

Understanding Foundation Expenses

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FOCUS ON ILLINOIS

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Executive Summary

Policy discussions about grantmaking foundations often focus on how much they spend on administrative activities relative to their giving. Yet often missing in these discussions is an understanding of the nature and range of foundations' operating and administrative costs and of what drives them. Foundation size, operating characteristics, and programmatic activities are among the many factors that must be considered when assessing charitable administrative expense levels, whether in Illinois or nationwide.

To provide a more informed perspective on this issue, *Understanding Foundation Expenses: Focus on Illinois* defines and delineates charitable (program-related) administrative and operating expenses, which are those that count toward a foundation's payout requirement. The report addresses specific questions such as: Which foundation costs are included in charitable administrative expenses? What are the limitations of Form 990-PF for reporting expenditures? How are charitable administrative expense levels measured? What are the most important factors driving expense levels? It also offers first-ever

multi-year trend information (2008–2010) detailing the expense practices of large Illinois independent foundations and compares them to the national experience.

Intended for foundation leaders, policymakers, advocates, journalists, and the general public, this brief serves as a key resource for understanding foundation operating and administrative expenses and as an unbiased source of facts on actual practice in Illinois.

Among key findings from this report:

- Illinois independent and family foundations' characteristics and practices strongly influence their charitable administrative expense patterns.
- Employment of staff is the single most important factor affecting foundation charitable expense levels, followed by staff size.
- Foundations that employ staff have median charitable expense-to-qualifying distribution ratios of nearly 9 percent, on average, compared with less than 1 percent for those without staff.
- National and international grantmaking, direct charitable activities, and operating as a "health conversion" foundation are strongly associated with higher charitable expense ratios in staffed foundations.
- Donor or donor-family involvement often coincides with lower charitable administrative expense ratios.
- Compensation is by far the biggest component of expenses for independent Illinois foundations, followed by *other expenses* and *other professional fees*.
- Illinois foundation charitable expense patterns are similar to those of U.S. independent and family foundations overall, and the characteristics that are associated with higher or lower expense ratios are the same. Foundations that engage in direct charitable activities or conduct other complex activities are most likely to have the highest expense ratios.

CHAPTER 1

Understanding Foundation Expenses

Policy discussions about foundations often focus on how much they spend on administrative activities relative to their grantmaking and programmatic activities. Foundations themselves seek guidance on this question. Yet often missing in these discussions is the need to consider foundation differences—such as size, operating characteristics, and programmatic activities—when assessing foundations’ administrative and operating expenses. These differences are striking even among the largest independent and family foundations, whether in Illinois or nationwide.

What Are Charitable Administrative Expenses?

Like other nonprofit and for-profit organizations, foundations incur operating and administrative expenses in conducting their business. These may include employee salaries and benefits, compensation of officers and board members, legal and accounting fees, other professional fees, investment services, travel, rent, utilities, taxes, and other expenses. Private foundations, including independent and family foundations, report these expenses annually on IRS Form 990-PF.¹ Of the total expenditures reported, *charitable administrative expenses* are those related to carrying out a foundation’s charitable mission, including expenses for

making grants and managing grants administration, direct charitable activities, and general overhead costs.² Along with total grants, these expenses are included as part of the *qualifying distributions* that comprise a foundation’s annual payout amount. Not all operating costs qualify (see below). Throughout this brief, *charitable administrative expenses* refers only to costs that count toward meeting payout.

What Are Not Included in Charitable Administrative Expenses?

Investment-related expenses, whether employee salaries, compensation for officers or trustees, professional fees, or other costs, do not qualify as charitable, i.e., program-related, and are therefore not included in qualifying distributions. These expenses are reported separately on IRS Form 990-PF.³

Why Do Charitable Administrative Expenses Matter?

Among policy issues, payout—the federal requirement that foundations distribute at least 5 percent of their investment assets annually for charitable purposes—is one of the most debated by watchdog groups, legislators, and the media. Because charitable operating and

“The 990-PF is the only public tool we have for comparing foundation expenses.”

Foundation Perspectives on Expense Reporting

The Donors Forum convened executive and financial officers from seven Illinois foundations in June 2013 to discuss the challenges they face in reporting on their charitable expenses, particularly using the IRS Form 990-PF. Comments from that convening are included as sidebar quotes throughout this chapter.

grantmaking/grants management expenses count toward payout, these expenditures figure prominently in such discussions. Policymakers and others want to know how much foundations spend relative to their grantmaking and programmatic activities, while foundations themselves seek guidance on this question from their peers and associations.

Do All Foundations Report Charitable Administrative Expenses?

In general, larger foundations are very likely to hire professional staff and invest in the infrastructure needed to conduct their programs. In recent national studies of larger independent and family foundations,⁴ only a small minority did not claim any program-related costs toward their payout amount.⁵ Presumably, these foundations relied on volunteer personnel to get their work done, while the donor or the donor's company may have absorbed other types of expenses, such as rent, utilities, and legal and accounting fees. Smaller foundations are less likely to employ staff and report other types of expenses.

Many small givers, especially those recently established and as yet unendowed, are administered wholly by unpaid family members or other volunteers. As foundations start to build their endowments and their programs grow and become more complex, they tend to hire staff to assist with grants administration and other activities and assume related costs.

What Are the Biggest Components of Foundations' Charitable Expenses?

For foundations that report expenses on Form 990-PF, compensation paid to staff, officers, and trustees (if applicable) for duties related to charitable activities typically accounts for the lion's share of costs.⁶ In addition to employee salaries and officer and board member remuneration, total compensation also includes pension plans and other benefits.⁷

After compensation, larger foundations tend to report spending the most for two ill-defined residual categories intended to capture expenses that do not fit into the form's specified line items: *other professional fees*,⁸ which refers to consulting services such as those for grants administration, communications, and evaluation; and *other expenses*,⁹ such as equipment and supplies, maintenance, and new technology.¹⁰ Because these catch-all categories provide no cost breakdowns, their usage obscures the purpose of many millions of dollars of foundation spending (see below).

Among the other specified expense categories listed on the form, larger foundations typically spend the most for rent (including utilities) and travel.¹¹ They spend the least for legal and accounting fees, printing and publications, taxes, and interest.¹²

“It's ‘one size fits all’; the 990-PF satisfies the needs of the IRS but doesn't provide the flexibility to really show our expenses.”

How Completely Does Form 990-PF Portray Foundation Expenses?

While IRS Form 990-PF is a uniquely valuable resource for examining foundation expenses, it has not kept up with the changing activities and costs incurred by private foundations and needs to be improved to promote greater clarity.¹³ Specifically, the 990-PF does not document foundations' relatively new kinds of expenses, such as communications, technology, and evaluation, and the extent of their reliance on consultants to manage these highly specialized activities. Nor does it adequately capture foundations' growing involvement with direct charitable activities, such as operating direct service programs or conducting research (see page 4). Until such types of staff- and resource-intensive activities are better reported, the 990-PF will not properly inform the public about grant- and program-related expenses, and for some foundations it will overstate charitable administrative and operating costs relative to qualifying distributions.

