COMMENTS IN RESPONSE TO
INTERNAL REVENUE SERVICE ANNOUNCEMENT 2003-29, 2003-20 I.R.B. 928
REGARDING INTERNATIONAL GRANT-MAKING AND INTERNATIONAL ACTIVITIES BY DOMESTIC 501(c)(3) ORGANIZATIONS

In Announcement 2003-29, 2003-20 I.R.B. 928 (May 19, 2003), the Internal Revenue Service requested public comment on how it might clarify the existing requirements that section 501(c)(3) organizations must meet with respect to international grant-making and other international activities.

The following comments are the individual views of the members of the Section of Taxation who prepared them and do not represent the position of the American Bar Association or the Section of Taxation.

These comments were prepared by individual members of the Committee on Exempt Organizations of the Section of Taxation. Principal responsibility was exercised by Betsy Buchalter Adler and Victoria Bjorklund. Substantive contributions were made by Boyd Black, David Chernoff, Deirdre Dessingue, Gina Fields, Lisa Johnsen, and Erich Kennedy. The Comments were reviewed by Carolyn Osteen of the Section's Committee on Government Submissions, who also serves as the Council Director for the Committee on Exempt Organizations.

Although many of the members of the Section of Taxation who participated in preparing these Comments have clients who would be affected by the federal tax principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

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EXECUTIVE SUMMARY

This submission responds to a request for comments released by the Internal Revenue Service in the form of IRS Announcement 2003-29, 2003-20 I.R.B. 928 (May 19, 2003). We divided this submission into seven sections. First, we present an overview of our comments in the Introduction. Second, we describe specific practices currently used by charities[1] to reduce the risk of diversion of any kind by any foreign recipient.[2] In the course of preparing this description, we requested and received examples from representatives of, and lawyers for, dozens of public charities and private foundations. The diversity of those charities' operations and their practices are represented in the numerous, but not exclusive, examples that we present. We particularly focus on examples provided by secular public charities, religious public charities, "American Friends of" organizations, and large and small private foundations.

Third, we discuss what, if any, changes we understand to have occurred in charities' operating procedures in the aftermath of the September 11, 2001, attack. Fourth, we discuss difficulties that charities report that they encounter in non-U.S. grantmaking and operations. As part of that discussion, we have identified communications issues as the main reason that expenditures are easier or more difficult to monitor.

Fifth, we comment on existing and potential precedential authorities. We begin by surveying and commenting on existing authority. We note that this authority is generally several decades old and associated with Internal Revenue Code[3] Section 170, regarding deductibility by U.S. individual and corporate donors, rather than with Section 501(c)(3), regarding organization and operations of charities. To address this point, we propose the issuance of new precedential authority under Section 501(c)(3). By analogy to the "Know Your Customer" approach taken by the federal government for the financial services industry, we strongly recommend a risk-based "Know Your Grantee" approach. We propose a four-step process that charities might follow to document that they "Know [Their] Grantee[s]":

- Step 1: perform a risk assessment;
- Step 2: review the risk assessment to determine whether a particular payment is high, medium, or low risk;
- Step 3: select and implement anti-diversion steps appropriate to the payment's level of risk; and

[1] The term "charity," when used alone, refers to both public charities and private foundations.

[2] In these comments, we use the term "foreign recipient" (sometimes abbreviated as "FR") or "grantee" to refer to the person or organization receiving charitable assets from a U.S. charitable organization. While the Treasury's Voluntary Guidelines refer to a "foreign recipient organization," sometimes abbreviated as "FRO," a significant minority of U.S. charities makes grants directly to individuals as well as to organizations, so we believe that it is more accurate to use "grantee" or "foreign recipient."

[3] All statutory references are to the Internal Revenue Code of 1986, as amended.

- Step 4: document the risk assessment and retain records for the period the U.S. organization's return is (or, in the case of a non-filer, would be) open.

At Table 1, we submit a "Continuum of Risk Factors" which lists 42 different factors graded by their degree of risk of diversion. We propose that an organization following this four-step process would enjoy a safe-harbor recognition of its efforts, similar to that which a financial services institution would enjoy or that a public charity enjoys in the rebuttable presumption of reasonableness under Section 4958.

