

Best Practices: Grantee Reporting

Host: Ted Hart

Guests: John Bennett – Simpson Thacher & Bartlett

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Announcer: Welcome to the *CAF America Radio Network*. A production of the Charities Aid Foundation of America. As the leader in global giving, CAF America offers more than 20 years of experience and expertise to corporations, foundations and individuals who wish to give internationally and with enhanced due diligence in the United States Through its industry leading grants management programs and philanthropic advisory services CAF America helps donors amplify their impact. This show is dedicated to these donors and the charity they support.

CAF America is uniquely positioned to serve as the bridge between these important partners and transforms vision into meaningful action. Guests on our *CAF America Radio Network* are leaders in their field who share tips for success and stories that inspire. Our host is Ted Hart the CEO of the Charities Aid Foundation of America. This is a live call-in show. Add your voice by calling 914-338-0855. After the show you can find all of our podcast at cafamerica.org. Don't forget to dial 914-338-0855.

Now welcome the host of the *CAF America Radio Network*, Ted Hart.

Ted: Welcome here to the latest edition of the *CAF America Radio Network*. Today's show is coming to you live from the global headquarters of the Charities Aid Foundation of America. Today our topic is international grant making and the best practices for charity reporting. Our experts today are David Shevlin who is a partner in the New York office of Simpson Thacher & Bartlett, and head is of the Exempt Organizations Group. He advises a variety of international and domestic exempt organizations, including all forms of private foundations and public charities.

Mr. Shevlin also advises donors to and about the governing bodies of exempt organizations. Mr. Shevlin is also recognized as a leading practitioner in Chambers USA, America's Leading Lawyers for Business. In addition he regularly speaks and writes on topics of relevance to exempt organizations. Joining also here today on the *CAF America Radio Network* is John Bennett. John Bennett is an associate in the same firm of Simpson Thacher & Bartlett where he practices in the Exempt Organizations department.

He advises a number of endowed universities, foundations, hospitals and cultural institutions in connection with the investment of their endowments. John has represented non-profit institutions in connection with secondary market sales of interest in various private investment vehicles. John also advises a variety of public charities and private foundations on structural and operating issues including governance, reorganizations, domestic and international grant making and taxation. Gentlemen welcome here to the *CAF America Radio Network*.

David: Thank you very much it's pleasure for us to join you.

Ted: It's great to have you here now this is a very important topic as from the prospective I would imagine of the IRS. Let's start off with if you gentlemen could set the table here specifically from CAF America's perspective. There are number of new requirements and change in practices after the Pension Protection Act of 2006 regarding grant making from donor advised funds. From the IRS' perspective what are the requirements for reporting of these grants?

David: Ted, this is Dave and I'm going to throw this to John in a moment, but I think you raised a very good point about the landscape that we're in with respect to international grant making from the IRS' prescriptive. After 2006 the law changed to bring donor advised funds among which I know CAF America sponsors within the realm of the types of organizations that are subject to the rules that apply to private foundations with respect to international grant making.

As we've recently seen the IRS is proposing to adopt new standards and has raised new questions about the ways that organizations go about making what we call equivalency determinations in making grants outside the United States. Reporting is a very key element of international grant making from both a best practices perspective which we can get to and also from the perspective of what the IRS requires and expects. John will talk a little bit about the realm in which the IRS requires reporting.

John: In terms of IRS requirements and going back to what you had raised and then what Dave had noted. The Pension Protection Act applied the private foundation rules on expenditure responsibility to sponsoring organizations of donor advised funds. In terms of reporting for donor advised funds that are making international grants. Donor advised funds now have to do expenditure responsibility in connection with these grants.

One of the requirements of expenditure responsibility, and expenditure responsibility is found in Section 4945 of the Internal Revenue Code, is to get regular reports from your grantees, so sponsoring organizations of donor advised funds making international grants now need to be sure to get reports from their international grantees and then also to report to the IRS on the grants that are made to international grantees. Private foundations do this on their Form 990 PF, the Form 990 has yet to be updated for public charities like sponsoring organizations of donor advised funds to specifically provide space to report on expenditure responsibility grants but many donor advised funds do report on attachments to the Form 990 what grants they're making to foreign organizations to comply with those requirements until there's a bit more clarity from the IRS as to precisely where to report those types of grants.