Among other limitations, the 990-PF does not separate salaries paid to officers who are also staff members from remuneration paid to trustees, which would improve data on compensation. Also, donated labor and in-kind gifts of space, equipment, and services are not captured. For this reason, the true cost of running many family foundations cannot be assessed.

How Are Charitable Administrative Expense Levels Measured?

The Foundation Center's studies measure the ratio of charitable expenses to total qualifying distributions for a sample of independent foundations with diverse missions, characteristics, and operating styles. Qualifying distributions, as noted above, are all disbursements that count toward a private foundation's payout amount. These include mainly grants, which account for the greatest share of distributions for most foundations, and direct charitable activities and program-related administrative expenses.¹⁴

Examining the relationship between charitable expenses and qualifying distributions for foundations with or without certain characteristics or activities shows how the different ways that foundations conduct their work raise or lower expense levels. This approach provides insight into the diversity of the foundation community and sheds light on the non-grantmaking charitable activities of foundations. For each characteristic, the study measures the median ratio (middle value) of expenses to qualifying distributions. To smooth the effect of large one-time fluctuations in spending, financial data are averaged over three years.

“ We can't use the 990-PF as a management tool. But the public judges our management based on what they see in it. ”

Are There Limits on Charitable Expense Levels?

Federal tax law permits foundations to report *reasonable* and *necessary* administrative costs related to their charitable activities among the qualifying distributions that count toward their 5 percent payout requirement. The law *does not* set a limit on administrative expense levels as a portion of total charitable distributions, nor does it set a minimum level for grants as a portion of overall distributions. Given the heterogeneity of foundations' missions and activities, one-size-fits-all limitations on charitable administrative expense levels or target ratios of expenses to qualifying distributions would likely have unintended consequences for foundations and the people they serve.

What Is the Single Most Important Factor Driving Foundation Expense Levels?

Employing staff influences independent foundations' expense levels more than any other characteristic that is measurable using public information. In general, foundations with paid staff¹⁵ spend far larger portions of their total qualifying distributions on program-related expenses than those without staff, and expense ratios rise consistently along with staff size.¹⁶ On the other hand, foundations with roughly the same number of staff tend to have decreasing median expense ratios as giving levels increase, suggesting economies of scale.¹⁷ While employing more

staff is often associated with bigger endowments and giving programs, what foundations do as much as how big they are affects the need for staff.

What Other Characteristics Predict Higher Expense Levels?

While foundation spending levels are certain to rise with staffing, they are likely to increase even more when foundations with staff engage in certain complex activities. At the national level, factors that have consistently predicted much higher expense ratios include: making grants internationally, operating grants-to-individuals programs, and engaging in direct charitable activities. Lesser factors that are associated with higher expense levels nationally include making program-related investments (which requires unique staff or outside expertise), maintaining a web site (a proxy for a larger communications effort), and operating as a health conversion foundation (based on the operating style of these institutions).¹⁸ This brief focuses on three characteristics or practices that influence spending levels and considers the effect of foundation size on each of them.

DIRECT CHARITABLE ACTIVITIES

Whether foundations achieve their missions solely by grantmaking or through a mix of grants and foundation programs—also known as direct charitable activities (DCAs)—strongly affects their expenditure levels. Such activities range from operating nonprofit conference centers or museums to providing technical assistance to grantees to maintaining web sites for

“People are looking at one figure on the 990-PF and trying to draw a complex conclusion. But these are not magic numbers and cannot tell a nuanced story.”

the public on mission-related issues. In general, the relatively small share of staffed foundations that engage in DCAs have notably higher expense-to-qualifying distribution ratios than those that only make grants.¹⁹ Not surprisingly, foundations that run their own programs tend to require relatively large staffs. As discussed above, more staff drives up costs, especially for smaller foundations.²⁰ Despite their higher costs, more foundations are engaging in DCAs,²¹ perhaps because of their hands-on appeal to donors. As these non-grantmaking program activities become more widespread, it is critical that the costs be better represented on Form 990-PF and better understood in foundation spending debates.

GEOGRAPHIC SCOPE OF GIVING

The geographic focus of a foundation's program strongly influences administrative expense levels. In general, expense levels increase with a wider scope of giving—and most dramatically for international giving. Presumably, a larger staff is needed to manage distant programs, and expense levels rise for items including travel, communications, operating overseas offices, and consulting services. These increased costs are highest for smaller foundations.²² Foundations that make grants overseas bear additional burdens associated with the post-9/11 era, such as tighter regulations on making grants to non-U.S. organizations, more rigorous due diligence requirements for screening grantees, and increased security needs. Of course, such

costs must be weighed against other gains: grantmakers engaging in international work—especially in the developing world—often find that their philanthropic dollars are worth more in the most impoverished countries and therefore will have a greater impact.

MAINTAINING A WEB SITE

Foundations' communications efforts aimed at informing the public about their programs and the work of their grantees often represent a significant investment. For lack of a more comprehensive measure, the presence of web sites has served as a proxy for larger communications and outreach efforts in foundation expense studies. Throughout the years studied, the practice of maintaining a web site has been associated with higher median expense levels. Smaller foundations bore the highest costs.²³ While the presence of web sites appears to be associated with higher spending, this factor by itself is unlikely to affect administrative expense patterns. Rather, foundations that invest in developing and maintaining web sites likely spend more for communications overall and for related technology, consulting services, and larger staffs. Together these costs may drive up administrative expense ratios. As foundations invest more heavily in web-based communications and social media (and less in print media²⁴), it is vital that such activities be represented on Form 990-PF.

“There is nowhere on the 990-PF to show the scope of our international work.”

Which Foundation Characteristics or Activities Predict Lower Cost Levels?

Two identifiable practices appear to moderate the charitable administrative expenses portion of qualifying distributions: donor-family involvement and operating as a pass-through foundation.

DONOR-FAMILY INVOLVEMENT

Donor or donor-family involvement in foundation operations consistently and notably reduces charitable expense levels.²⁵ The importance of this factor is magnified by its prevalence: family foundations typically make up the majority of staffed foundations in samples of larger independent foundations. While family involvement reduces median expense levels for all sizes of staffed foundations, the impact of this factor is strongest for the very largest foundations.²⁶ The lower expense ratios for family foundations compared to non-family foundations suggests that family members hold staff-related costs down by providing no- or low-cost labor for administering grants and other programs. Evidence of such support is seen in lower typical numbers of staff in family foundations compared with non-family foundations of similar size.²⁷ In addition to the work they perform, family members may also lower costs by contributing office space, equipment, administrative services such as legal and accounting, and investment services.

PASS-THROUGH STATUS

Similar to donor-family involvement, operating as a non-endowed or “pass-through” foundation tends to lower expense levels, although there are relatively few examples since most larger independent foundations maintain endowments.²⁸ Similar to the impact of donor involvement, the effect of pass-through status tends to be strongest among the biggest givers. As the size of giving programs decreases, the effect of this factor is less consistent. The higher expense levels associated with endowed foundations compared to pass-throughs suggest that these foundations employ larger, more specialized staffs. Since pass-through foundations have no permanent corpus, they may not invest heavily in staff and other long-term infrastructure.