Sixth, we reprise our previously submitted comments on what changes, if any, might be made to IRS Forms 990, 990-PF, and 1023. In that connection, we note that individuals intent on committing fraudulent diversions will not likely report them voluntarily on these forms. Instead, we state our belief that diversions are criminal activity better tracked by law-enforcement officials than by the TE/GE Division of the IRS or by charitable organizations themselves.

Finally, we provide comments on the November 2, 2002, Treasury Department "Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities." We reproduce the Executive Summary of the Council on Foundations' detailed submission to Treasury General Counsel David Aufhauser dated June 20, 2003. Some of the individual members who contributed to these comments also participated in the formulation of the Council's comments and generally agree with the substance of those comments. At Table 2, we present a chart comparing our understanding of current practices of charitable organizations against practices proposed in the Voluntary Guidelines.

INTRODUCTION

As members of the Committee on Exempt Organizations of the American Bar Association, Section of Taxation, we welcome the opportunity to respond to the IRS's request for comments in Announcement 2003-29, on how the IRS might clarify the existing requirements that Section 501(c)(3) organizations must meet with respect to international grantmaking and other international activities. At our May 8, 2003, meeting in Washington, D.C., some 400 Committee members and guests attended two panel presentations on these topics. When the audience was asked to indicate by a show of hands how many either worked for or advised charities involved in international grantmaking or operations, virtually every person in the room raised a hand. In an effort to accurately represent the breadth of the sector, however, the individual authors sought input from many individuals who are not Committee members. These included clergy, academics, and advisors representing many different faiths, as well as representatives of corporate-giving programs, sponsoring charities of donor-advised funds, and other grantmakers and operating charities of different sizes, orientations, and experience.

We believe that the IRS's requests and our comments address some of the most critical issues facing charities today: how to grant funds and conduct operations responsibly outside the United States while minimizing the risk that funds might be diverted to non-charitable uses. These issues, which have ever been with us, have gained urgency since the terrorist attacks of September 11, 2001. Charities and federal, state, and local government are all aligned in wanting to keep charitable funds safe from diversion to *any* non-charitable use, and especially not to any terrorist use. We understand that a small number of bad actors may try to masquerade as charities while pursuing criminal ends and that their identification and punishment are important law enforcement priorities. Charities know that their well-earned reputations for integrity can be seriously harmed by confusion in the public mind with fraudulent actors. We also believe, however, that the vast majority of U.S. charities have been, and continue today to be, careful stewards of the funds entrusted to them by their millions of donors. Therefore, the sector always invites advice, especially from law enforcement officials, on how charities can improve their operating procedures at reasonable human and financial cost. Stated differently, charities welcome the opportunity to learn from federal government officials how funds are now being diverted, and to learn from their peers on what practices, procedures, and information might better insure that all funds are expended exclusively for the charitable purposes for which they were intended.

We believe that collection of comments responsive to the IRS's questions will likely be only the first step in this process. We note further that this process is most significant consideration of international charitable expenditures since the Kennedy administration in 1963. Since that time, we have experienced many changes, the most significant of which for our current purposes are a host of new technologies barely imaginable in 1963. At the same time, we are faced with the reality that while U.S. charities enjoy the advantages of these new technologies, many of the foreign recipients with whom we work still operate in a pre-1963 world. Aware of this reality, we sought to draft our comments to address a multitude of risks, and not just the risks on which our law-enforcement officials and regulators are currently focused. Further, we seek to present a practical, flexible, process-based approach that might be used effectively by all

charities, whether U.S. or foreign, public or private, large or small, experienced or inexperienced. We believe that this focus on process has proved effective in the Section 4958 context in modifying the behavior of charities for the better, without unduly burdening either the charitable sector or the IRS, and we commend it to your attention in this context as well.

Finally, we welcome the opportunity to continue working with the Treasury Department and the IRS in a constructive dialogue on these issues and positive approaches, including providing draft texts and additional comments in the future.

I. What specific practices and safeguards are currently used by public charities and private foundations to ensure that grants to foreign recipients are not diverted for nonexempt purposes and overseas activities are in furtherance of exempt purposes?

