THE CHALLENGES OF FOUNDATION STEWARDSHIP: WHEN A PHILANTHROPIC GIFT BECOMES A BURDEN

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On Oct. 15, 2013, Mr. King, a board member of The Gift Fund, called a nonprofit consultant. For Mr. King, an opportunity that had once been a blessing had become a curse. Mr. King explained to the consultant that the four board members of the Gift Fund who were in charge of administering the fund's $3.5 million in assets had found themselves unable to fulfill their duties as trustees. Communication amongst the board members had broken down, they disagreed about everything, and they were operating without a clear purpose or mission. Indeed, as the consultant would soon discover, their actions had exposed The Gift Fund to legal challenges. Their mutual anger and distrust led to a failure to cooperate and inability to function as a unified board. This left them questioning the future of The Gift Fund.

The Graham Foundation: Precursor to The Gift Fund

The Gift Fund derived from The Graham Foundation, which was established by Mr. Graham Sr. in 1950. The founder of this foundation, Mr. Graham Sr. was part of a large family of Russian-Jewish immigrants to the United States. His wife and three children described him as determined, demanding, despotic, and at times cruel.

Mr. Graham's determination served him well during his life in the United States as he became an extremely successful investor and businessman. He became the majority shareholder of a national chain of women's retail clothing stores while he personally owned many of the properties on which the retail stores were located. As his business acumen grew, Mr. Graham Sr. involved the rest of his family in his ventures while endowing his three children with wealth sufficient to sustain them for life without having to work.

Despite his great generosity towards his family, Mr. Graham Sr. was not an ardent supporter of organized charitable causes. Nonetheless, he established The Graham Foundation with the ostensible purpose of making philanthropic donations that would have a positive impact on society. Soon, however, it became evident that The Graham Foundation was simply an alter ego of Mr. Graham Sr., another means of bolstering his standing in the business community.

Initially, The Graham Foundation's board of directors was comprised of the male members of the Graham family: Mr. Graham Sr., Mr. Graham Jr. and Mr. Graham Sr.'s two sons-in-law. In due course, evidence was found that one of the board members was embezzling the foundation's resources. While this was never brought to the attention of the authorities, that board member was asked to resign. This action eventually led Mr. Graham Sr. to divide The Graham

Foundation into three separate private foundations that would be administered independently by each of his three children. When forming these three new private foundations, Mr. Graham Sr. neglected to establish a clear philanthropic policy or mission that would provide guidance as to how his children should be awarding grants from their respective foundations. A pattern repeated under Mr. Graham, Jr.'s stewardship.

Mr. Graham Sr. died in 1963. One of his greatest disappointments in life was that he and his only son, Mr. Graham, Jr., were practically estranged.

Mr. Graham Jr. was an affluent, well-educated gentleman. While he never married, he shared a long-term romantic relationship with Miss Jones. Mr. Graham Jr.'s wealth derived from investments, real estate activities in Southern California, and direct gifts from his father.
Like his father, Mr. Graham Jr. gave generously to family and friends. Unlike his father, however, Mr. Graham Jr. was frugal and never wanted to appear wealthy. He was overall uncomfortable with the proportions of his wealth and avidly supported charitable causes through the private foundation which his father had entrusted to him, and which he had renamed The Gift Fund.

While Mr. Graham Jr. was delighted to award charitable grants that could benefit society at large, his charitable giving was not distributed with a particular agenda, nor did it strongly favor a single cause or charity, with one notable exception. Inspired by a belief that the Holocaust led to the formation of Israel and its brilliant research organizations, Mr. Graham Jr. awarded large annual gifts to the Weisman and Technion Institutes of Israel. In addition, after losing his eyesight to macular degeneration, he also became a strong supporter of ophthalmic research.

Mr. Graham Jr. eventually moved to the Pacific Northwest and passed away in January of 2009 without heirs. His estate was left primarily to two friends who were board members of The Gift Fund.

The Gift Fund
The Gift Fund was supported primarily from income generated through a 50-year lease on properties located on Wilshire Boulevard in Los Angeles, California.

Mr. Graham Jr. invited Mrs. Bailey, Miss Jones, and Mr. Anderson to serve as the initial board members of The Gift Fund. Mr. Anderson was a friend of Mr. Graham Jr. and Mrs. Bailey was Mr. Graham Sr.'s secretary. After Miss Jones and Mr. Anderson passed away, Dr. Ford, Mr. Graham Jr.'s physician, was asked to join the board. Soon thereafter, Mr. Graham Jr. asked his friend, Mrs. King, to join the board of directors. Mrs. King and Dr. Ford remain on the board as of 2015.

Mrs. King and Mr. Graham Jr. shared a close friendship that intensified after Mr. Graham Jr. became blind. According to Mrs. King, Mr. Graham Jr. often asked her for advice regarding matters pertaining to the management of The Gift Fund even before she became a board member. Mr. Graham Jr. trusted Mrs. King's judgment because she was directly involved in the management of other charitable entities such as Westminster College, Bellevue Botanical

Gardens, The Center for Wooden Boats, the Leavenworth Ski Hill Heritage Foundation, and the Wenatchee River Institute.