They are also far less likely than endowed foundations to engage in staff- and resource-intensive direct charitable activities and are more likely to demonstrate family involvement.²⁹

Conclusion

Identifiable factors consistently and predictably influence program-related administrative expense patterns of large independent and family foundations, and these effects persist over time. Documenting the relationship of foundation characteristics and practices to charitable expense levels sheds light on how large foundations work and achieve their missions. Hiring staff and employing more staff drives

“While there are guidelines, I think it’s not entirely clear what constitutes a direct charitable activity.”

up expense levels more than any other factor. While employing more staff is often associated with bigger endowments, what foundations do as much as how big they are affects the need for staff. Undertaking more complex activities, such as international grantmaking, direct charitable activities, and making grants to individuals, tends to increase staffing levels and raise other costs. Smaller foundations often bear the highest costs. Conversely, operating with donor-family involvement and as a non-endowed or “pass-through” foundation are practices usually associated with lower charitable administrative expense levels. Foundation oversight and regulation would benefit from deeper understanding of the diversity of foundations’ missions and activities. To promote better understanding and greater transparency, improvements are needed in IRS Form 990-PF. This key information source has not kept pace with the changing activities and costs incurred by private foundations.

ENDNOTES

1. Total administrative expenses is reported on IRS Form 990-PF, Part I, line 24, *column a*. For an explanation of the components of “administrative overhead costs” from a grantmaker’s perspective, see the Gates Foundation’s *Reader’s Guide to the Form 990-PF*, page 3, at docs.gatesfoundation.org/about/documents/2010-readers-guide.pdf.
2. Total charitable administrative expenses is reported on IRS Form 990-PF, Part I, line 24, *column d*.
3. Total investment-related expenses is reported on IRS Form 990-PF, Part I, line 24, *column b*.
4. Throughout this brief, references are made to two studies of larger independent foundations conducted by the Foundation Center. *Benchmarking Foundation Administrative Expenses: How Operating Characteristics Affect Spending* (2011) examined 1,026 foundations between 2004 and 2006. *Benchmarking Foundation Administrative Expenses: Update on How Operating Characteristics Affect Spending* (2012) examined 1,171 foundations between 2007 and 2009. (Visit foundationcenter.org/gainknowledge to access these reports).

Foundations included in each study gave at least \$2 million a year; giving (vs. assets) served as the measure of foundation size so that unendowed foundations that nevertheless had consistently large grantmaking programs were not excluded.

5. Between 2004 and 2006, nine of every 10 foundations studied reported some charitable expenses as part of their qualifying distributions. Between 2007 and 2009, the share of foundations was seven out of eight. In both study periods, two of every three foundations had at least one paid staff or reported compensation for grants administration or other program-related activities.
6. Between 2004 and 2006 and 2007 and 2009, compensation accounted for 50 percent and 46 percent, respectively, of the total charitable administrative expenses among studied foundations.
7. Compensation that qualifies toward payout is reported on Form 990-PF, Part I, lines 13–15, *column d*.
8. The instructions for Form 990-PF provide two examples of *other professional fees*: those for fundraising or investment services charged by outside firms or individuals. (Note that the latter example does not qualify as a charitable expense.) Foundations that report legal, accounting, or other professional fees are required to attach a schedule showing the type of service and expense for each.
9. The instructions for Form 990-PF provide no examples of possible *other expenses*. Foundations that report other expenses are required to attach a schedule showing the type and amount of each expense.
10. Between 2004 and 2006 and 2007 and 2009, *other professional fees* and *other expenses* together represented 32 percent and 38 percent, respectively, of the total charitable administrative expenses of studied foundations. On Form 990-PF, *other professional fees* and *other expenses* are reported in Part I, lines 16c and 23, respectively (*column d*).
11. Between 2004 and 2006 and 2007 and 2009, occupancy (rent and utilities) represented 6 percent of total charitable administrative expenses, while travel and conferences represented 5 percent. Occupancy and travel are reported on Form 990-PF, Part I, lines 20 and 21, respectively (*column d*).
12. Except for legal fees, which represented 2 percent of expenses, none of the remaining expense categories represented more than 1 percent of the total charitable administrative expense dollars reported by foundations between 2004 and 2006 and 2007 and 2009.
13. More detailed suggestions for changes to IRS Form 990-PF are found in the Foundation Center’s 2004–2006 study (page 6). These and other recommendations were first proposed in *Foundation Expenses and Compensation: How Operating Characteristics Influence Spending* (Washington, DC: The Urban Institute, the Foundation Center, and GuideStar, 2006).
14. Qualifying distributions also include program-related investments (PRIs) and set-asides.
15. Between 2004 and 2006 and 2007 and 2009, approximately two-thirds of the more than 1,000 larger independent foundations studied were flagged as staffed either because they provided this information via surveys or because they reported staff-related compensation on IRS Form 990-PF.

“Foundations don’t need to be defensive about their expenses. They need to figure out how to do a better job of telling their own stories.”

16. Between 2004 and 2006 and 2007 and 2009, foundations with staff had median expense ratios of roughly 8 percent, on average, compared with less than 1 percent for those without staff. In both periods, foundations with one staff had the lowest median expense ratios (2–3 percent), while foundations with more than 50 staff had the highest median ratios (15–17 percent).
17. Between 2004 and 2006, foundations with four to six staff (a typical staff size category) had median expense ratios of close to 16 percent when giving was under \$3 million but just 5 percent when giving exceeded \$10 million.
18. Not all of these factors apply to broad enough segments of the foundations to be meaningful at the state level. To learn about the relationship of the other characteristics to spending ratios, see the complete 2004–2006 and 2007–2009 studies, which are available at foundationcenter.org/gainknowledge.
19. Between 2004 and 2006 and 2007 and 2009, DCA foundations had median expense ratios that were at least twice as high as those of non-DCA foundations.
20. Also, for some smaller foundations DCAs represent a major portion of their charitable work. In contrast, these activities tend to be a more modest share of larger foundations' diversified charitable "portfolios."
21. The share of staffed foundations that engaged in DCAs rose from 18 percent between 2004 and 2006 to 20 percent between 2007 and 2009. The very biggest foundations were by far the most likely to report DCAs.
22. Between 2004 and 2006 and 2007 and 2009, international givers reported median expense ratios that were nearly twice as high as local givers and about 50 percent higher than national givers. In both study periods the smallest givers that made grants internationally had the highest median ratios while the very largest givers that made grants only locally had the lowest median ratios.
23. Between 2004 and 2006 and 2007 and 2009, larger foundations with web sites had median expense ratios that were more than twice as high as foundations without a web site. As foundation giving size increased, the relative cost for maintaining a web site decreased.
24. Currently, *printing and publications* is the only communications-specific charitable expense line item on IRS Form 990-PF (Part I, line 22, column d).
25. Between 2004 and 2006 and 2007 and 2009, family foundations studied had median expense ratios of approximately 6 percent, compared to 10 percent for non-family foundations.
26. The median expense ratios of the very largest family foundations (by giving) were one-half as large as those of the largest non-family foundations. The difference in spending levels was also acute for the smallest givers. It was more moderate for mid-sized foundations.
27. Based on findings from the 2004–2006 study. See Chapter 3, Endnote 20 (page 25).
28. Between 2004 and 2006 and 2007 and 2009, pass-through foundations in the studies had median expense ratios that were approximately one-half as high as endowed foundations. The relatively few staffed pass-through foundations that gave at least \$10 million, on average, had the lowest spending ratios.
29. Between 2004 and 2006, a larger proportion of pass-through than endowed foundations demonstrated family involvement. The foundations that operated as pass-throughs and had family involvement reported the lowest median expense ratio of any group of staffed foundations studied.

