

Private Foundations Bulletin

Considerations for Director Recommended Grants

Many in the private foundation community are familiar with the practice of “discretionary grantmaking” at the Board level. We often receive questions about best practices pertaining to this specific type of grantmaking, or what many commonly refer to as “director recommended grants.” In this bulletin, we address certain items that foundations and foundation managers should consider as well as some best practices to follow when it comes to director recommended grants.

Background

Historically, foundations that have a director recommended grant program typically allocate each year a modest dollar amount – relative to the foundation’s total grantmaking budget – to its directors to recommend grant recipients to be awarded. This has been seen by many in the foundation community as an alternative to paying director fees. In addition this can also be a great tool to keep foundation directors engaged and to thank them for their volunteer time and service on the Board.

For many years, most foundations paid out what is commonly known as “discretionary” grants as long as the selected grantee was a public charity in good standing with the Internal Revenue Service (IRS). In recent years, we have seen more foundations put additional structure and guidelines into place around the process of director recommended grants.

Best Practices

As a best practice, foundations can protect themselves as a whole by designating these grants “director recommended grants” and requiring them to continue to be subject to Board approval, as this allows the Board as a whole an opportunity to consider and mitigate any risk in the rare event that there are unfavorable circumstances. This is important as sometimes director recommended grants, while charitable in nature, may fall outside the foundation’s primary areas of focus or a collective Board’s “comfort” level.

Some foundation Boards also allow the director recommending the grants to discuss their reason for proposing the grant, thereby educating fellow Board members on the opportunity. We have even seen some director recommended grantees become part of the overall foundation’s grant portfolio, potentially resulting in more substantial grants in future periods.

Many foundations have a streamlined process for the interactions taken with a director recommended grantee. For example, once the entity is verified as a public charity in good standing with the IRS, a foundation may have a minimal grant letter awarding the grant, rather than a complex grant agreement, which may be more in line with what is used within the core grantmaking function of a foundation.

A foundation’s Board has the ability to set-up their director recommended grant program as they see fit. In addition to having a dollar allotment, some foundations also limit the total number of director recommended grants in a given year (e.g., a total of \$50,000 to be spent on no more than three recommended grantees). Foundations do this for a number of reasons, but also to keep the administrative burden of carrying out the recommended grants program to a minimum. In addition, other foundations may set guidelines or restrictions regarding the type or mission of not-for-profit organizations that can be considered, such as confining grantmaking to a certain geographical area or excluding organizations that have activities in direct contrast to the foundation’s mission.

Due Diligence Considerations and Avoiding Inadvertent Self-Dealing

Despite being director recommended, a certain level of due diligence still needs to be performed over each potential grantee. Each potential grantee should still be recognized as a 501(c)(3) not-for-profit organization by the IRS, except for potential grantees who are non-public charities where expenditure responsibility would have to be performed. Furthermore, the foundation should ensure that the grant funds are not designated for lobbying or to influence the outcome of any public election and that the grant funds cannot be used for non-charitable purposes.

One of the most overlooked, unasked, and under-documented considerations is confirming that a director recommended grant does not satisfy a director's personal pledge. Once any disqualified person (such as a director) makes a personal pledge, it becomes a legally binding and enforceable personal obligation and a foundation is prohibited from using foundation assets to satisfy a personal obligation under the IRS self-dealing rules. Foundations should clearly state in its director recommended grant policies that board members must be careful and mindful of this when signing personal pledge letters as individuals. Additionally, as a best practice, many foundations do not allow their directors to make multi-year grant commitments with their discretionary allotments nor bind the foundation to any financial commitment that hasn't been approved by the greater board or management.

Constructive Engagement

Through our experience, director recommended grant programs have been generally positive for foundations and their boards as it encourages directors to remain engaged and committed to the philanthropic work of the foundation. Keeping these considerations and best practices in mind will help mitigate risks for a foundation prior to any transactions taking place.

Contact Us

We welcome the opportunity to answer any questions you may have related to this topic or any other accounting, audit, tax or advisory matters relative to private foundations. Please call 212.286.2600 or email any of the Private Foundation Services team members below:

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