Prior to Mr. Graham Jr.'s death, Mrs. King's adult son was also asked to join the board, bringing the board up to five members: Mr. Graham Jr., Mrs. Bailey, Dr. Ford, Mrs. King and her son, Mr. King. With the passing of Mr. Graham Jr., Dr. Ford's wife, Mrs. Ford, joined the board. Subsequently, in 2013, Mrs. Bailey passed away. As of 2014, the board of directors of The Gift Fund was composed of four members: mother and son King and the married couple, Dr. and Mrs. Ford. All four board members resided in the Pacific Northwest.

According to The Gift Fund by-laws, a vacancy in the board due to "death, resignation, removal, disqualification or otherwise may be filled by the Board of Directors for the unexpired portion of the term." However, The Gift Fund by-laws do not specify term limits, enabling members to serve in perpetuity. Additionally, the by-laws do not provide any guidance with respect to replacing board members or enlarging the board. New board members were simply selected by Mr. Graham Jr. with the exception of Mrs. Ford, who was added as a means of balancing out the board after Mr. Graham Jr.'s death. Furthermore, nothing was stipulated in the by-laws with regards to expected board performance and possible removal of disruptive or underperforming board members.

The Gift Fund by-laws stipulate that the officers were elected every year during the annual meeting. Historically, the board members have rotated through the officer positions.

The lack of succession plan to replace any board member in the by-laws immediately proved to be problematic because of the two incompatible families that control The Gift Fund. If any board member were no longer able to serve, the appointment of a new board member would inherently weigh in favor of the opposite family, which would then have one more vote. A creative solution was needed.

The Gift Fund is a Private Foundation

A private foundation is defined as a "nongovernmental, nonprofit organization having a principal fund managed by its own trustees or directors. Private foundations maintain or aid charitable, educational, religious, or other activities serving the public good, primarily through the making of grants to other nonprofit organizations."[1]

Private foundations derive their principal funding from limited sources, such as an individual, a family, or a corporation. Unlike public charities, private foundations do not solicit funds from the public.[2] When a private foundation is established as a result of a single large contribution, it is common for family members of the contributing person to serve on the board of directors. For example, Bill and Melinda Gates and Bill Gates Sr. were the founding board members of The Bill and Melinda Gates Foundation.

Private foundations are required to make a minimum payout in the form of charitable grants each year. The annual *payout requirement* must meet or exceed 5% of the average market value of the foundation's net assets. The payout requirement is satisfied by the sum of *qualifying distributions*, such as grants, and, within certain limits, administrative and operating expenses.[3]

These expenses range from trivial at small foundations to more than half a percent of the endowment value at the largest foundations.

The Internal Revenue Code institutes a web of excise taxes to quasi-penalize those foundations that do not live within established parameters. For example, if the minimum payout requirements are not met, the foundation becomes subject to a 30% excise tax on any undistributed income.[4] This excise tax is effectively encouraging foundations to meet the minimum 5% payout requirement. Another excise tax of 10% discourages investments that may jeopardize the foundation's exempt status.[5] Another excise tax of 10% discourages the foundation from engaging in excessive for-profit business activities.[6] Yet another 20% excise tax is imposed on certain expenditures incurred for lobbying or to influence legislation.[7]

The Gift Fund differs from a 'traditional' private foundation in two key respects:

1. The board of directors was not composed of family members, but unrelated friends of Mr. Graham Sr. and Mr. Graham Jr.
2. According to Dr. Ford, two of the board members, namely Mr. Graham Jr. and Miss Jones, were not familiar with matters pertaining to tax compliance and seemed to take their tax obligations lightly.

The By-laws

By-laws are written guidelines adopted by an organization to regulate its own actions and structure. By-laws guide the board in its roles and responsibilities and outline board operations. With the exception of adding the mission statement in 2011, the by-laws had not been revised since the establishment of The Gift Fund in 1963. The by-laws were unclear as to who could be a board member because the words "member" and "director" were used inconsistently. For example, the by-laws stated that, "there shall be only one class of members" and "there shall be no less than 3 and no more than 100 members." Furthermore, the by-laws stated that, "[a] director need not be a member of the corporation." Yet, typically, private foundations have no member class with all business conducted by the board members.

Board Meetings

In accord with the by-laws of The Gift Fund, the foundation held an annual meeting of the members "for the election of directors and for the transaction of such other business as may properly come before the meeting." In addition, "[t]he Board of Directors shall hold one regular meeting during each calendar year immediately following the annual meeting of the members."

When Mr. Graham Jr. was still alive, the annual meetings took place at his home on the second Tuesday in November, as dictated by the by-laws. Mr. Graham Jr. kept The Gift Fund meeting and interactions quite informal. For example, board members would often discuss the approval of grants informally, quasi-casually. After the death of Mr. Graham Jr., the meetings became more frequent, formal, and, according to one board member, "more business driven and contentious." Most recently, the annual meetings have been held in neutral spaces such as the offices of the foundation's investment advisor. These actions frustrated the Kings, particularly Mrs. King who had enjoyed the informality in her relationship with Mr. Graham Jr.

Regular attendance at Board meetings is one of the important duties for all Board Members. The position of board member of a nonprofit organization means accepting individual and shared roles and responsibilities. Individual board member roles and responsibilities include such things as abiding by the duties of care, loyalty, and obedience[8]. Roles and responsibilities shared by all board members include hiring the executive director, furthering the mission/purpose of the organization, and monitoring programs and services. Appendix A provides details concerning the explicit duties and associated responsibilities borne by the Board.