CHAPTER 2

What Drives Foundation Expenses in Illinois

This chapter explores how variations in foundations' characteristics, activities, and giving levels influence charitable (program-related) administrative expense levels for a sample of 90 of the approximately 130 largest Illinois independent foundations between 2008 and 2010 (see "Sampling Information"). Since these organizations account for the majority of foundation resources in the state, they are of paramount interest to Illinois policymakers, watchdog organizations, and foundation leaders concerned with self-regulation.

To provide a context for Illinois foundations' expense patterns, this brief compares them with a national sample of foundations of similar size. Such comparisons confirm that at the broadest level, patterns of expenses for Illinois's

larger independent foundations were consistent with those of larger U.S. independent foundations overall during the study period.

Illinois Foundation Operating Characteristics and Expense Patterns, 2008 to 2010

Illinois independent foundations' characteristics strongly influence their charitable expenses.

Even among the largest foundations, differences in giving levels, endowments, operational styles, geographic reach, and programs vary dramatically and produce very different expense patterns. While some Illinois independent foundations in this study reported expenses in the millions in 2008–2010, one in six of these larger

grantmakers reported no expenses as part of their qualifying distributions in that period. Nearly one in two had no paid staff (Figure 1). These foundations were likely functioning with volunteer labor and/or operating costs were absorbed by the donor or the donor's family business. Compared with U.S. foundations of similar size, larger Illinois independent foundations were a little less likely to report program-related expenses; they were more likely to operate without paid staff.¹

Employment of staff is the single most important factor affecting Illinois foundation expense levels, followed by staff size.

Having paid staff significantly raises administrative costs, and expense levels tend to increase with the number of staff. Similar to

What Are Independent Foundations?

Independent foundations, including family foundations, typically derive their funds from a single source, usually an individual or family. The activities of these private foundations are governed by the U.S. tax code and its regulations. Two regulations are particularly relevant to this study of foundation expenses: (1) private non-operating foundations are required to distribute for charitable purposes a minimum of 5 percent of the average monthly value of that year's investment assets; and (2) they must file with the IRS the annual information Form 990-PF, which includes information on finances, grants awarded, direct charitable activities, and other charitable expenses that qualify toward the payout requirement.

Independent foundation activities may be conducted by paid staff, consultants, paid or unpaid board members, institutional trustees, or some mix of these groups. Some independent foundations finance their grants and expenses from endowment earnings; others "pass through" funds—that is, they maintain a small or no endowment and cover grants and expenses with periodic gifts.

Independent foundations may operate programs locally, nationally, or internationally. Although the principal activity of independent foundations is grantmaking, they may accomplish their mission through a range of activities, including foundation-administered programs and program-related investments, which require unique staff or outside expertise.

sampled U.S. foundations, Illinois independent foundations with more than three staff had median expense levels that were notably higher than those with fewer staff (Figure 2).² But whereas median expense levels of foundations in the national-level sample rose gradually and consistently as staff size increased, median expense levels grew much faster for Illinois foundations with four to 10 staff and then contracted at the top of the staff-size range (more than 10 staff). Staff size, which varies greatly even among foundations with similar giving levels, depends on a foundation's mission, roles, and scope of activities. In general, the foundations that tend to give the most have the largest staff, but smaller foundations with complex programs often have above-average staff size relative to their giving.

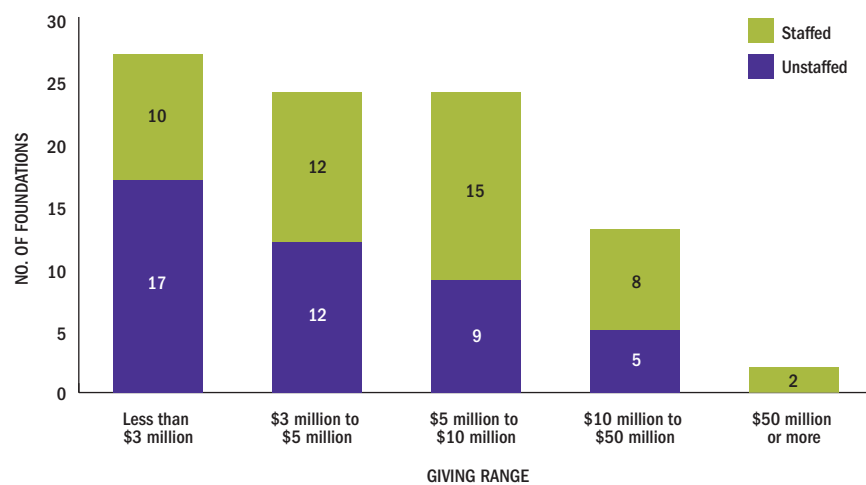
Illinois foundations that employed staff had median charitable expense ratios of nearly 9 percent, on average, compared with less than 1 percent for those without staff.

Just 23 percent of staffed Illinois independent foundations had a charitable expense ratio below 5 percent, while 98 percent of unstaffed foundations were in this range (Figure 3). More than half of staffed foundations (55 percent) had ratios of less than 10 percent. At the top end of the spectrum, a handful of larger Illinois foundations had ratios greater than 30 percent. Compared with sampled U.S. foundations with staff, slightly bigger proportions of Illinois foundations were in the higher expense ranges. Yet the median ratio for larger staffed Illinois and U.S. foundations was strikingly similar (8.6 percent vs.

8.2 percent) (Figure 4). Also, size of giving was not a steady predictor of higher or lower expense levels for staffed foundations in either sample. In Illinois, for example, foundations that gave \$5 million to \$10 million a year, on average, had the highest median charitable expense ratio

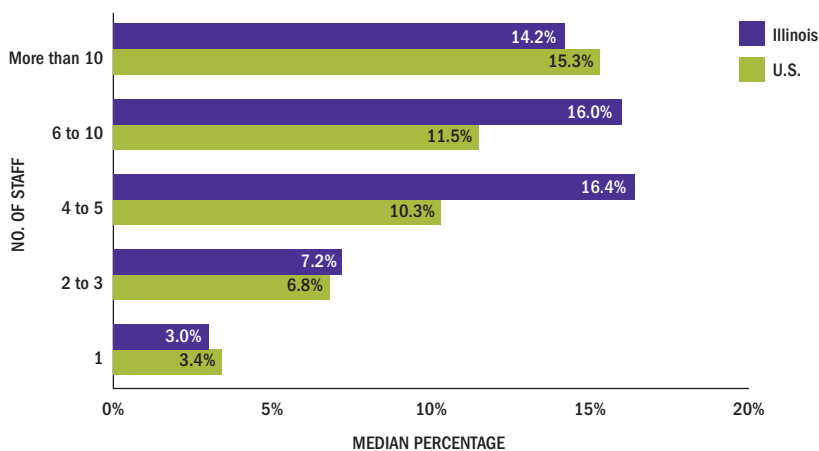
by far (nearly 14 percent),³ while smaller and larger givers had lower median ratios. At the national level, the smallest givers had the highest median ratio (just over 10 percent), while mid-size givers had the lowest ratios.

