



COMMUNITY  
FOUNDATION  
*of Northeast Alabama*

## **Expenditure Responsibility Due Diligence Policy**

The National Standards for U.S. Community Foundations require that a community foundation have due diligence policies that determine which grants require the exercise of expenditure responsibility.

The Pension Protection Act requires that expenditure responsibility is required for certain grants from donor advised funds. Specifically this applies to grants to organizations other than those described in section 170(b)(1)(A), type III supporting organizations that are not “functionally integrated” and any supporting organization if the organization it supports is controlled by the donor or donor appointee.

Certain grants from donor advised funds are taxable unless the community foundation follows a due diligence process called “expenditure responsibility.” Briefly, expenditure responsibility is designed to ensure that a grant is used for charitable purposes and that the community foundation maintains appropriate oversight and documentation of certain grants from donor advised funds.

Certain types of grants from Donor Advised Funds are prohibited under the Pension Protection Act of 2006. They include:

- a. Grants to individuals, including grants made directly to an organization for the benefit of a specific individual (ex: grant to a school)
- b. Grants to donors, advisors or related parties
- c. Grants for non-charitable purposes.

### **Staff Expenditure Responsibilities**

Staff has grant expenditure responsibility when such is required by law or policy.

Grants to organizations **not** described in Section 170(b)(1)(A) of the Internal Revenue Code all require expenditure responsibility. Common examples of such grants include:

- Grants to non-charities
- Grants to international organizations unless equivalency determination is followed
- Grants to private non-operating foundations

In addition, grants to certain supporting organizations (Section 509(a)(3) public charities) also require expenditure responsibility, including:

- Type III supporting organizations that are not “functionally integrated”
- Any type of supporting organization (even a functionally integrated Type III) if the organization that is being supported is controlled directly or indirectly by either the donor, donor advisor, or related party.

Supporting organizations receive public charity status from the IRS due to their particular relationship with another publicly supported charity or government unit. Based on that relationship, a supporting organization is defined as Type I, Type II, or Type III. Type III supporting organizations are further defined as functionally or non-functionally integrated. *Any type of supporting organization that supports a public charity which is controlled directly or indirectly by the donor, donor advisor, or related party requires expenditure responsibility by the Foundation. Any non-functionally integrated Type III supporting organization requires expenditure responsibility.*

**Process for Determining Whether a Grant Recommendation from a Donor Advised Fund Requires Expenditure Responsibility:**

1. Verify that the organization is a public charity by checking its status in IRS Publication 78, the organization’s IRS determination letter, or IRS Business Master File.
2. Determine if the public charity is a supporting organization from one of the following sources:
  - a. The IRS Business Master File (BMF) and the potential grantee’s IRS determination letter, or
  - b. A report from a third party that includes the grantee’s name, Employer Identification Number (EIN), and public charity classification under §509(a)(1), (2), or (3); a statement that the information is from the most currently available IRS monthly update to the BMF, along with the IRS BMF revision date; and the date and time of the Foundation’s search. The Foundation will retain this report in electronic or hard-copy form.
3. Determine the type of Supporting Organization from one of the following sources:
  - a. For **Type I or Type II** supporting organizations a written representation signed by an officer, director, or trustee of the grantee if **both** of the following are true:
    - i. The representation describes the process used for selecting the grantee’s officers, directors, or trustees and references the pertinent provisions of the grantee’s organizing documents that establish the grantee’s relationship to its supported organization.
    - ii. The CFNEA will collect and review copies of the grantee’s governing documents. If the grantee’s governing documents are not sufficient to establish the relationship, the CFNEA will also collect organizing documents from the supported organization.
  - b. For determining that a **Type III** supporting organization is functionally integrated the CFNEA will rely on a written representation signed by an officer, director, or trustee of the grantee if all of the following are true:
    - i. The Grantee’s written representation identifies the organizations it supports.

- ii. The Foundation collects and reviews the grantee's organizing documents (and those of the supported organizations if necessary).
    - iii. The Foundation collects a written representation signed by an officer, director, or trustee of each supported organization stating that the supporting organization is functionally integrated and that but for the involvement of the supporting organization, the supported organization normally would engage in those activities itself.
  - c. Alternatively, the Foundation may rely on a reasoned written opinion of counsel of either the grantee or the Foundation in making the determination that a supporting organization is a Type I, Type II, or functionally integrated Type III supporting organization.
4. Once the Foundation has determined that a potential grantee is a supporting organization and is not a Type III non-functionally integrated supporting organization (where expenditure responsibility is automatically required), the Foundation, working with local counsel, will determine whether the donor, donor advisor, or related parties control the supported organization. Control can be determined in one of the following ways:
  - a. If any donor, donor advisor, or related parties may, by aggregating their votes or positions of authority, require a supported organization to make expenditure, or prevent a supported organization from making expenditure.
  - b. Working from a collected list of organizations that the potential grantee supports, the Foundation will work with the donor(s) and advisors to determine whether any of those supported organizations are controlled by the donor, advisor, or related party. Certification from either the donor or advisor or directly from the supported organization indicating that the donor, advisor, or related parties do not control the supported organization either directly or indirectly must be obtained.

### **Process for Exercising Expenditure Responsibility**

If the CFNEA determines through the above stated processes that expenditure responsibility is required, it will perform the following steps:

1. The Foundation will conduct a pre-grant inquiry to determine whether the proposed grantee is reasonably likely to use the grant for the specified purposes.
2. The Foundation will determine whether the potential grantee is a non-charity, private foundation, or supporting organization.
3. The Foundation will conduct a pre-grant inquiry including a reasonable investigation of the grantee to ensure that the proposed activity is charitable and that the grantee is able to perform the proposed activity.
4. The Foundation will execute a written agreement with the grantee with specific terms as required by law that includes the charitable purposes of the grant and provisions that prohibit use of the funds for lobbying activities and require the grantee to return any funds not used for the designated purposes.

5. The Foundation will require the Grantee to maintain the grant funds in a separate account on the grantee's books so that charitable funds are segregated from non-charitable funds.
6. The Foundation will require the Grantee to report to the Foundation, in writing, not less than every six months during the term of the grant, explaining how it used the funds, the charitable activity supported by the grant, and describing its compliance with the grant terms and its progress toward the grant purposes.
7. The Foundation will include a report on Form 990-PF about the grant including a brief description of the grant, the amount, the charitable purpose, and the current status of the grant. (Note that the current and revised Form 990 for public charities does not have instructions indicating that such information should be reported on the Form.)

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