Awarding of Grants

After the passing of Mr. Graham Jr., The Gift Fund grants were disbursed based on a formula that divided the required 5% annual minimum payout requirement by the total number of board members. As the board was composed of only four members in 2014, each board member could authorize the writing of grant checks equal to one fourth of the required 5% annual minimum payout amount. For example, in 2011 the minimum required payout amount was $148,858, which divided by four enabled each board member to authorize $37,214.50 in grants. Because the board members had different philanthropic interests, this system seemed to work well because it allowed them to award grants by family affiliation. Mother and son King awarded a few large grants to local charitable causes, while Dr. and Mrs. Ford awarded numerous smaller grants to local, national, and international charities. Each party felt that their gifts were more appropriate in terms of societal impact.

Table 1: Financial Summary of The Gift Fund 2002-2011

Tax Year	Net Value of Assets	Excise Taxes Paid	Adjusted Qualifying Distribution
2011	$3,045,176	$478	$148,858
2010	$3,246,751	$1,694	$143,793
2009	$2,889,796	$118	$144,378
2008	$3,469,960	$818	$209,774
2007	$4,048,793	$1,637	$181,248
2006	$3,719,329	$2,479	$119,045
2005	$2,691,801	NA	$117,228
2004	$2,664,776	NA	$111,303
2003	$2,460,359	NA	$76,733
2002	$2,448,377	NA	$75,772

Because of the separatist approach to awarding grants, no board discussion, oversight, accountability, or even voting ever occurred and no single uniform gift had ever been awarded. No reports were ever requested on the uses of funds, once distributed.

All four of the board members recognized that the lack of discussion and absence of voting on grants prevented the foundation from making a substantial gift that may have significant social impact. The advantage of consolidated giving is that a single larger grant can have a more meaningful impact to the recipient organization.

Table 2: The Gift Fund Allocations, 2010-2011

Type of Grants and Contributions	2011 Number of Grants	2011 Value	2010 Number of Grants	2010 Value
Charitable	25	$91,900	30	$95,700
Educational	4	$48,100	5	$45,500
Arts & Culture	1	$1,500	0	$0
Research	1	$500	1	$500
Total Grants and Contributions	31	$142,000	36	$141,700
Allowable adjusted qualifying distributions		$148,858		$143,793

The Gift Fund's Mission

Like public charities, private foundations typically have a mission statement, which guides their actions. The mission of The Rockefeller Foundation is to "promote the wellbeing of humanity throughout the world"[9] while Carnegie established his foundation to "promote the advancement and diffusion of knowledge and understanding."[10] For these and other private foundations, the mission directs the distribution of grants. By awarding grants in accordance with a mission, the foundation can achieve a greater social impact. For example, the Bill and Melinda Gates Foundation, whose mission is "guided by the belief that every life has equal value," seeks "to help all people lead healthy productive lives" by partnering with organizations worldwide to tackle critical problems in four program areas: (1) Global Health; (2) Global Development; (3) United States Division; and (4) Global Policy & Advocacy Division.[11]

When Mr. Graham Jr. initially established The Gift Fund, he did not provide any guidance or stipulations for how the funds should be distributed, because he felt that the foundation board members should simply have 'fun' giving the money away. The Gift Fund by-laws neither included a purpose or mission statement nor explained what the donor meant by having fun giving the money away.

In 2011, almost 50 years after the inception of the foundation, Mrs. King drafted The Gift Fund's first mission statement in response to Dr. Ford's attempt to clarify The Gift Fund operations. The mission statement drafted by Mrs. King read as follows:

> *"The mission of (The Gift Fund) is to support, raise money, obtain contributions and create funds to assist persons, firms or corporations which are engaged in religious, charitable, scientific, literary and educational work."*

At the next annual meeting, the board members approved the mission statement without any discussion. Unfortunately, The Gift Fund board seemingly had no clear understanding of the significance of a nonprofit organization's mission statement, nor was it used in guiding gift giving or the creation of a giving policy. The board still had no guidelines by which to award and measure the effectiveness of the grants.

Investment Philosophy

According to the current board members Mr. Graham Jr. had no particular investment philosophy and was not an aggressive investor. This was consistent with his overall disinterest towards money as he viewed money as a nuisance. Mr. Graham Jr. disliked showcasing his wealth to such an extent that, throughout his entire life, he only owned three cars.

Initially, Deutsche Bank in New York managed The Gift Fund's assets. After Mr. Graham Jr. moved to the Pacific Northwest and the Kings were added to the board, investment management of The Gift Fund's assets was moved to the Kings' financial advisor. When this financial advisor became incapacitated after a stroke in 2013, Dr. Ford, who was the secretary/treasurer of The Gift Fund, began a search for a new financial advisor. After interviewing both the Kings' and the Fords' personal financial advisors, the board of directors agreed to retain the Fords' investment firm. In his role as secretary/treasurer, Dr. Ford also terminated The Gift Fund's long-time bookkeeper. According to Mr. King, these successive changes ultimately contributed to distrust between the two families. Mrs. King had known the bookkeeper for as long as she had known Mr. Graham Jr. and she both trusted the bookkeeper and felt an obligation to keep her in this role because of her ties to Mr. Graham Jr.

The Absence of a Grant Awarding Policy

The Gift Fund board members operated without a grant awarding policy to direct the distribution of funds until January of 2104. In addition to operating without a grant awarding policy, the lack of a guiding mission statement wafted The Gift Fund board members towards a disjointed spending pattern based solely on their personal interests.