Ted: Let's break this down a little bit. Very clearly the IRS' expectations is that these reports are being collected on a regular basis even if the 990 right now is not explicitly reporting those back the sponsoring organization CAF America in this regard is expected to be collecting those and having those available should there be an order or a question about any grant.

John: Yes that's correct.

Ted: Looking at best practices now. We understand where the legal requirement regulation comes down for international grant making. Let's talk about the best practices in terms of how often these reports should be collected and what information needs to be included.

David: Let's take the first question which is how often should these reports be collected from a best practices point of view. I think we can start from the premise that they should at the very least come on an annual basis if not more frequently.

Ted: When you say annual basis, are the annual basis of when the grant was made, or somehow tied to the organizations' fiscal year, or the sponsoring organizations' fiscal year?

David: I think that in our experience most organizations find that it's appropriate to tie it to the grantees fiscal year because that is really the way that their grantees is going to be in the best position to give you the most transparent and accurate reporting about their results. If you do it on a schedule that ties to their fiscal year. If you do it to the sponsoring organizations' fiscal year which may or may not match the grantee's fiscal year. You may not be getting the best information that you might otherwise want to have, and if you trigger it solely on the schedule of the grant then you may be getting reports that come at a time of year that may not be again the most informative.

I would look at it from the fiscal year of the grantees preservative, but again the nature of the project, the nature of the grant will also inform how frequent these reports should come and when they should come. We do have clients that have some form of reporting on a quarterly basis as well. This may be with respect to projects that are anticipated to be short term, maybe a year or two in which the funds are going to be expended quickly and rapidly, and the grantor may be looking for updates in more real time if you will than an annual report could provide so they may be looking for something on a semi-annual or a quarterly basis.

Ted: You just mentioned an important concept of that the frequency may be less than a year, but I think backing up from there, you're also raising the issue of the initial grant agreement, and how that's reviewed. Can we talk a little bit about that and how that then, dog-tails into this reporting requirement?

David: Sure. John, why don't you take this one. Ted, you are asking about what are best practices for the provisions that should be included in a grant agreement?

Ted: Sure, yes. I'm picking up on your line of the answers here and that the frequency could be tied to the grant itself and presumably there is some grant agreement and what should be in that agreement and how should that be interpreted.

John: If a sponsoring organization, in this case CAF America, is making a grant to a foreign organization and performing expenditure responsibility on that grant, you do need to enter into

a grant agreement with that grantee. What you want to include in that grant agreement is very specifically what the purpose of the grant is so that you've clearly set forth an understanding between the grantor and the grantee, what those funds are to be used for.

Also, some provisions requiring that the grantee either return monies that are spent for other purposes and then also step forward very specifically your reporting expectations from that grantee so that the grantee knows when reports are expected and so that you have a contract between you and the grantee requiring that those reports are provided.

David: And what those reports need to say. The contract will speak about those. When those reports are due and how frequently they need to be submitted and perhaps as importantly, what the expectation is with respect to the content of those reports. That's where you see practiced very widely and that's where you see grantors and grantees really needing to establish some good communication upfront about what those expectations are because this is where we see problems arise.

Ted: The agreement becomes extremely important. Of course, here at CAF America we have an agreement in place for each and every grant. For our listeners today who are looking for guidance on how they should best report, what are the best practices, one of the places for them to go back to is to make sure that they understand the details of the initial grant agreement.

David: Precisely, exactly.

Ted: Talking about those reports now, is it better for charities to state their goals in terms of measurable results only or stories, or both?

David: It will depend on what the situation call for but I would perhaps break it into three categories. Generally we'll need some quantifiable results in terms of metrics. How much was spent? What was it spent on? And then, what's the impact? How many patients did the clinic serve in that quarter, in the previous quarter? How long did the refugee camp stay in operation? These kinds of metrics that give you some quantifiable objective results, and then qualitative results, which aren't just about dollars and cents, but a narrative if you will.

Most of our clients, I think it's fair to say with respect to their international grant making, to some degree their domestic grant making, will not just be looking from their grantees to submit financial information with their reports, but narrative information as well. "Tell us about what you've been doing with our grant and generally speaking and what achievements you as an organization have been able to make." It is important both from compliance perspective but also these are charities with whom you may be thinking about a longer term relationship who may come back to you for more money and these reports are key in terms of evaluating the future relationship that may [crosstalk].