FIGURE 1: Large Illinois Independent Foundations by Staffing Status and Giving Range, 2008–2010



SOURCE: The Foundation Center, 2013: The Foundation Finances Database (2008–2010). Sample includes 90 of the approximately 130 top Illinois-based foundations by giving in 2008, 2009, and 2010 for which data were available for all years; qualifying foundations gave at least \$1.8 million in two or more years. Giving level is based on a three-year average for 2008–2010.

FIGURE 2: Charitable Administrative Expenses as a Share of Qualifying Distributions by Staff Size for Staffed Large Illinois and U.S. Independent Foundations, 2008–2010



SOURCE: The Foundation Center, 2013: The Foundation Finances Database (2008–2010). Sample includes 90 of the approximately 130 top Illinois-based foundations by giving in 2008, 2009, and 2010 for which data were available for all years; qualifying foundations gave at least \$1.8 million in two or more years. Of the 90 foundations sampled, 47 had paid staff including 45 for which number of staff was available. (For comparative purposes, the sample includes 1,218 U.S. foundations that met these criteria. Of those sampled, 722 employed staff including 679 for which number of staff was available.) Data are based on a three-year average for 2008–2010.

Direct charitable activities, national and international grantmaking, and operating as a health conversion foundation are strongly associated with higher expense levels for Illinois foundations.

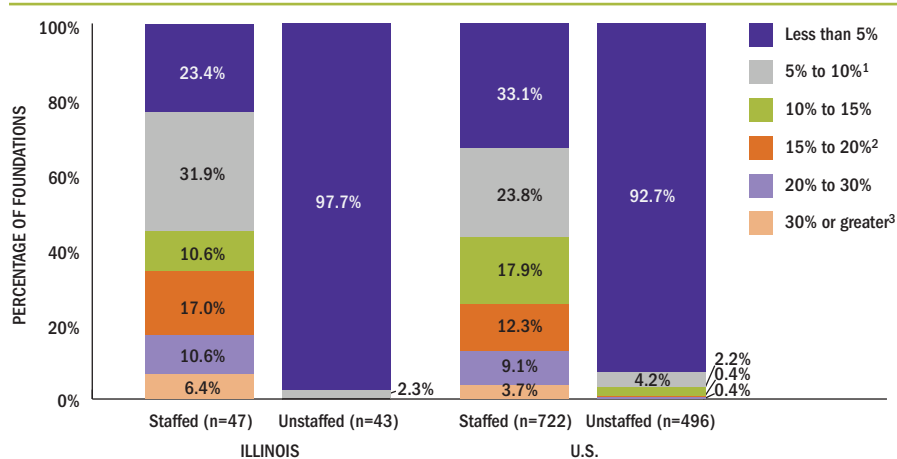
The relatively small number of Illinois-based independent foundations that engaged regularly in each of these practices between 2008 and 2010 had median expense-to-qualifying distribution ratios that were 50 to nearly 100 percent higher than those that did not (see Table), and the results were consistent each year. As noted earlier, the staff- and resource-intensive nature of these activities contributes to higher spending levels. A far more widespread foundation practice that predicted much higher administrative expense levels was maintaining a web site, which in this study serves as a proxy for a broader and costlier communications efforts. Between 2008 and 2010, the two out of three Illinois foundations with web sites had expense levels that were nearly three times greater than those without. Smaller foundations that invested in web sites had a much higher relative cost than did the larger foundations, which tend to enjoy some economies of scale.⁴

Illinois foundations with high charitable administrative expense levels often mix grantmaking and direct charitable activities.

While making grants is the primary function of most Illinois foundations, approximately one in four of the staffed independent foundations in this study engaged regularly in direct charitable activities

(DCAs) (Figure 5), ranging from operating a scholarship program for individuals to mapping community-based data to conducting organizational assessments for nonprofits. Only staffed foundations in the sample reported direct charitable activities. In fact, most of the 11 DCA foundations employed at least four staff and two of them had 20 or more staff.

FIGURE 3: Charitable Administrative Expenses as a Share of Qualifying Distributions by Staffing Status for Large Illinois and U.S. Independent Foundations, 2008-2010



SOURCE: The Foundation Center, 2013: The Foundation Finances Database (2008-2010). Sample includes 90 of the approximately 130 top Illinois-based foundations by giving in 2008, 2009, and 2010 for which data were available for all years; qualifying foundations gave at least \$1.8 million in two or more years. Of the 90 foundations sampled, on average 47 had paid staff. (For comparative purposes, the sample includes 1,218 U.S. foundations that met these criteria of which 722 employed staff.) Charitable administrative expenses ratios are based on a three-year average for 2008-2010. Due to rounding, figures may not add up to 100 percent.

¹In Illinois, no unstaffed foundations had an average expense to qualifying distribution ratio greater than 10 percent.

²Nationally, no unstaffed foundations had an average ratio of 15 percent to 20 percent.

³At the Illinois level, the highest expense ratio for staffed foundations was 45 percent; at the national level, five staffed foundations (but no unstaffed foundations) had ratios above 50 percent.

Sampling Information

This study focuses only on large independent foundations, which includes family foundations. The sample includes 90 Illinois-based foundations that ranked consistently among the state's approximately 130 largest independent and family foundations by giving in 2008, 2009, and 2010 and for which IRS Form 990-PF was available publicly for all years. These foundations gave \$1.8 million or more in at least two out of three study years. (For comparative purposes, the national sample includes 1,218 U.S. foundations that met these giving criteria.)

While foundations in the study represented less than 3 percent of all Illinois independent foundations in 2008, they accounted for more than 57 percent of all giving by Illinois independent foundations that year and 61 percent of all independent foundation assets.

Foundations of all sizes engaged in DCAs. Whether large or small, most foundations absorbed substantial costs for engaging in these staff- and resource-intensive activities, and their administrative expense ratios were among the highest reported. For example, one-half of the Illinois independent foundations in this study with charitable expense ratios greater than 20 percent and two-thirds of those with ratios greater than 30 percent engaged in DCAs.

Donor-family involvement usually lowers charitable administrative expense ratios for Illinois staffed foundations.

More than three in five staffed Illinois independent foundations reported donor or donor-family involvement, and these foundations together had median expense levels that were less than half as high as non-family foundations (Figure 6).⁵ While staffed foundations of all giving levels had notably lower expense ratios, the savings were most striking for smaller family foundations. Family members may help hold down staff-related costs by providing unpaid grants and program administration and other help. Family-owned businesses may provide free office space, equipment, and accounting and legal services.

Components of Large Illinois Independent Foundations' Charitable Administrative Expenses

Compensation is by far the biggest component of Illinois foundation expenses.