There is no secret to creating grant guidelines; however, the funding award policies are as different as are the types of foundations. Most foundations will have a set format for composing grant request proposals. A grant proposal may be reviewed by a staff person (typically a Program Officer in large foundations) or a committee of the board for a first round review and decision. At this point in the review process, most foundations are seeking to decline those proposals that are out of the scope (or mission) of the foundation or are of inferior quality.[12] In some foundations, the full board reviews all proposals. No matter the vetting process, all funding requests are eventually submitted to the board for approval. The grant proposal would ordinarily include the following: (1) the purpose of the grant (purpose or need statement), (2) expected outcomes and how your idea for a project or program will solve a particular problem, (3) explanation of how the grant will support the foundation's mission and the mission of the organization requesting the funding, (4) the qualifications of the organizations making the request for funding (background and accomplishments), (5) how success will be measured (evaluation) and (6) program or project budget including the total amount being requested in the grant proposal.[13]

Distrust and Anger Among the Board Members

The breakdown of the board began as soon as Mr. Graham Jr. passed away. With the loss of Mr. Graham Jr., the relations among the board members became increasingly tense. With the passing of Mrs. Bailey, the remaining four board members were divided into two distinct groups, the Kings, mother and son, and Dr. and Mrs. Ford, a married couple. The Fords advocated a mission statement and grant policy that was more globally focused and targeted underserved and undereducated populations. This was in clear conflict with the Kings' philanthropic interests, which focused primarily on local communities.

The two families could not even agree on why they disagreed! According to the Kings, the distrust began shortly after Mr. Graham Jr.'s death and was enhanced by the change in financial advisors, the formalization of the meetings, and the change in bookkeeper, coupled with the two families' extremely different philanthropic philosophies. Dr. and Mrs. Ford felt that the breakdown between the families was due to different views regarding The Gift Fund's mission, challenges in scheduling meetings, the need for professionalism at the foundation, and disagreements over financial strategies.

In hindsight, Mr. Graham Jr.'s decision to invite two unrelated families with different philanthropic philosophies to serve on The Gift Fund board was a mistake. As one board member said, "this is a non-family, family foundation." It quickly became clear that Mr. Graham Sr.'s 'gift of generosity' was more of a burden than a pleasure.

Final Attempt to Keep the Foundation Operational

By 2013 The Gift Fund board members were no longer having 'fun.' Faced with the prospect of dissolution, the board members agreed to make one last attempt to keep the foundation operating as such. Mr. King hired a professional nonprofit consultant and all parties agreed to attend a retreat with the consultant in January 2014.

From the consultant's perspective, The Gift Fund was divided along family lines into two camps, which nurtured mutual anger and visible distrust. In phone conversations with the board members prior to the retreat, and subsequently during the retreat, the tension between the Kings and the Fords was palpable. None of the board members made any attempt to hide their feelings. The dire situation demanded that the board members would either find common ground or agree to divide or dissolve the foundation. Interestingly, prior to Mr. Graham's Jr.'s death, Dr. Ford had already advanced the idea to split The Gift Fund into two separate foundations. At that time the proposal was brought before the board of directors, but the Kings, who were more committed to maintaining the legacy of Mr. Graham Jr., rejected the motion.

The retreat agenda included drafting a new mission statement, a grant awarding policy, and a board member succession policy. The common sentiment was that, once a clear mission and grant policy were in place, the families could learn to work together and The Gift Fund could continue in perpetuity without having to dissolve. Furthermore, if the families could build consensus around a clear mission and grant policy, The Gift Fund could finally award larger, more focused grants in order to achieve greater societal impact.

The retreat was held in a conference room at the office of the foundation's investment advisors. The consultant began with the following series of questions to assess the meaning of The Gift Fund to the individual board members and to determine their individual commitment to the foundation:

1. What does this foundation mean to you personally?
2. What is the best project/grant that you think was funded by the foundation?

3. What do you think was the founder's intention when the foundation was first established and for the future? What was the story behind the establishment of the foundation?
4. What is your vision for the future of the foundation in 10 years and 50 years?

The responses to these questions were written on medium-size index cards to ensure that the individual board members wrote a meaningful response. The answers were shared and discussed enabling the board members to reflect about their respective feelings and involvement with The Gift Fund.

The consultant determined that the board members needed fundamental training on how to properly govern a private foundation. This evolved into a discussion of individual and shared roles and responsibilities of the board members.

Individual board members and the board as a whole are expected to be informed about their specific roles and responsibilities[14]. These are identified in Table 3:

Table 3: Roles and responsibilities of the board of directors

Individual Board Member	**Whole Board**
Attend board meetings	Determine organization mission/vision/purpose
Be informed about the organization's mission, services, policies and programs	Select/hire Executive Director or CEO
Review agenda and materials prior to board and committee meetings	Support majority decision on issues decided by the board
Be involved in the strategic planning process; serve on committees and task forces	Ensure effective planning
Make a personal contribution annually	Assist in developing and implementing fundraising strategies
Inform others about the organization	Develop a comprehensive public awareness strategy
Suggest new board members	Orient new board members; assess the Board's effectiveness; assess board members performance
Remain informed on developments within the organization's field or sector	Build a competent board
Comply with conflict of interest policy	Ensure legal integrity
Maintain confidentiality	Ensure ethical integrity

Provide support to the Chief Executive/Executive Director	Assess performance regularly via formal comprehensive reviews
Assist board in reviewing fiduciary duties such as reviewing financial documents	Ensure adequate financial resources; review annual audit; and establish appropriate cash management controls
Review the 990 forms	Review and approve the 990 forms
Abide by the duty of Care, Loyalty, and Obedience	On-going training and education related to the duty of Care, Loyalty, and Obedience

Source: Ingram, 2003[15]

A discussion of private foundations as grant-making organizations and not fundraising organizations ensued as a means of setting up the challenge of creating a new mission statement. After giving careful consideration to donor intent and each board member's philanthropic interests, the following new mission statement was drafted.