Whether the charity is a private foundation, a secular public charity, or a religious public charity, the charities contacted for these comments were unanimous that the bedrock principle of good philanthropy, whether international or domestic, is know your grantee. Toward that end, certain practices are common in one form or another throughout the organizations that provided information to the Committee about their international activities:

1. Pre-grant review and inquiry, focusing primarily on the ability of the foreign recipient to achieve the payment's[4] charitable purposes and secondarily on the ability of the foreign recipient to protect the funds from diversion to non-charitable purposes.

2. A written grant agreement that specifies the purposes of the grant and the responsibilities of the U.S. charity and the foreign recipient.

3. Transmittal of funds by electronic means where possible; by check if electronic means are not available at reasonable cost or reliability; and by cash only where banking systems in the foreign recipient's country are not trustworthy.

4. Written reports from the foreign recipient, at intervals specified by the U.S. charity, regarding the foreign recipient's use of the funds.

[4] In these comments, we use the terms "grant" and "payment" interchangeably to refer to the transfer of charitable assets from a U.S. charitable organization to a foreign recipient for charitable purposes, whether in the form of a grant (in cash, securities, or tangible personal property such as tents, mosquito netting, computers, textbooks, or medicines) or in the form of payment for goods or services that will be put to public benefit use. The reader should not assume that reference to a grant means that we speak only of grantmaking charities; we speak of operating charities as well.

5. Further inquiries by the U.S. charity, sometimes including site visits by staff or volunteers, when facts and circumstances indicate (whether before funds are distributed, during the term of the grant or project, or afterwards) that more attention is needed or desired.

While these elements are consistent, they appear in different forms depending on the nature of the U.S. charity, the nature of the foreign recipient, the location of the foreign recipient, the purpose of the grant or collaborative effort, and the circumstances under which the foreign recipient operates. There is no single "best practice" because the sector is diverse and its activities are legion. There are, however, many effective practices by which charities seek to protect charitable assets from diversion. In this portion of our comments, we offer examples of effective practices of secular public charities, religious public charities, and private foundations. Our discussion is organized with reference to the specific items mentioned in the Service's information request.

Public Charity Grantmakers

A. What kind of due diligence investigation is done in advance of grantmaking?

Public charity grantmakers use a variety of pre-grant due diligence practices. We offer the following descriptions of five actual public charities[5], large and small, to illustrate the range of effective due diligence practices in the secular philanthropy world. We then address the pre-grant due diligence practices of religious-affiliated public charities.

Example 1. Public Charity C is a small grantmaker whose charitable purpose is to promote the human and civil rights of a particular segment of the population. C makes grants to charities both inside and outside of the U.S. to support programs and projects that further C's charitable purposes. C's annual grants budget is approximately $2 million. C's grant application process begins with the submission to C of a proposal (which may come at C's request or entirely at the applicant's initiative) containing the applicant's contact information and details on the applicant's goals and objectives, governance and leadership, history, activities, future plans, budget, and requested funding. C's program officers (staff members acting under the ultimate supervision of C's governing body) review the proposal and, if it appears worthy of further attention, follow up by correspondence to obtain more information. C's staff speaks multiple languages in addition to English; however, most of the proposals C receives are in English. C also looks to an extensive network of advisors who are experts in the needs and resources of the population that C serves. Some of these volunteer advisors are part of a formal Advisory Council whose members serve specified terms and who are selected by C's Board; others are informal resources for C's program staff. C's staff queries the advisor network about applicants,

[5] Among the organizations that provided examples to the authors are large public charities with multiple overseas offices and wide-ranging charitable purposes; small public charities that focus on specific areas of need and that work with volunteers in various nations to bring potential grantees to their attention and follow up as needed; and "friends of" organizations that focus on projects of one specific foreign charitable organization or network.

asking whether the applicant is run by honest and effective people; whether the applicant will make a positive difference; and whether the applicant faces problems that the advisor thinks will affect the applicant's use of grant funds. C's staff also checks the U.S. government lists[6] of ineligible recipients. Only if the applicant passes these multiple levels of review will staff recommend approval to C's Board of Directors.

