



## Seven Tips for a Successful Family Foundation

By Nancy Opiela

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Managing a foundation's assets wins you the cachet of being seen as helping your clients fulfill their philanthropic goals, and it is extremely lucrative work that can create a practice-building bridge to the next generation.

"Foundation assets are sticky," says Jeff Briskin, a principal at [Briskin Consulting](#), a Boston-area strategic marketing and philanthropic advisory firm. "Generally, annual distributions amount to little more than the 5 percent required minimum, whereas high net-worth clients could withdraw huge amounts from other investment accounts advisors manage to purchase yachts or second homes."

Accordingly, many advisors hope the family foundations they help establish become multi-generational philanthropic vehicles. But managing a foundation entails responsibilities very different from managing personal assets, and families often become frustrated with operational details.

Advisors often get high marks from clients for defining a foundation's investment policy, investing the initial gift, and handling the ongoing management of the portfolio for a percentage of the assets they manage. A survey of family foundation managers conducted by Briskin Consulting, however, found that more than 45 percent said they wished their financial advisors had done a better job of educating them on the administrative responsibilities and time commitment associated with operating a foundation.

"Advisors tend to emphasize the excitement of awarding grants, receiving public recognition and supporting favorite causes while downplaying the enormous fiduciary and legal obligation that come with managing a complex charitable entity that must comply with both state and IRS regulations," says Briskin.

Without the proper guidance regarding administrative duties, Rushworth Kidder [says](#), many family foundations become overwhelmed and "find themselves functioning in an arrogant, superficial, inharmonious, and dysfunctional way." Kidder is president and founder of the [Institute for Global Ethics](#) in Rockland, Maine, a nonprofit organization dedicated to promoting ethical action in a global context.

Emphasizing the administrative side of foundation work will become even more important as foundations become an increasingly popular charitable vehicle. According to the *2008 Bank of America Study of High Net Worth Philanthropy*, 15



percent of respondents (wealthy Americans with household income greater than \$200,000 and/or net worths of at least \$1,000,000 excluding primary residence) planned to form a foundation by the end of 2010. And, according to the [Foundation Center](#), a leading authority on organized philanthropy that supports nonprofits and grant makers, private foundations grew in number from 44,146 in 1997 to 75,187 in 2007.

If you're interested in helping your clients pursue their philanthropic interests through a family foundation, sharing the following tips can help them avoid administrative headaches:

1. **The money is there to be spent.** To avoid taxes for under-distribution, a private foundation must generally distribute at least 5 percent of the value of its investment assets (minus fees and investment taxes) every year. "It's critical for private foundations to calculate the annual distribution amount as early as possible and monitor grant distributions throughout the year," advises Briskin. "Many foundations scramble to make contributions in the last weeks of the year to avoid shortfalls."

A foundation that misses its target may have to pay higher taxes on investment income, although Briskin notes that the IRS gives some flexibility for foundations missing the 5 percent distribution to make up the difference by contributing more than 5 percent in the following year.

During the first five years of operation, all private foundations must pay a 2-percent investment income tax directly from the foundation's assets. With an established a five-year track record of distributing at least 5 percent of assets annually, however, the tax decreases to 1 percent.

2. **Establish proper governance.** The family's excitement for beginning their charitable work can cause them to overlook the importance of setting up governance structures, says John B. Smith, principal at [Cambridge Consulting](#), a Cambridge, Massachusetts management consulting firm focused on philanthropy. "Effective grant-making depends on a clearly established mission, guidelines for operations, and processes to ensure the ethical conduct of the foundation and compliance with fiduciary duties."

In fact, just as investments are evaluated in an ongoing manner, it's also advisable to create a governance committee that will monitor a foundation's structure, leadership, and practice. To help families act as responsible stewards of their foundation resources, the [Council on Foundations](#) offers [Stewardship Principles for Family Foundations](#), which outlines best practices to help foundations strive for excellence in governance and ethics.