> *"(The foundation) seeks to enhance opportunities for disadvantaged individuals and groups through gifts to charitable organizations that increase access to education, healthcare, and a safe and supportive environment."*

Using the new mission statement as a guide, the rest of the retreat focused on formulating a grant policy. This discussion included proper stewarding of future grants. Stewarding grants includes careful monitoring and assessing to ensure the grants were used properly and effectively. In an ideal situation, the granting organization would request mid-year reports from the grantees on how the money was being spent. In addition, the granting organization generally performs annual site visits and a comprehensive assessment of outcomes using previously agreed upon matrices. However, given the small staff size of The Gift Fund, this amount of involvement would be overwhelming and unattainable.

The Gift Fund board members decided that all grant proposals would be brought before the board for a vote. Each of the four board members could propose grants in an aggregate amount equal to one fourth of the 5% annual minimum payout requirement. Each grant proposal would be submitted to the entire board one month prior to the annual board meeting using a standardized grant proposal form. The form required the board member proposing a grant to identify the grantee organization, the proposed donation amount, and answer the following three questions:

1. How would this donation address The Gift Fund's mission?
2. How would we assess outcomes of The Gift Fund's donation?
3. Has The Gift Fund donated to this organization previously? If so, what outcomes resulted from that donation?

A discussion ensued regarding board member succession. Despite the animosity toward one another, the board members unanimously agreed not to expand the board because that would dilute their individual influence on the disbursement of funds. Furthermore, the shared concern was that additional members, particularly an uneven number of new board members, may change the dynamics in favor of one family or the other. A consensus was reached with respect to a board succession plan: each board member would give the foundation's lawyer a sealed envelope with a suggestion for a successor upon his/her respective death. The envelope would be opened upon that board member's death and the board would posthumously consider his/her recommendation for the new board member.

With the consultant present, during the retreat the board members were able to engage with one another civilly, though, according to the consultant, the underlying tensions resulted in some snippy responses and defensive behaviors. At the conclusion of the retreat the board members were optimistic that they could keep The Gift Fund operating in perpetuity without the need to dissolve. However, despite the sizable progress towards a more amicable working relationship, the board members were neither able to establish a cohesive grant policy nor formal assessment procedures for grant outcomes.

Six Months Later

Despite the efforts to keep The Gift Fund together, anger and distrust remained. Six months later, the board members convened once again with the consultant in order to discuss options for dividing or dissolving the foundation. Following a quick discussion, a motion was proposed and unanimously passed to investigate moving forward with the dissolution of The Gift Fund. A second motion was proposed and unanimously passed allowing any expenses related to the dissolution to be paid from the foundation's assets. However, it was suggested that a threshold cap be placed on the amount of dissolution costs. This resolution was meant to prevent overspending, which would deviate from the charitable intent of the foundation. If the dissolution costs would exceed the threshold, the board members noted that they may just have to learn to work together.

The board agreed to hire a nonprofit attorney and the meeting was adjourned.

The Consultant's Perspective

After this final meeting with the Gift Fund board members, the consultant's head was spinning. What happened? Thinking back to the conclusion of the retreat The Gift Fund had a new mission statement, the board members seemed to understand their roles and responsibilities, and the beginnings of a gift policy was in place. There were many unanswered questions about what had transpired since. How had the board members once again found themselves in such a state of dysfunction despite the earlier retreat? Why is there such deep hatred and distrust? Why were their funding philosophies so irreconcilable? What kept the families from finding compromise? What happened to The Gift Fund that it was in such a state of dysfunction that the only solution was to dissolve? These were substantive issues, but why were the board members so intransient against trying to fix them? Finally, what should the next steps be in order to proceed with the dissolution of the foundation in such a way that they do not further abrogate their fiduciary responsibilities?

Reflecting back on the interactions, both individually and collectively, the consultant realized that the deep hatred and distrust amongst the board members was long standing. It appeared that the board members were jealous of the relationships that Mr. Graham Jr. had with the other board members. At one point one board member confided that they were sure one of the other board members had convinced Mr. Graham Jr. to give them large sums of money. Moreover, in fact, the accused board member said virtually the same about the accuser. There appeared to be beliefs that the other parties had taken advantage of Mr. Graham Jr.'s generosity. Both families appeared to have been beneficiaries of monetary gifts for many years prior to even serving on The Gift Fund board. Accordingly, the consultant concluded that these gifts and the deep friendships both families had with Mr. Graham Jr. bred the jealousy, hatred and distrust between the two families.

