibilities available to foundation members. For grants to domestic charities, customized grant letters meet strict legal requirements to protect the foundation's interests. More advanced grantmaking options, such as cross-border giving and expenditure responsibility grants, are assisted by each foundation's dedicated Private Client Advisor in conjunction with our own expert legal staff and philanthropic advisors. We offer an expansive array of grantmaking tools, including grants to individuals for emergency assistance and hardship needs, scholarship programs, grant certificates and program-related investments.

For foundations that solicit grant proposals from public charities, we also offer *Foundation Source Requests*®, an optional service that provides each foundation with a customized public web site where charities may apply online. Foundation Source Requests gives foundation members online tools to track and evaluate requests, communicate with charities, and process approved requests.

FOR MORE INFORMATION

To learn more about the support services that Foundation Source provides for private foundations, call us, or go to www.foundationsource.com.

To find out about other informational booklets available from Foundation Source, or to obtain additional copies of this booklet, contact us at: **800-839-0054** or **booklets@foundationsource.com**.

A few high profile scandals from the last decade are often repeated in the press and in Congress to underscore the need for greater accountability and oversight in the nonprofit sector. In an effort to avert cumbersome legislation or new IRS regulations, many high profile organizations, such as the Independent Sector, the Council on Foundations, and many Regional Associations of Grantmakers, are developing and encouraging their members to adopt voluntary principles and practices that reflect the highest standards of ethics and good governance.

Our own thinking has been informed by the efforts of these organizations. In this publication, we encourage responsible and ethical philanthropy. Through our services, we actively enable it by installing transparent and effective operational practices that empower well-informed boards to make good decisions.



WORKING WITH ATLANTIC TRUST AND FOUNDATION SOURCE

Atlantic Trust has partnered with Foundation Source, the number one provider of management and advisory services for private foundations.

Foundation Source runs over 1,000 private foundations, of all sizes, nationwide. Running foundations is what separates us from consultants and software companies, and it's why our clients turn to us. We step in to operate, advise and strengthen all working aspects of the foundation, while Atlantic Trust manages the foundation's assets. This combined approach frees donors and families to enjoy their philanthropy with total ease and confidence while we handle the details.

We work with both established foundations and individuals interested in starting a new foundation. For every foundation, we provide complete back-office administration, award-winning online systems and experienced philanthropic advisors. The result is a foundation that always runs smoothly, engages the family, and has the impact every client wants.

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