3. **Narrow your charitable focus.** Finding the right mission entails more than identifying an interest, says [Andrew Bangser](#), president of [Foundation Source](#), a provider of back-office, technology, and support services designed to automate and simplify foundation management. “An effective mission statement is one you have the scale to accomplish,” he says. “Biting off the right size chunk of the problem is the key in being able to make a difference.” He once worked with a client who was interested in the environment. He brought in an environmental consultant to the Clinton White House, met with family and board, and decided the foundation could be the most effective focusing on state environmental regulations.
4. **Guard against jeopardizing investments.** The Madoff scandal’s devastating effect on many leading private foundations offers a clear example of imprudent investment practices that the IRS might consider “jeopardizing investments,” says Briskin. “It’s the fiduciary responsibility of a foundation’s board to scrutinize the facts behind reported results, particularly when all assets are being managed by a single advisor,” he notes. “Boards should be measuring an advisor against tightly defined investment policies and asset allocation processes geared toward generating specific total return targets (such as the CPI plus 5 percent) at targeted risk levels.”

Note, however, that the IRS’ definition of jeopardizing investments – investments that show a lack of reasonable business care and prudence in providing for the long- and short-term financial needs of the foundation – is vague and open to interpretation. For example, although the agency views a foundation manager trading on margin or short-selling as problematic, it does not address whether the same standards apply to outside investment advisors or asset managers hired by private foundations to execute these strategies.

“If a foundation suffers losses due to jeopardy investments, both the foundation and its asset manager may have to pay a 10 percent tax on the cost basis (original purchase price) of the jeopardy investments and a penalty up to \$10,000 on individual asset managers,” Briskin explains. “An additional 25 percent penalty on the cost basis of the jeopardy investments and up to \$20,000 per manager may be levied if the foundation fails to liquidate the jeopardy investments.”

5. **Take a long-term view.** If a family foundation operates without a formal office, check writing often happens at home, around the kitchen table, says Kidder, and that informality can foster too casual a view of the



foundation's charitable efforts. "It's important to do the right thing and do the thing right," Kidder says. "A foundation may be well intended, but it can cause grief, or even the collapse of a small nonprofit, if the giving isn't handled in a thoughtful way."

For example, he says, a foundation could make a significant gift one year and lose interest in the organization the next. "If the change in focus isn't communicated, the organization mistakenly could be counting on the money," he notes.

Further, Kidder encourages foundations to take the time to publicize their grants for the additional benefit of the organization. This is especially important in cases where a foundation supports new research or a relatively small organization. "If you are funding leading-edge research and it is working, it won't be long before Pew or Lily money will follow and enable the non-profit to make a real difference," he says.

6. **Be wary of self-dealing.** Foundation assets cannot be used for the personal enrichment of foundation managers, either through excessive salaries or fees paid for products or services, and it's the gray areas that cause problems, says Kidder. "It's clear that you can't make a grant to a theater company in exchange for season tickets, but making ethical choices is not always as simple as separating right from wrong," he says. "For example, what if you want to hire your cousin? He might be great guy and qualified for the job, but the hire could be classified as self-dealing. You could make an argument either way."
7. **Engage the next generation.** "A family foundation affords clients the opportunity to educate their children or grandchildren not only about finances, but family values," says Brett S. Ellen, CFP®, founder and president of [American Financial Network](#) in Calabasas, California. "If you teach the kids while you are alive, they can carry on with your family's mission after your death."

In fact, Ellen's young sons play a big role in the non-profit foundation [TKO \(Turn Kindness On\) Helping Hands](#), which the family founded in 2001 to encourage children to perform volunteer community service. TKO recently expanded its reach from feeding the homeless in downtown Los Angeles and Santa Monica and participating in local beach cleanups to visiting poverty-stricken areas of the world's most beautiful destinations to donate money, food, toys and other supplies. Ellen visited orphanages in Bali with his family last summer. "Through TKO, we're teaching our children that supporting a cause involves an investment of time as well as money. Those who actively engage in the philanthropy as children and young



adults will be less likely to be one of those well-intending donors who are eager to support a cause but just want to write a check.”

Bangser says a family’s satisfaction with a foundation hinges on the answers to three questions: How engaged are family members, are they having fun, and are they making the impact they want? “The more an advisor can do to reduce time spent on a foundation’s administration, the more time families have to enjoy their philanthropy,” he says.

Kidder adds that providing education about potential pitfalls and suggesting additional professional resources can reduce the odds that the foundation becomes an administrative headache that reflects negatively on the wealth advisor.

“Advisors should seek to free families to concentrate on changing the world for the better,” Kidder concludes. “I tell families to expect some stress with the workload or family dynamics, but that getting together once a year to figure out how to help others is better than getting together for Thanksgiving and talking about the last Thanksgiving.”

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