While the two families had divergent giving philosophies, this was simply the result of a difference in their charitable interests. Neither philosophy should be considered better than the other. That the Kings enjoyed giving locally to organizations they were personally involved with is no better or worse than the Ford's giving of smaller grants to local, national, and international organizations. The problem was both families felt that they were making more significant and impactful gifts and scorned the other's choices. While both the Fords and the Kings talked about finding ways to give a single larger gift that may foster social change, neither was willing to give up on their existing charitable causes, nor support what the others were doing. It appeared that they intellectually may have wanted a compromise; however, the feelings of superiority that each of the families had over the other prohibited such an action.

The desire to work together to create a functioning board was fleeting. Immediately after the retreat with the consultant, the Fords suggested a change in administrators of the foundation to their personal financial consultants, which to the Kings was a sign that the Fords wanted to take control of The Gift Fund. Within days of the retreat, the Kings decided that they wanted to dissolve The Gift Fund due to a lack of trust of the Fords. In addition, despite the fact that the board members had agreed to approve of all gifts at the annual meeting, some members did not want to postpone their gift giving to the following November. Neither did they really want to discuss with the others their gift giving. It was apparent that the work done at the retreat was not going to undo the animosity between the families. As Mr. King said to the consultant, if The Gift Fund was dissolved he would be thrilled to never have to see the Fords again. It was apparent that The Gift Fund was in such a state of dysfunction that the only solution was to dissolve. It was clear that there was never going to be a compromise.

The consultant's analysis of the situation was that Mr. Graham Jr. had set the fund up to fail by his "having fun" philosophy and lack of clear mission. If only Mr. Graham Jr. had established clear donor intent, cohesive by-laws, a strong mission, a grant policy, and matrices for assessing the impact of grants, the dissolution could likely have been prevented. With so many fundamental disagreements, it is no wonder that The Gift Fund had no choice but to dissolve. But, now that this decision has been made, how could the board members act responsibly in breaking apart the foundation? "This will be the board's final task and maybe they can do this properly and responsibly," the consultant thought to herself as she ruminated about the situation.

Dissolution Options

When the Board initially resolved to dissolve The Gift Fund, it was under the impression that dissolution would be easy and simple. However, when the Board retained the services of Mr.

Johnson, a non-profit attorney, the way forward appeared much more complicated and costly than expected.

Mr. Johnson visited with all the Board members in June 2014. He explained to them that a private foundation like The Gift Fund is a tax-exempt entity. Since the status as tax-exempt entity was received by virtue of federal tax laws, dissolving the foundation was not a formality but instead required careful consideration of certain provisions of the Internal Revenue Code.[16] After gathering some key facts concerning the history of The Gift Fund, Mr. Johnson informed the Board that he would prepare a written memorandum to outline the several dissolution options available within three weeks. Before leaving the meeting, however, Mr. Johnson admonished the Board that the way The Gift Fund had been administered to this point may have already violated some tax laws. Before leaving the meeting, Mr. Johnson gave each member of the Board a copy of an IRS Publication titled "Compliance Guide for 501(c)(3) Private Foundations"[17] and asked each one of them to read it carefully. This IRS publication addressed activities that could jeopardize a private foundation's tax-exempt status and identifids general compliance requirements on recordkeeping, reporting, and disclosure for private foundations.

The Board anxiously waited for Mr. Johnson's memorandum, which arrived exactly three weeks after their first meeting. Mr. Johnson's memorandum (included in Appendix B) clearly outlined the options available. Assuming that all board members would like to have this matter finalized by the next board meeting (in November), what options might be most palatable to the Fords and the Kings respectively? What should they do?

APPENDIX A: FIDUCIARY RESPONSIBILITIES OF THE BOARD OF DIRECTORS

The concept of fiduciary responsibilities is best understood when we grasp the real meaning of the word "fiduciary." The term "fiduciary" stems from the Latin *fiducia*, which means "trust." In very general terms, when a person is entrusting someone else to take a certain action on behalf of the first person, the latter person becomes a fiduciary towards the first person. In acting on behalf of the first person, the fiduciary owes him/her a sacrosanct duty of loyalty. The purpose of the duty of loyalty is to ensure that the fiduciary will not act for his/her personal gain, but will do what is in the best interest of the person who is trusting in him/her.

In today's world, a member of the board of directors or a corporate officer owes fiduciary responsibilities directly towards the corporation and indirectly towards the shareholders. This notion is equally applicable to nonprofit organizations. Each member of the board of directors of a nonprofit organization owes a duty of trust towards the organization. This duty of trust is fulfilled when the board member does what it takes to further the organization's mission, even if this comes to his/her own detriment. Therefore, any person holding a fiduciary position should be able to separate personal interest from organizational interest and, when the two are in conflict, should choose to serve the latter.

The duty of trust embodied by a fiduciary relationship can be further dissected into three separate duties: the duty of care, the duty of loyalty, and the duty of obedience. These were established in 1974 as part of the Sibley Hospital Case,[18] whereby the presiding judge clearly clarified the legal responsibilities for nonprofit board members. Failure to abide by any of the above-mentioned duties could expose the directors and the foundation to legal liability.

Table 4: Major Areas of Nonprofit Board Member Responsibilities

Concept/Duty	Description
Care	Specifies that board members must attend meetings, read and understand materials, and pay attention in order to vote with an understanding of the issues. This also means exercising due diligence in monitoring the organization's finances. Duty of care means exercising common sense and not wasting resources as a result of inattention, recklessness, indifference, or failure to seek appropriate advice. Informed participation in all areas of stewardship is required.
Loyalty	Stipulates that board members must act in good faith by putting the interests of the organization above their own personal financial interests or those of another organization with which they may also have a formal relationship. Board members may not use their position on the board of directors to enhance their own business or financial position vis-à-vis another organization. This further includes giving undivided allegiance to the organization, respecting all decisions made by the Board and observing confidentiality related to the Board's deliberations and decision making.