Example 2. Public Charity D is a large grantmaker with broad charitable purposes. It focuses its charitable funding on a specific continent. D has field offices in more than 15 countries in that continent, staffed by people who speak the local languages and are familiar with local cultures. D's field staff reviews grant proposals before forwarding recommended grant files to D's U.S. office for inclusion in the Board docket. In some regions, D's Board has delegated authority to field staff to approve grants that meet certain criteria established by the Board and that do not exceed a dollar amount established by the Board. The field staff considers both the organization's general operations and the project for which funding is sought. D's staff reviews the applicant's governing documents (focusing on charitable purpose and responsible governance structure); its registration with local authorities where it is required by local law; and its financial information, including budgets showing sources and uses of revenues and audit reports where available. Staff also assesses the applicant's reputation in-country, before local audiences, and reviews the applicant's programs to assess its experience, capabilities, and track record. D has implemented an automated checking function so that organizations and individuals are checked against lists of ineligible recipients published by various agencies of the U.S. government.

Example 3. Public Charity E is a large grantmaker that is part of an international affiliated group of charities with shared goals and a common "brand." E is the central coordinating body with which these foreign charities are affiliated. E makes grants both from unrestricted assets and from numerous donor-advised funds and field-of-interest funds. E's grants include support for specific projects and also general charitable support, particularly for E's local affiliates who must go through a thorough review and qualification process in order to become affiliated in the first place. Whether an organization applies independently or is recommended by a donor-advisor, an applicant for a grant from E must complete an application form which contains information on the applicant's governing documents, governing body, government registration if applicable, budget, sources of income by category, audited financial statements if available (if not, E requires a complete and Board-approved statement of income and expenditures for the most recently completed year), and information on the charitable activities for which funding is sought. E works with its affiliate in the potential grantee's country to obtain more information if the grant application reveals potential problems or is not complete. E also asks applicants to provide their annual reports, if available, and copies of media coverage or other external evidence of the organization's effectiveness. Finally, E checks the lists published by U.S. government agencies against the names of organizations and individuals.

Example 4. Public Charity F is a small grantmaker whose efforts focus on a public health issue that affects people across national borders. Like Public Charity C, this organ-

[6] In Part II, we note the difficulties that public charities and private foundations have encountered in checking the multiple lists.

ization seeks information from a carefully selected panel of expert advisors as well as relying on its staff review of grant applications. F's multilingual staff is based in the U.S. F's volunteer advisors in various countries and regions work directly with applicants, under the supervision of F's staff, to gather information during the application process. Applicants must complete an information form that includes contact information, information required by F's bank for electronic funds transfer, a budget with names of other donor organizations, information on the applicant's history and purposes, and a detailed description of how the funds will be used. F also requires applicants to complete and submit an affidavit which includes information on any lobbying activity by the applicant, confirmation that the applicant will not allow any part of the grant to benefit any private parties improperly, and the identities of all board members. Any applicant that is registered with its home country's government must provide a copy of its registration documents. In countries such as India and Russia where a charity must have governmental permission to receive funds from abroad, applicants must provide proof of such permission.

A member of F's staff who is responsible for activities in the applicant's geographic region then reviews the advisor recommendation, the grant application, and all related documents. Staff pursues further information where appropriate. For example, if the name on the applicant's bank account is different from the name on its application form or its affidavit, staff will require an explanation. If an application passes this review, it is then forwarded to F's senior grant manager, who reviews the application in conjunction with F's senior program officer and F's financial officer. As part of this final level of review, F checks the U.S. government anti-terrorist-financing lists to be sure that neither the organization nor individuals involved with it appear there. Only then is an application forwarded to F's Board for approval.

