HOW TO SET ASIDE CONTINGENCY FUNDING

Funders should set aside contingency funding as part of their organizational and grant budgeting processes. Every foundation should have contingency funds, although the size and scale of its contingency resources will depend on its risk profile and the type of organizations and projects in its grant-making portfolio. This document provides guidance on how funders can determine what amount of contingency resources would be appropriate.

1. Set aside contingency resources at your foundation and inform your staff members of their purpose.
Consider setting aside a portion of your grant-making budget to deal with the inevitable but unexpected challenges that your grantees will face. You can establish contingency funds at the project or portfolio level as either a set dollar amount or a percentage. Make sure staff members are aware of these contingency resources and of the criteria and decision-making protocols for accessing them. Managing contingency funds centrally can help ensure both efficiency and open communication around utilizing contingency funds.

2. Determine an appropriate amount of contingency resources based on:

a. **Your foundation's general risk profile.** Refer to How to Talk About—and Determine—Your Appetite for Risk. If your foundation is investing in projects that have a higher potential of unknowns or variables that can affect impact, it will likely require more contingency resources than if you are investing in more understood efforts where the risks are more overt, easily mitigated, and/or less likely.

b. **The composition of your grant-making portfolio.** Assess how much of your portfolio is made of high-, medium-, and low-risk investments. If your portfolio leans toward higher-risk grants, you will need to set aside a larger percentage of your budget for contingency funding. In addition, examine your track record of funding. If your portfolio skews toward start-up organizations and first-time, planning, experimental, or learning projects, then you may need to set aside more contingency resources than if you typically fund well-established organizations and proven or well-understood projects.[6]

Contingency Funding for Donor Collaboratives

Setting aside contingency funds can be a particular challenge for donor collaboratives where no funder is solely responsible for the outcomes of the project. Here are a few suggestions to address this:

1. Have a conversation with all stakeholders upfront to establish a plan.
2. Consider having everyone contribute equally or a weighted amount, or having one funder pick up the tab.
3. Create an escrow of contingency by setting aside the funds internally or paying into a third-party account that is only accessible based on agreed-upon criteria.

[6] Certain high-risk strategies, such as challenge grants or venture philanthropy models, may make the deliberate choice not to have contingency funds as the purpose of the strategy is to fail fast.

c. **Your grantees' financial situation.** Analyze your grantees' financials. If your grantees tend to have less cash on hand and lower unrestricted net assets, then you will likely need a larger contingency fund.[7]

d. **Your track record of contingency requests.** Poll your staff members to see how many contingency requests they received over the past year and the total dollar amount of those requests. Keep in mind that these figures may be artificially low if you have not historically had a policy or practice of contingency funding.[8]

e. **Your assessment of future risk factors.** Consider increasing your contingency fund if there are factors that may lead to greater risks—for example, a shift in your risk profile or an external event (e.g., an election for a funder that invests in advocacy activity) that may have an outsized impact on one of your program areas.

3. On an annual basis, assess how your contingency funds have been used and whether the resources you set aside were sufficient. Review your grantees' interim and final reports to determine whether specific challenges arose that can be more effectively addressed upfront in future budgeting processes. Determine whether the contingency requests you received exceeded your available resources and whether requests you had to decline were particularly troubling for your staff members. Consider additional questions that allow you to reflect on your approach to contingency, such as:

a. What additional impact might your grantees have been able to accomplish if you had had more contingency resources on hand?

b. How might shifts in your foundation's or program's strategy lead to increased/decreased risk in the future?

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[7] Financial stability (a.k.a. enterprise risk) at a nonprofit is a key risk that can have significant consequences on any project. For more on enterprise risk at the nonprofit level, see: Risk Management for Nonprofits and The Nonprofit Starvation Cycle.

[8] In 2015, Open Road conducted a baseline survey, which shows that approximately one in five projects will need contingency funding: http://openroadalliance.org/risk-in-philanthropy-funders-dont-ask-nonprofits-dont-tell-2015-survey-report/.