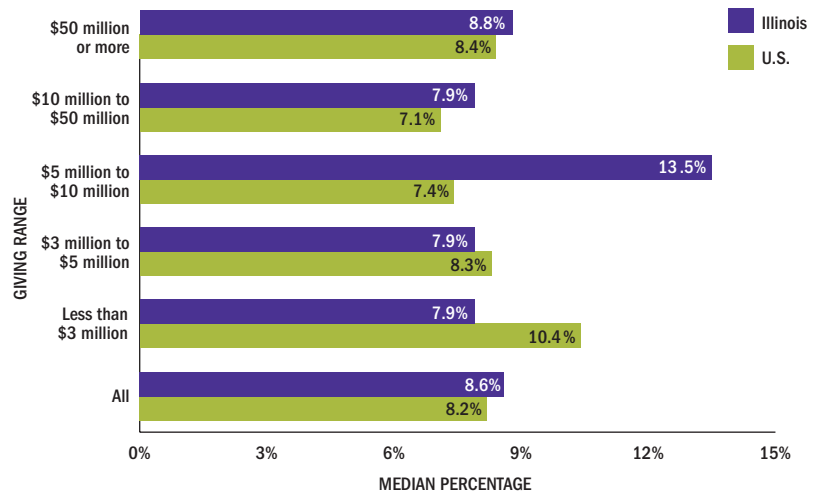
Compensation accounted for 53 percent, on average, of all 2008–2010 charitable administrative

expense dollars of sampled Illinois independent foundations⁶ (Figure 7), and that share varied only a little by year. In addition to employee salaries and remuneration of officers and board members, charitable (program-related) compensation includes pension plans and other benefits associated with a foundation's mission and programs. Excluded are salaries and remuneration for investment-related activities.

After compensation, the largest Illinois foundation expense categories by share of dollars are "other expenses" and "other professional fees."

Between 2008 and 2010, 24 percent of sampled Illinois independent foundations' expenditures went to *other expenses*, which is a residual category for costs such as equipment, maintenance, insurance, and fees that do not fit into one of the

FIGURE 4: Charitable Administrative Expenses as a Share of Qualifying Distributions by Giving Range for Staffed Large Illinois and U.S. Independent Foundations, 2008–2010



SOURCE: The Foundation Center, 2013: The Foundation Finances Database (2008–2010). Sample includes 90 of the approximately 130 top Illinois-based foundations by giving in 2008, 2009, and 2010 for which data were available for all years; qualifying foundations gave at least \$1.8 million in two or more years. Of the 90 foundations sampled, on average 47 employed staff. (For comparative purposes, the sample includes 1,218 U.S. foundations that met these criteria of which 722 employed staff.) Giving level is based on a three-year average for 2008–2010.

TABLE: Operating Characteristics Affecting the Charitable Administrative Expense Ratios of Staffed Large Illinois Independent Foundations, 2008–2010

	Yes		No	
	Median Expense Ratio	No. of Foundations	Median Expense Ratio	No. of Foundations
Undertakes direct charitable activities	16.2%	11	8.5%	36
Operates as a health conversion foundation	16.1%	4	8.6%	43
Makes grants nationally and/or internationally	12.1%	11	7.9%	36
Maintains a web site	13.5%	31	5.1%	16

SOURCE: The Foundation Center, 2013: The Foundation Finances Database (2008–2010). Sample includes 90 of the approximately 130 top Illinois-based foundations by giving in 2008, 2009, and 2010 for which data were available for all years; qualifying foundations gave at least \$1.8 million in two or more years. Of the 90 foundations sampled, on average 47 had paid staff.

major expense line items listed on Form 990-PF. Another 7 percent of expense dollars went to *other professional fees*, which refers in general to consulting services associated with grants administration, communications, evaluation, etc. But because both of these categories are vaguely defined and often used as catch-alls, it is questionable whether foundations are using the same line items on Form 990-PF to report the same expenses (see below).

Illinois foundations' distributions by major expense categories differ from U.S. foundation patterns, but spending overall for the top three categories is the same.

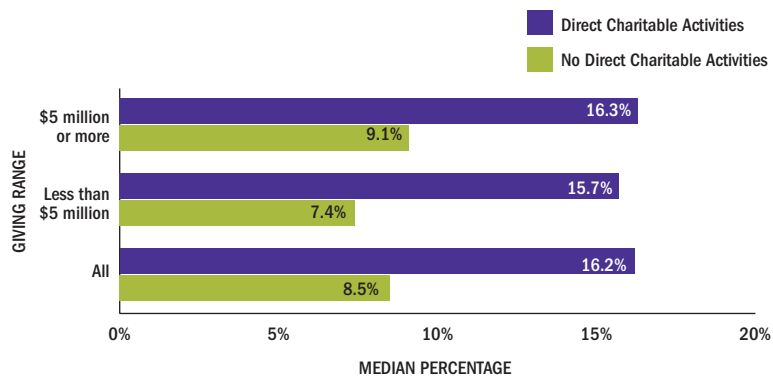
Compared to a national-level sample of foundations of similar size, large Illinois independent foundations reported a bigger share of their expenditures for compensation but a far smaller share for *professional fees* (Figure 8). It appears that Illinois foundations rely more on internal staff for grantmaking, program administration, and other functions and less on consultants. At the same time, Illinois foundations had a disproportionate share of *other expenses* compared to their peers nationwide. A review of the Forms 990-PF of a handful of Illinois foundations with the largest *other expenses* confirmed that for some, especially those with operating programs, this expense category included consultants' fees as well as undefined, aggregated program costs.⁷ The Form 990-PF would benefit from revisions to improve reporting on direct charitable activities and to include new types of foundation expenses.

Despite these differences in expense patterns, it bears noting that compensation, *other professional fees*, and *other expenses* represented approximately 84 percent of the overall charitable administrative expense dollars of both large Illinois-based and U.S.-based independent foundations. Also, the shares of spending for lesser expense items, such as travel and conferences, occupancy, and legal fees, were similar for both foundation samples.

CONCLUSION

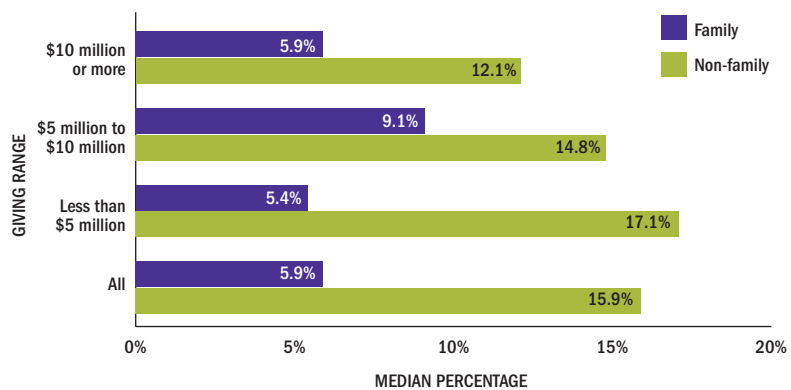
Broadly speaking, the charitable administrative expense patterns of Illinois foundations are similar to those of U.S. foundations overall, and the operating characteristics and practices that are associated with higher or lower expense ratios are the same. Employing staff is the single most important factor

FIGURE 5: Charitable Administrative Expenses as a Share of Qualifying Distributions by Engagement in Direct Charitable Activities for Staffed Large Illinois Independent Foundations, 2008-2010



SOURCE: The Foundation Center, 2013: The Foundation Finances Database (2008-2010). Sample includes 90 of the approximately 130 top Illinois-based foundations by giving in 2008, 2009, and 2010 for which data were available for all years; qualifying foundations gave at least \$1.8 million in two or more years. Of the 90 foundations sampled, on average 47 had paid staff.