Example 5. Public Charity G is an "American Friends of" organization. G's certificate of incorporation, mission statement, and solicitation literature all provide that G will raise funds to support projects carried out in the field by its non-U.S. operating affiliates, G1, G2, and G3. Having this limited universe of foreign recipients means that G is intensely focused on its relationships with G1, G2, and G3. In fact, G has entered into a "privileged partnership" arrangement with G1 where, among other things, the organizations exchange staff and brief each other at least weekly on field operations. This arrangement also provides for G to send its employees overseas to participate in G1's annual planning meetings and in periodic staff meetings in the field. A majority of G's board members have served in the field as volunteers or staff of G1, G2, or G3 and are well acquainted with their operations protocols. Three directors (a minority of the total) serve on G's board as representatives of the non-U.S. affiliates. G's program staff reviews requests for funding from G1, G2, and G3. Proposals that pass this initial review are then reviewed by the Program Committee of the Board of Directors of G, which votes either to approve them or return them for reconsideration. The organizations have annual meetings in each organization's country, at which time joint finances are evaluated and operations are discussed.

Example 6. Public Charity H conducts environmental education programs in two New England states. From time to time, H also provides grants and program assistance to selected charities in other parts of the U.S. with similar charitable purposes. H has learned that T, which is organized under the laws of Country L as a nonprofit association with educational

purposes, conducts environmental education programs in L that are similar to those that H operates in the U.S. H's staff members belong to various professional associations through which they learn that T is well-respected in its home country and region, and that several U.S. grantmakers have seen good results from their grants to T. H's staff members obtain and review a grant request from T for a specific environmental education project, including a budget and copies of T's governing documents in the original language and in English translation. H's staff members also consult legal counsel to find out whether H may properly make a grant to a foreign charity. H's Board, after reviewing and discussing the proposal, approves a grant to T for the specific project subject to a written agreement that limits T's use of funds to that project and requires T to report to H in writing at least once a year during the term of the grant.

Religiously affiliated public charities. Some religiously affiliated public charities file Form 990 with the Service. However, much religious charitable activity is not reported on Form 990 because it is carried out by organizations classified as churches[7] under Section 170(b)(1)(A)(i), integrated auxiliaries of churches, or conventions or associations of churches under Section 6033(a)(1)(2)(A) (collectively " religious organizations") which are exempt from the filing obligations that apply to other Section 501(c)(3) organizations. We begin this section, therefore, with some background information on religiously affiliated public charities and their international charitable activities.

In the U.S., the landscape of religious organizations varies as widely as the types of religious expression our country has fostered. The unique religious rights guaranteed by the First Amendment have promoted a wide array of religious organizations in this country that vary in size, purpose, and belief. Despite this diversity, many religious charities include outreach efforts[8] in their public benefit activities because their respective theologies often mandate that in some form they "spread the faith." As part of this outreach, religious organizations share their faith messages in a variety of ways, from preaching and engaging in religious discourse to performing relief and development work throughout the world.[9] The heritage of religious

[7] The Code reference to "church" includes synagogues, mosques, temples, zendos, and similar institutions.

[8] We use "outreach" here to include activities as diverse as the efforts of some traditionally observant Jewish groups to reach non-observant Jews, the missionary efforts of certain Christian denominations that are directed at all who are not affiliated with those denominations, and the open-door policy of many denominations and faiths where all are welcome but proselytizing is not an article of faith.

[9] The scope of relief and development activities by U.S. religious organizations is impossible to calculate. We have been advised that U.S. religious organizations easily account for billions of dollars in assistance to hundreds of thousands of disadvantaged individuals throughout the world every year. A quick review of some of the relief and development activities performed by just a few of the largest U.S. religious organizations (drawn from the organizations' web sites and certain other contacts) provides an impressive list. Last year alone, U.S. religious organizations worked to provide invaluable support abroad to combat a growing AIDS epidemic in Africa; to provide basic housing and other necessities to homeless children; to offer much needed medical services in impoverished countries; to supply food and water in areas of extreme drought; to provide vocational training for at-risk youth; to establish the infrastructure necessary for sustained educational instruction; to connect adoptive parents with abandoned and often physically handicapped children; to respond with basic necessities for people afflicted from natural disasters; to promote, establish, and operate programs dedicated to the development of spiritual and moral character; and more. Undoubtedly, U.S. religious organizations performed such relief and development activities in almost, if not every, country in the world.

freedom in this country, coupled with the relative wealth of U.S. religious organizations as compared to those in foreign countries, has allowed U.S. religious organizations to accomplish their outreach activities not only domestically, but also abroad. As part of these international outreach activities, U.S. religious organizations often engage in some form of international grantmaking.