Ted: And how successful they were but is there also not a prohibition against granting to an organization that has not yet reported on prior grants from a best practice perspective?

David: It would be very difficult to advise the client to proceed with a subsequent grant when the grantee was not in compliance with the first grant on any material term, including the timely submission of reports.

Ted: Looking at those statistics and the financials, do you find that organizations have a tough time getting to those quantifiable measures and are better at the story telling or vice versa?

David: It's a really good question. When you're dealing with grants in developed markets outside the United States, you don't really run into the concern as often. You have different accounting metrics and accounting methodologies and those sometimes can get bumpy or a little frustrating. In the emerging markets, which is why having a clear and transparent understanding of what the expectations are upfront is so important because sometimes in the emerging markets, you have financial systems that aren't as necessarily as evolved and sophisticated.

You may be asking for, or used to seeing from other grantees a level of financial reporting that these grantees are not necessarily up to the task. That doesn't necessarily mean that you have to disqualify all those grants just because they can't report in a manner that's commensurate with what you would get in the United States, but John you want to add.

John: Yes. One of the things that you can do to be sure that you're getting the type of information that you want and that you want to review in terms of actual quantifiable information is to attach to your grant agreement, a schedule of the information. If you've attached an example of a report showing people the type of details that you would want so that then those organizations can specifically track that even if they are as everyday practice with respect to other grants may not be tracking that, but so that they can track that information for you and provide it to you in the reports that they send you.

Ted: Model some well-written reports to give some clues as to what you might be looking for.

David: That's exactly right. Expenditure responsibility, the process we are talking about today with respect to international grant making, requires the grantor to do a pre-grant inquiry which is due diligence on the grantee. As part of the due diligence process, one element as John was referring to, can be a review of their systems and their methods for accounting and producing financial information.

Ted: Now, you mentioned that around the world there are different accounting standards and certainly they vary widely from one organization to another based on the sophistication of their internal controls. How much latitude would you say should be granted to a charity reporting based on those differences?

David: What I would say to a client is when you look at these numbers that have been produced to you, do you have a reasonable basis of comfort that you understand what you've been presented with? Do you have a reasonable basis to conclude that this information, of course assuming it's been honestly prepared, is an accurate reflection, or are you shrugging your shoulders and saying, "Well, I can't make head or tails of these numbers but they appear to be done in accordance with whatever systems they have in that area."

Latter is not the right way to go about it. The former is the way to go about it. You can have latitude, but at the end of the day, you have to be able to close that file and be able to say, "I have confidence that I understand the results."

Ted: This is where professional judgment and skill comes in to the evaluation process, its not a matter of just checking the right boxes or submitting the right report, it's were the goals of the grant met?

David: Precisely.

Ted: What if money was spent differently, what should the charity do, is that illegal?

John: It depends. Going back to our original point about grant agreements is that you're going to want to have an agreement with each of these grantees setting forth what they can use the money for. The agreement also may say that if money is used for different purposes, they'll return that money to you immediately and terminate the grant agreement. What you want to look for is, is the money being used for what it's supposed to be used for? If it's not, what is it being used for? Is it being used for something where you can provide a waiver and allow them to use it for that purpose, or if it's something that's being used for a non-charitable purpose, you need to request that money comes back.

David: Expenditure responsibility includes within its requirements that you specify there's been a diversion of your funds that you'll have the recourse to get that money back. The short answer to your question is it most certainly is illegal in the sense that it will violate a ER compliant grant agreement if the money is diverted for purposes other than what was specified in the grant agreement.

Ted: You need to be quite explicit that any changes would need to be immediately notified and would need to be approved otherwise the organization, the granted organization risks a request for those funds to be returned.

David: That's right.

Ted: In fact, the granting organization, in this case CAF America would be required to request that money back if in fact it was found to be diverted for non-charitable purposes?

David: That's right.

Ted: Keeping on the topic of reporting on how money is spent, best practice in terms of reporting length. We talked about the timing of the frequency can also be a matter of professional judgment based on the extent of the grant. What if the money is desired for different purposes, is there any latitude on the part of the charity, or it's the only latitude is on the granting organization?