FIGURE 6: Charitable Administrative Expenses as a Share of Qualifying Distributions by Family Foundation Status for Staffed Large Illinois Independent Foundations, 2008-2010



SOURCE: The Foundation Center, 2013: The Foundation Finances Database (2008-2010). Sample includes 90 of the approximately 130 top Illinois-based foundations by giving in 2008, 2009, and 2010 for which data were available for all years; qualifying foundations gave at least \$1.8 million in two or more years. Of the 90 foundations sampled, on average 47 had paid staff.

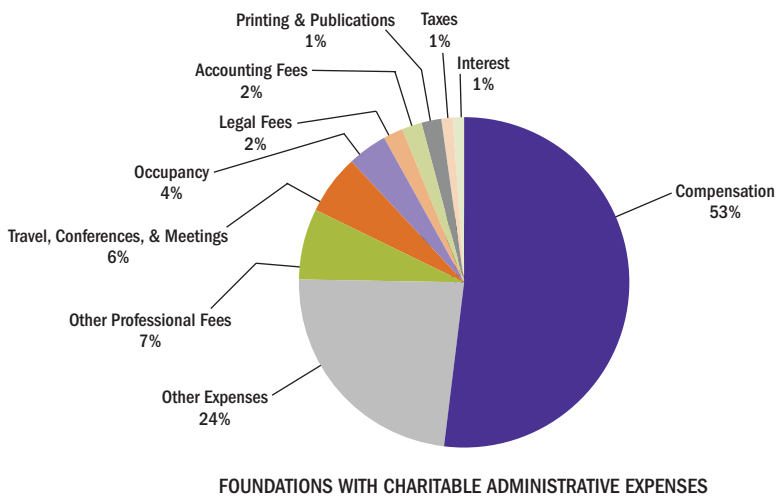
affecting the charitable expense ratios of larger independent foundations, whether Illinois-based or nationwide, followed by staff size. But while most staffed foundations in both study samples had expense ratios of less than 10 percent, slightly bigger proportions of Illinois foundations had expense ratios in the higher ranges, and mid-sized foundations were the most likely to have higher-than-average expense ratios. Engaging in direct charitable activities, making grants nationally or internationally, operating as a health conversion foundation, or maintaining a web site (a possible indicator of a larger communications effort) tended to further raise expense levels of staffed Illinois foundations. By contrast, donor-family involvement tended to lower spending ratios.

5. It bears noting that although staffed family foundations overall had much lower median expense ratios compared with non-family foundations, three of the four Illinois foundations in this study with expense ratios higher than 30 percent had donor or donor-family involvement. All three foundations appeared to have operating programs, although just one of them reported direct charitable activities on Form 990-PF.
6. Between 2008 and 2010, approximately one-half of the 90 larger Illinois foundations sampled reported program-related compensation.
7. Just three staffed foundations accounted for 60 percent of the *other expenses* dollars reported by sampled Illinois foundations. All appeared to have operating programs, and two reported large amounts of undifferentiated program costs among *other expenses*. In addition, one foundation reported high facilities management costs in this category.

ENDNOTES

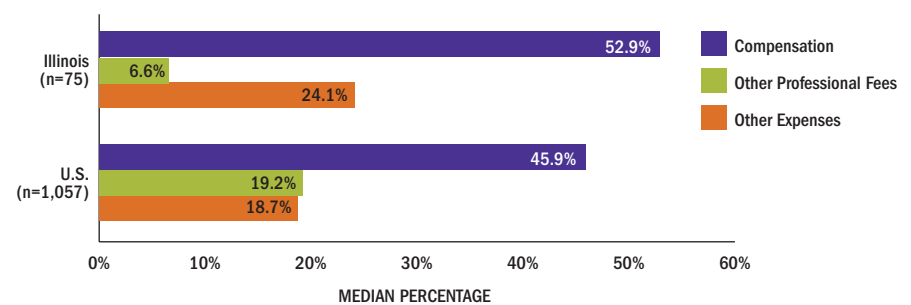
1. Among the sample of 1,218 larger U.S. foundations, 13 percent reported no expenses, while 41 percent had no paid staff.
2. For this study, staff-size ranges were tailored to best illustrate the distribution of the 45 sampled Illinois foundations for which number of staff was available. A large majority of these foundations had between two and 10 staff, on average. Of the six foundations that had more than 10 staff, four had between 20 and 24 staff and one had more than 100 staff.
3. The 15 Illinois foundations that gave between \$5 million and \$10 million, on average, tended to have larger staff sizes than their peers in the national sample and included seven foundations with expense ratios of at least 15 percent and two with ratios greater than 30 percent. These seven high-expense foundations had staff sizes ranging from four to 42. Of the seven, three engaged in direct charitable activities, three operated nationally or internationally, and one was a health conversion foundation. As noted elsewhere in this study, larger staff size and more complex activities are often associated with higher-than-average expense levels.
4. Foundations with web sites that gave at least \$10 million a year, on average, had a median expense ratio of 9.5 percent; in contrast, foundations that gave less than \$10 million had a median ratio of 15.7 percent.

FIGURE 7: Components of Charitable Administrative Expenses for Large Illinois Independent Foundations, 2008–2010



SOURCE: The Foundation Center, 2013: The Foundation Finances Database (2008–2010). Includes 75 of the 90 large Illinois-based foundations sampled that reported charitable administrative expenses. These are costs related to a foundation's charitable mission and exclude investment-related expenses. The data are based on a three-year average for 2008 through 2010. Fifteen Illinois-based foundations did not have any charitable administrative expenses. Due to rounding, figures may not add up to 100 percent.

FIGURE 8: Compensation, Other Professional Fees, and Other Expenses as a Percentage of Charitable Administrative Expenses for Large Illinois and U.S. Independent Foundations, 2008–2010



SOURCE: The Foundation Center, 2013: The Foundation Finances Database (2008–2010). Includes 75 of the 90 large Illinois-based foundations and 1,057 of the 1,218 large U.S.-based foundations sampled that reported charitable administrative expenses. These are costs related to a foundation's charitable mission and exclude investment-related expenses. The data are based on a three-year average for 2008 through 2010. Fifteen Illinois-based and 161 U.S.-based foundations did not have any charitable administrative expenses.

More than Grantmaking: How Funder Strategies Affect Expenses at Three Illinois Foundations

Whether Illinois foundations report that they formally engage in direct charitable activities (DCAs), some may nevertheless be involved in staff-led and/or resource-intensive activities beyond check writing that account for a good portion of their charitable administrative and operating costs. In recent years, the growing needs of communities and grantees have put more pressure on foundation staff and their administrative expense budgets for purposes such as the delivery of capacity-building programs and technical support for grant applicants and grantees.