The amount and extent of international grants made by religious organizations depend on the size of the organizations, their financial standing, and their primary purposes. For example, some U.S.-based religious organizations focus principally on international activities while others have only secondary or tertiary activities in foreign countries. Numerous small congregations may engage in international activities only in exceptional circumstances such as natural disasters. In addition, some U.S. religious organizations concentrate their international activities in only one foreign country while others may focus on multiple countries or a specific region. Also, the manner in which these organizations go about their international activities varies by organization. The international activities of some religious organizations may consist of one or two U.S. missionaries in a particular foreign country. Other religious organizations may have more extensive support networks in a particular country with which they operate widespread relief and outreach efforts. They may operate those relief and outreach programs directly (i.e., the individuals in that country may serve as employees of the U.S. religious organization) or they may operate them in collaboration with certain "grass-roots" organizations in a particular foreign country. There is a similar diversity with regard to the dollars invested in these activities, which may range from $5-10,000 per year to more than $100 million per year. To make the picture more complicated, while an organization may have millions of U.S. dollars in international expenditures in any given year, the expenditures per project or per country may only amount to a few thousand dollars.

Given the diversity in structure and scope of the international activities carried on by U.S. religious organizations, there also exists a diverse range of efforts to insure that foreign recipients use granted funds for the intended purposes. However, and perhaps most importantly, no matter the method used, religious organizations invariably concern themselves with the manner in which foreign recipients use granted funds. The great majority of U.S. religious organizations take great care in this matter because of the stewardship required by their own religious doctrines and the expectations of donors that donations be used in a manner consistent with the religious principles of the organizations. These motivations supplement the desire of U.S. religious organizations to comply with U.S. law. Like their secular counterparts in the charitable world, religiously affiliated public charities have internal motivations, in addition to their legal compliance obligations, to adopt and implement policies and practices that will insure that the funds they send to foreign recipients will be used for the intended purposes.

To insure that foreign recipients use international grants for the intended purposes, religious organizations employ a variety of policies and practices. Again, these policies and practices depend on a number of factors, including primarily the size of the U.S. religious organization and the size of the grant. The policies and practices also depend on other factors, such as whether the U.S. religious organization has ever granted funds before to this particular recipient (i.e., is this a first-time recipient or a recipient with whom the religious organization has

had a continued relationship) and the country in which the recipient resides, among others. Some of these policies and practices are quite common while others are more specialized given the factors briefly discussed above. Depending on how the U.S. organization weighs these factors, it is likely to adopt some or all of these practices in order to exercise appropriate control and discretion over the granted funds:

1. requiring a written grant request indicating how the requested funds will be used.

2. requiring the board of directors, a board committee, or the officers of the U.S. religious organization to pre-approve the grant after reviewing the grant request.

3. requiring periodic progress reports (including in some situations audited financials) that indicate how recipients have used the funds.

4. retaining the ability to demand a refund of unused funds.

5. making grants in installments after recipients have satisfied certain benchmarks.

6. formalizing the grantor/grantee relationship through a formal, written agreement.

These policies and practices are not typically cost-prohibitive in that the cost incurred to comply with these policies and practices usually will not dissuade a religious organization from making international grants and engaging in certain international activities.

As a part of these common policies and practices, U.S. religious organizations attempt to verify that the use of the funds will correspond closely with their respective exempt purposes and that the foreign recipient possesses sufficient competence to accomplish a particular project. Initial grant applications typically require a budget detailing how certain funds will be used. Depending on the size of the grant, the U.S. religious organization may conduct or commission a site visit. If the recipient is a foreign organization, an initial grant request might include certified copies of the recipient's organizational documents, if available. More and more, U.S. religious organizations will also conduct research as part of reviewing an initial grant request to verify that distributing funds to a particular recipient is not prohibited by U.S. law.

In these comments, our references to U.S. religious organizations primarily deal with international humanitarian aid and education-related activities of the larger religious-affiliated public charities. The range of religious-based charitable activity is wide, however, and includes informal donations by individuals affiliated with religious institutions as well as direct links between institutions in the U.S. and their co-religionists overseas. We offer the following

examples of international religious activity in addition to the religious-affiliated humanitarian aid groups described elsewhere in these comments.