Obedience	Expects that the board take actions that uphold, and are consistent with, the mission and values of the organization. Also requires that the board actions comply with all laws and regulations governing its formation and status. In order to fully exercise the duty, board members are required to have a full understanding and working knowledge of the organization's mission, bylaws and policies such that all programs and activities of the organization are executed in accordance with the mission.

Source: Worth, MJ (2009)

APPENDIX B: MEMORANDUM BY KEVIN JOHNSON, ESQ.

THE JOHNSON LAW FIRM, PLLC

Kevin Johnson, Esq.
Attorney at Law

1 Main St
Vancouver, WA 98660
Phone: (509)999-9999
Fax: (509) 999-8888

September 4, 2014

<u>ORIGINAL SENT VIA U.S. MAIL</u>
The Gift Fund
Board of Directors
105 Thousand Oaks Circle
Spokane, WA 99201

Re: Dissolving The Gift Fund
Invoice for Legal Services

Dear Board of Directors:

It was a pleasure to meet with you on August 14, 2015. I understand that you wish to dissolve The Gift Fund and that your priority is to do so in a way that minimizes costs and allows you to continue the legacy of Mr. Graham, Sr.

In essence a private foundation such as yours can dissolve in two ways, a bad one and a good one. The bad one is an involuntarily dissolution, where either the attorney general of our state or the IRS decides to shut down The Gift Fund due to the foundation's failure to abide by applicable laws. We don't want to let that happen!

The good way to dissolve a foundation is voluntarily. A voluntary dissolution begins with a resolution to this effect by you, the Board of Directors. Therefore, the first step in dissolving The Gift Fund consists of formalizing your decision to dissolve with a signed document titled Resolution to Dissolve. Once the Resolution to Dissolve is formalized in writing, you must prepare and file Articles of Dissolution with the secretary of state and notify the IRS of your intent to dissolve. If you wish to proceed with the dissolution, I can prepare and file all these documents for you.

Signing a Resolution to Dissolve, filing Articles of Dissolution, and notifying the IRS are only the first steps. Dissolving The Gift Fund from a tax perspective requires considerably more thought. In essence federal tax laws require that each dissolving private foundation pay a special tax called a "termination tax." Computing the amount of termination tax is quite complicated as it is equal to the lesser of: (1) the aggregate amount of tax benefits received by the foundation and any of its substantial contributions since inception resulting from its exempt status; or (2) the value of its net assets. As you can quickly surmise, the termination tax could cost up to the entire endowment of The Gift Fund.

Since your objective is to dissolve The Gift Fund in a way that minimizes costs and allows you to continue the legacy of Mr. Graham, Sr., I am sure you would like to know how you can avoid the termination tax such that the remaining endowment is spent for charitable purposes. Luckily there are four strategies to accomplish this task:

- <u>Option 1.</u> By distributing all of the assets as grants before terminating (also known as 'sunsetting'); or
- <u>Option 2.</u> By distributing all remaining net assets to another private foundation, which will inherit all relax tax attributes, thus effectively stepping in the shoes of The Gift Fund; or
- <u>Option 3.</u> By resolving to continue operations only for the purpose of making donations to other public charities;
- <u>Option 4.</u> By distributing all remaining net assets to one or more public charities that have been in existence for at least five years.

In any of the above options, The Gift Fund should file a final tax return on Form 990-PF as well as a protective Form 8940 to receive assurance that no termination tax is due. I can prepare and file both forms for you. I will now provide you with the key aspects of each of the four options outlined above. First, and most logically, you could let The Gift Fund simply sunset; in other words, the foundation could continue awarding grants until it distributes all of its assets and dissolve only when no assets are left to be taxed. Dissolving in this manner is the most simple and inexpensive way. The Gift Fund could be dissolved as quickly as you are able to award grants.

Second, The Gift Fund could distribute all remaining net assets to another private foundation, which in turn inherits all related tax attributes, thus effectively stepping in the shoes of The Gift Fund. This method is a mere postponement, not a true avoidance, of the termination tax. In fact, if the receiving private foundation were to terminate while still holding the assets it once received from The Gift Fund, the receiving private foundation will be liable for the termination tax that would have been due by The Gift Fund. This method only makes sense where the receiving foundation is enduring and can effectively distribute the assets. Therefore, if you choose to pursue this option, you should carefully consider your choice of a receiving foundation.

Third, the private foundation could terminate its status by becoming a public charity. This option begs the question: how can a private foundation wishing to terminate like The Gift Fund possibly become a public charity? This is rendered possible by the intricacies of federal tax law, which essentially determines that a tax-exempt organization that carries out its exempt purpose by providing support to other public charities is itself a public charity (also known as a "supporting organization"). Therefore, rather than completely dissolving The Gift Fund, you could resolve to carry on its charitable purposes solely by providing support to other public charities. This method is particularly attractive in light of the internal disputes you have experienced concerning a spending policy. By choosing this option, your spending decisions as the Board of Directors of The Gift Fund would become somewhat simpler as The Gift Fund would no longer directly award grants, but would fund other public charities, which then make direct contributions to aid recipients. For example, if you wish to make a contribution to a health cause, you could simply agree to award a grant to the Red Cross, which in turn will independently choose when and where to apply those funds.