These are among the insights drawn from in-depth interviews conducted by Donors Forum with a small sample of Illinois foundation leaders about how their operating styles influence their program-related administrative costs and the current state of these expenses. While not representative of all Illinois foundations, these three foundations illustrate the ways that diverse operating styles drive foundation expenses.

At one end of the spectrum, an Illinois foundation with a large, formal DCA program carries on capacity-building programs for local grantees—mainly health and human service providers—in areas such as leadership and organizational development and executive coaching. In fact, for this particular foundation, capacity-building represents their single most important program (and their largest expense item, followed by staff salaries), with a separate designated annual budget. “Our operating style is to strategically align our grantmaking and non-grantmaking efforts together so that organizations will be offered opportunities to not only get grants but to participate in our capacity-building programs,” according to a representative. The foundation employs a full-time staff member who is responsible for directing and coordinating capacity-building programs; it also hires top nationally recognized organizations, consultants, and experts to conduct the programs. Specific activities range from formal online leadership assessments and leadership institutes for grantees and board members, to informal focus groups to learn about grantees’ needs, to workshops on board development. In recent years, capacity-building programs have grown faster than the foundation’s direct giving. “We are about making a difference within our community,” commented the spokesman. “We have increased our capacity-building programs and our role as an educator, particularly around the Affordable Care Act.” The goal is to “fulfill the needs of our communities and provide more opportunities for our grantees to sustain themselves.” As these programs have grown, so have the foundation’s overall operating and administrative expenses.

In the middle of the spectrum, another Illinois foundation similarly defines its operating style as accomplishing its mission by being “responsive and respectful to our community and grantees’ needs.” However, this foundation’s primary strategy is to provide grants. While it states that it does not engage formally in DCAs, it acknowledges that it nevertheless “performs a limited number” of these staff-intensive activities. Most notably, it provides technical assistance to applying organizations prior to the submission of grant requests and after an application is declined. Staff members, including the Executive Director, are involved in reviewing grants. The foundation also hires consultants and experts with specialized skills to conduct grantee workshops and collaborates and partners with area companies to develop workshops. Topping the list of its operating and administrative expenses by share of dollars spent is salaries, followed by rent. The main factors that have affected recent trends in this foundation’s administrative expenses are increased healthcare costs for staff and the pressure of more communities seeking grants, therefore requiring more staff time. The foundation has also had to increase its expenditures for upgrades to its web site.

Just slightly lower on the “grants only” vs. “more than grants” continuum, a third Illinois foundation accomplishes its mission by “providing funding support and maximizing resources to serve our communities.” Similar to the foundation above, this foundation’s primary focus is providing grants and it reports engaging in no formal conferences or workshops or other types of direct charitable activities. Nevertheless, the foundation collaborates and partners with other foundations with similar missions to develop workshops for applying organizations and grantees. While in the past the foundation relied heavily on consultants for grant application reviews and analyses, it is in the process of reducing the role of consultants by hiring more staff members to fulfill these functions. (The Executive Director is also involved in reviewing grant applications.) The foundation’s top five expense areas are staff salaries, consulting fees (for strategic planning, workshops, and communications planning), rent, health insurance, and capacity-building for grantees. Compared with five years ago, the newest type of major expenditure has been the implementation of new capacity-building programs for grantees. Among the external factors that have most affected recent trends in administrative expenses are state budget cuts, which have led to more nonprofits applying for grants and produced greater needs among grantees.

CHAPTER 3

Recommendations

The goal of this study is to inform foundation practice in Illinois by documenting program-related administrative expenses and assessing the factors that consistently drive these expenditures over time. These findings may also be used to educate Illinois policymakers about the actual operating and administrative expense levels of large foundations in their state relative to their total charitable expenditures. Yet, while the IRS Form 990-PF used for this analysis provides the only publicly available source for comparable data on foundation expenses, it lacks the type of specificity necessary to create a truly nuanced and up-to-date portrait of foundations' charitable expenses.

At present there are no publicly announced plans by the IRS to modernize the Form 990-PF. This means that it will be up to foundations themselves to ensure that their program-related administrative expenses are properly understood by policymakers, community leaders, and the public. To this end, Donors Forum suggests that Illinois foundations consider a few practices beyond completing their required reporting on the Form 990-PF:

- Use the data contained in this report to benchmark your foundation against peer institutions with similar operating characteristics. If your expenses differ, be sure you have a clear understanding of why these differences are occurring and how to explain them if asked.
- Provide a breakdown in your annual Form 990-PF of the catch-all categories *other professional fees* and *other expenses* and footnote expense line items to provide additional detail where there may be confusion, particularly related to your foundation's direct charitable activities. This additional information will ensure that your foundation's work is properly represented and demonstrate a clear public commitment to transparency.
- Use your annual reports, web sites, and other communications vehicles to convey how your foundation's mission translates into your specific operating strategies in terms of both your grantmaking and activities that go beyond writing checks. And, whenever possible, show how the unique style of your grantmaking is having an impact on the issues you care about.
- Encourage your peers to be equally transparent about their foundations' strategies and expenses. All members of the Illinois foundation community benefit from being recognized as good public stewards of their resources.

Donors Forum hopes that *Understanding Foundation Expenses: Focus on Illinois* will serve as a model for similar research by regional associations of grantmakers across the country. Through this type of undertaking, all members of society can develop a more complete understanding of the unique role and contributions of U.S. foundations.

Glossary of Terms

Key Financial Variables

Charitable Operating and Administrative Expenses:

Expenses related to carrying out a foundation's charitable programs, including overhead and grant- and program-related administrative expenses. This figure is derived from Form 990-PF, Part I, line 24, column d.

Qualifying Distributions:

All disbursements that are counted toward the payout requirement (the minimum amount a private foundation is required to expend for charitable purposes annually), including grants, direct charitable activities, program-related investments, set-asides, charitable operating and administrative expenses, and amounts paid to acquire assets used for charitable purposes. This figure is derived from Form 990-PF, Part XII, line 4.

Total Compensation:

The total amount paid in salaries, wages, pension plans, and other employee benefits reported as part of a foundation's charitable operating and administrative expenses. This figure is derived from Form 990-PF, Part I, lines 13-15, column d.

Foundation Operating Characteristics Provided by the Foundation Center

Family Foundation Status:

Identifies a subset of independent foundations that report or demonstrate donor or donor-family involvement on the board and often in the foundation's operations.

Geographic Scope:

Based on the known scope of their grantmaking, foundations are classified as local (either giving within their local community or within a few designated states), national, national/international, or international.

Health-conversion Status:

Identifies a subset of independent foundations that were formed from the sale of not-for-profit hospitals and health organizations to for-profit enterprises.

Program Expenses:

Expenditure amounts for foundation-administered programs and other direct charitable activities.

Staffed or Unstaffed:

Foundations are flagged as staffed if they report having paid staff via survey or at their web sites or if they list staff members or report a minimum level of staff-related compensation on Form 990-PF.

Staff Size:

Number of full-time, part-time, or unspecified paid staff reported via survey or determined from public reporting.

Web Site:

Identifies that a foundation has its own URL or maintains a site hosted by a third party.