Example 7. L is an international hierarchically organized religious denomination with headquarters in the U.S. In order to operate in various countries consistent with local law and custom, L has established subordinate legal entities ("subordinate bodies") in other nations. L is a church described in Section 170(b)(1)(A)(i) and does not file Form 990 with the IRS. L's overseas subordinate bodies are fully controlled by L and receive funds from two sources: (a) donations from individuals in the subordinate body's country, and (b) supplemental funding, in the form of charitable grants, from L. L prescribes policies and directs the operations of the subordinate body; it holds the subordinate body accountable and audits its compliance with L's policies. L selects and approves the managers, directors, and officers of the subordinate bodies. L mobilizes additional resources for humanitarian aid projects from time to time, relying on staff and volunteers from the subordinate bodies to implement these projects and oversee the use of charitable funds.

Example 8. M, a religious organization incorporated in State Z, operates in the U.S. and in Country Y. M carries out its activities in Country Y through ordained members of the clergy and through volunteers. In addition to organizing religious services and education, also provides monetary and in-kind support for certain projects run by organizations in Country Y that adhere to the same faith as M. Monetary and in-kind support may be provided for a variety of projects, ranging from the distribution of religious texts to the provision of certain relief efforts. Ministers in Country Y are subject to the control and discipline of senior U.S. staff and ultimately to M's board of directors. Volunteers are subject to the control and discipline of the ministers. A committee of M's board of directors must approve the funding of projects in Country Y. In addition, M's ministers and volunteers must typically retain a supervisory role in a particular project as a condition of funding. These ministers and volunteers provide periodic reports to the committee of M's board of directors, which then determines whether to continue funding. Depending on the circumstances (e.g., the size of the grant, the type of project, the identity of the recipient), M will transfer funds to Country Y either through its ministers, who are then responsible for transferring funds to a specific project, or directly to the grant recipient.

Example 9. A religious institution described in Section 170(b)(1)(A)(i), located in State A, is part of an international congregationally organized religious denomination, B. While all B congregations share a common theology and religious practice, each congregation governs itself. The various B congregations support themselves by donations from congregation members. Several times each year, B congregations in State A host visiting clergy persons from other countries who are seeking financial aid to carry out their work in their home countries. The religious leaders of the U.S. host congregations take up a collection for the visiting religious leader to carry back to his home congregation. Typically these "faith offerings" are in cash and are not accounted for in any formal fashion. The payments are from individual members of the host congregation, not from the congregation itself. These individuals trust the visiting religious leader to use their donations only for religious and charitable purposes and do not expect reports on how their gifts were in fact used.

The religiously motivated charitable grants in Examples 7 and 8 are far more similar to the secular charitable grants described in Examples 1 through 6, in terms of oversight and accountability, than to the religiously motivated charitable giving in Example 9. The informal giving in Example 9 is not amenable to governmental oversight because it consists of cash that is transported by individuals rather than transmitted through regulated financial institutions.

In this context, it is important to note that increased regulation of organized U.S. charities, whether religious or secular, will not effectively address the potential diversion opportunities presented by informal charitable giving.

B. What provisions are used in grant agreements to ensure grants are used for their intended purpose?

Although all public charities contacted for these comments confirmed that they intend their grant agreements to be enforceable against the foreign recipient, these agreements vary considerably in their degree of formality. Some grantmakers use brief single-page letters countersigned by a representative of the grantee; others use lengthy documents resembling business contracts. Whatever the format, grant agreements are a common thread in secular international philanthropy. We know of no secular public charity grantmaker that transmits funds internationally without a written agreement that, at minimum, limits the grantee's use of grant funds to purposes and activities that are charitable under U.S. law.

The following features commonly appear, in one form or another, in the grant agreements of those public charity grantmakers with whom the authors of these comments are familiar:

- The agreement specifies the charitable purpose of the grant and limits the use of funds to that purpose.

- Funds are not disbursed until the grantmaker has received a signed copy of the grant agreement.