Fourth, The Gift Fund could dissolve by distributing all its remaining net assets to one or more public charities that have been in existence for at least five years. This option comes with a variance that requires some background information. As you know, public charities welcome donations from all sources. Once money is donated to a public charity, it is generally available to further the charity's mission without strings attached. Many donors, however, may be reluctant to part ways from large sums of money and relinquish total control. Therefore, some public charities offer Donor Advised Funds, which are essentially dedicated sub-accounts within the public charity holding the donor's funds apart from the rest of the public charity's assets. Each Donor Advised Fund may feature a personalized giving policy, investment policy, or administration policy.

In effect, a Donor Advised Fund can be likened to a private foundation incubated within a public charity. For this very reason, Donor Advised Funds offer more privacy and a negligible management burden to the donor. In your case, you could choose to split the remaining endowment of The Gift Fund into one or more donor advised funds, which independently reflect the spending wishes of each faction of the Board. In other words, you could divide up the remaining net assets and spend them in a way that is consistent with what each of you believes should be the correct spending policy of The Gift Fund. While this option may appear particularly attractive and customizable, it will require considerably more time and more work on my part.

To help you with your decision, I have prepared a table to estimate the costs and timing associated with each option outlined above.

Option	**Estimated Additional Legal Fees & Costs**	**Estimated Time to Dissolve**
1 – Sunsetting	$2,000	Up to you
2 – Distribution to Other Private Foundation	$3,500	3-6 months
3 – Supporting Organization	$4,500	2-4 months
4 – Donor Advised Funds (DAF)	$10,000/per DAF	9-12 months

Attached please find your invoice for legal services rendered to this point. Make your check payable to The Johnson Law Firm, PLLC, and remit payment within 20 days of receipt of this letter.

Kindly let me know at your earliest convenience how you wish to proceed with this matter. Depending on which dissolution option you choose to pursue, I estimate that you will incur up to $10,000 in additional legal fees.

Sincerely,

Kevin Johnson

Kevin Johnson
Attorney at Law

Encl: Invoice for Legal Services

INVOICE FOR LEGAL SERVICES, JUL 25-SEP 4, 2014

Date of Service	Task Description	Hourly Fee	Minutes	Charge	Notes
July 25, 2014	Initial phone call from Dr. Ford. Scheduled appointment for August 14, 2015. Quick discussion about the scope of the engagement.	$325.00	30	$162.50	
August 14, 2014	Meeting with The Board of Directors	$325.00	120	$650.00	no charge
August 14, 2014	Costs associated with meeting with The Board of Directors: parking, toll, mileage	N/A	N/A	$33.25	no charge
August 15, 2014	Prepared notes following the meeting with The Board of Directors	$325.00	30	$162.50	
August 18, 2014	Legal Research re: dissolution of private foundations	$325.00	45	$243.75	
August 22, 2014	Began preparing written memorandum for the Board of Directors	$325.00	180	$975.00	
September 1, 2014	Phone call from Ms. King. She asked for an update on the status of my memorandum. The memo will be completed by September 5.	$325.00	15	$81.25	no charge
September 4, 2014	Completed and sent memorandum to client.	$325.00	120	$650.00	
TOTAL FOR COSTS AND EXPENSES				$33.25	
TOTAL FOR PROFESSIONAL SERVICES				$2,843.75	
AMOUNT DUE AND PAYABLE					**$2,877.00**

Make all checks payable to:

The Johnson Law Firm, PLLC
1 Main St
Vancouver, WA 98660
Phone: (509)999-9999
Fax: (509) 999-8888

Thank you for your business!

ENDNOTES

[1] The Foundation Center (www.foundationcenter.org).
[2] See Endnote 1.
[3] 26 U.S.C. § 4942.
[4] See Endnote 3.
[5] 26 U.S.C. § 4944.
[6] 26 U.S.C. § 4943.
[7] 26 U.S.C. § 4945.
[8] Worth, M.J. (2009). *Nonprofit Management: Principles and Practice*. Thousand Oaks, CA: SAGE Publications, Inc.
[9] Rockefeller Foundation (www.rockefellerfoundation.org).
[10] Carnegie Foundation (www.carnegiefoundation.org).
[11] Bill and Melinda Gates Foundation (www.gatesfoundation.org).
[12] Orosz, J.J. (2000). *The Insider's Guide to Grantmaking: How Foundations Find, Fund, and Manage Effective Programs.* San Francisco, CA: Jossey-Bass Inc., Publishers.
[13] Hummel, J.M. (1996). *Starting and Running a Nonprofit Organization (2nd ed).* Minneapolis, MN: University of Minnesota Press.
[14] Board Source , 2010, The Handbook of Nonprofit Governance, San Francisco, CA: Jossey-Bass
[15] Ingram, R.T. (2003). *Ten Basic Responsibilities of Nonprofit Boards*. BoardSource, Washington, DC
[16] All references to Internal Revenue Code are to Title 26 of the United States Code.
[17] See IRS Publication 4221-PF, Compliance Guide for 501(c)(3) Private Foundations available at: www.irs.gov/pub/irs-pdf/p4221pf.pdf.
[18] Stern v. Lucy Webb Hayes Nat'l Training School for Deaconesses & Missionaries, 381 F. Supp. 1003 (D.D.C. 1974).