David: Expenditure responsibility, because of its requirements that the grantee provides you with reports and then you the grantor report on those grants in your Form 990. Expenditure responsibility lends itself best to specific projects that have a defined lifespan, so that when the project is complete, the reporting is complete, your reporting obligations to the IRS are complete and the file can be closed. They have to report through the life of the grant, that's required within expenditure responsibility. You have to get at least annual reports with a final report at the end of the grant. And that is why general support grants are not always as good for expenditure responsibility because it's difficult to test the expiration of the life of a general support grant, it can go on and on and on and on.

Ted: There needs to be something specific in the grant agreement.

David: Right. You want to say I'm supporting this project that is estimated to conclude by X. Now, the grantor can certainly say look, "If you haven't been able to spend and complete the project by the end of one year, two years or three years, whatever the term is specified in agreement, then I the grantor can extend the life of the grant with my permission. Otherwise, you've got to complete it by X date and get and get the final report to me by X date." Grantees do with some frequency negotiate some flexibility in terms of the project completion because it's fair to say, I think it's fair from their perspective that they may not always have the exact date in mind when they're going to have something complete.

Ted: What are some of the best ways for a charity and a grantor in this case CAF America to interact to meet the standards which are fairly robust standards?

David: I think the pre-grant inquiry process is a very important process not just for checking the box and saying that you met the expenditure responsibility requirement of a pre-grant inquiry but so you could do exactly what you just asked Ted, which is interact with each other to make sure that you are creating basically the best possible relationship when it comes to reporting and also on the other aspects of the grant. The grantor can get a very good sense during that pre-grant inquiry period of whether or not the grantee is up to the expectations that it's going to have as to complete reporting so that it's going to be in a position to turn around and comply with the IRS rules.

Ted: What would you say that the IRS is most concerned about in reporting on grants, international grants?

David: I think the IRS is most concerned about ensuring that there hasn't been a diversion, that the grant funds have not been used illegally, that the grant funds haven't been used in a

manner that would then implicate concerns under our anti-terrorist financing regime, our OFAC regime, the IRS has worked with Treasury and obviously the first 10, 12, 13 years of this century has been a great deal of focus paid to ensuring that all areas of financing in the public and the private sector, in the non-profit, in the for-profit sector are conducted in a way to best avoid financing illegal and terrorist activity outside the United States.

Ted: You had mentioned the OFAC or the Office of Foreign Assets Control, can you speak specifically in terms of these IRS concerns that you point out, are much of those concerns matching up the pre-grant assessment to the grant report and that the charity needs to be very cognizant of that review?

David: Yes. The best way that you can demonstrate to a regulator in the United States that you've taken reasonable steps to ensure that your grant won't be used for illegal purposes is to one show that you did do due diligence on the grantee, which depending on the grantee and where the grantee is located might include what we call list checking on OFACs website to ensure that the grantee or some of its officers or principles don't appear on any watch lists, and then after the due diligence the second way that you demonstrate that you've done what you should do from a regulatory perspective to avoid illegal use of your funds is to be getting those reports, reading those reports and getting comfortable that your money was used as it was intended.

Ted: In reading those reports would you suggest that the best practice is on the part of the grantor and reading and digesting those reports in the file that would include the due diligence and now include the reporting that there be a definitive statement signed off by someone from the organization, saying that the terms of the grant were met. No funds were diverted and in fact this was legally attended to?

John: Yes, in terms of best practices we do think that that's a good way to go about it. I mean, first of all to make sure that you do have someone reviewing each of those reports when they come in and giving it the smell test giving a close review and then making sure that everything looks like it's supposed to look like and then noting for your files that in case anyone wherever dared to ask that you have reviewed the report and that the report appears to be in compliance with not only what you asked for but what the charity was supposed to do. We tell-

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Ted: Part of this of course is that professional judgment noting the time here, gentlemen. Can you just quickly round up the show by giving us the shortlist of what would be that legal compliance review at the end?

David: The legal compliance review at the end would be to and we tell people use a form that you will have a piece of paper at the have boxes on it that you check all reports received, no indication of diversion and grant completed. Essentially, you have a file that you can close that file at the end of the day that shows paperwork that you have the diligence your grant

agreement and your report and that paper that shows we've read these reports and they are in compliance with the grant agreements requirements for the reports.

Ted: Excellent job today gentlemen, we have today on the show David Shevlin and John Bennett, both from the firm Simpson Thacher & Bartlett giving us their insights and expert opinions on how we can best do grant reporting, and that is today's edition of the *CAF America Radio Network*. Gentlemen, thank you for joining us today.

David: Thank you good bye.

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