- If a grant is for general charitable support, the grantee may spend the funds only for activities that would qualify as charitable under the laws of the U.S.

- If a grant is for a specific project, the grantee may spend the funds only for that project and may not apply the funds to a different project or purpose, even if entirely charitable in nature, without the prior consent of the grantmaker. Some grantmakers permit line item variance up to a limit specified in the grant agreement, e.g., 10% or 15%, but require grantees to obtain grantor consent for any variances exceeding that limit.

- Reporting requirements are specified, and further support is ruled out if reports are not provided to the grantmaker's satisfaction.[10]

- If any part of the grant is used other than for the purposes specified in the agreement, the grantee must either retrieve the funds in question or return them to the grantmaker.

- The agreement is signed by responsible persons on behalf of the grantmaker and the grantee.

Some public charity grantmakers will make grants to foreign organizations only for specific projects. Others make grants both for specific projects and for general charitable support. Grantmakers who make general charitable support grants report that they take special pains to assure themselves that the funds are used only to support charitable activities and are not applied to non-charitable ends. In most cases, general charitable support grants are directed only to organizations which are particularly well known to the grantmaker, either because of prior successful funding of projects or because of greater pre-grant due diligence.

After the events of September 11, 2001, many grantmakers added anti-terrorist financing provisions to their grant agreements. We reproduce several examples in our response to Question 2, below.

C. What reports or other mechanisms are used to track the use of grant funds?

Under the grant agreements, as described in the previous section of these comments, public charities typically require grantees to provide written reports as to their use of the grant funds. The level of detail that a grantmaker requires will vary with the size of the grant, the purpose of the grant, and the nature of the grantee and the grantmaker. At minimum, grantees are required to confirm that all funds were applied to the charitable purposes of the grant. Where the grant is of significant size, or where the grantmaker believes that the diversion of assets to non-charitable purposes is a risk of more than negligible proportions, public charity grantmakers require more detailed reports. In such cases, the grantee is required to provide both narrative and financial information. Where the grant covers multiple years, reports are required at least annually and sometimes more frequently.

Some grantmakers require their grantees to use specific question/answer forms provided by the grantmaker. Other grantmakers simply specify the information they require and allow the grantee to provide the information in the format of their choice. Although not yet the norm, it is becoming more common for grantmakers to allow grantees to submit their reports electronically.

The frequency of required reports varies among grantmakers. The small public charity grantmaker described in Example 4 requires two progress reports per year, one at six

[10] Funders typically put much effort into obtaining reports if grantees fail to provide them as the agreement specifies, and learning what became of the funds.

months and the other at twelve months. These reports are first reviewed by the regional advisory board volunteers, then by the regional coordinator (a staff person), and finally by two program officers in the charity's U.S. office. The large public charity grantmaker described in Example 2 requires its grantees to provide two types of reports: financial reports of actual expenditures against the grant funds, certified by an officer or senior staff member of the grantee, and program narrative reports that describe the status of the program. The grantmaker's financial and program staff review both reports, as financial information helps the program staff understand the narrative better and vice versa for financial staff. Depending on the grant amount and the duration of the grant period, the grantmaker in Example 2 may require a grantee to submit reports quarterly or annually. Larger grants are paid in installments which are conditioned on the receipt of satisfactory reports.

Grantmakers use other mechanisms as well. The large grantmakers in Examples 2 and 3 work with on-site staff of their local offices and affiliates, who may conduct site visits, check with grantees by telephone, or conduct an independent review of the grantee's financial or operating systems. The smaller grantmakers described in Examples 1 and 4 work with carefully selected volunteer advisors who are familiar with the grantee's culture, language, challenges, and opportunities. These advisors are the grantmaker's local eyes and ears and are able to confirm what the grantee reports indicate or to alert the grantmaker to discrepancies that should be investigated. Smaller public charity grantmakers generally reserve staff site visits only for special circumstances (e.g., where local volunteers report problems that merit intervention) or for regional visits where travel costs may be leveraged for maximum benefit to the charity. They use other means to assure themselves that the grantees are using their grants within the terms of the grant agreement. Those other means include collaborative funding with other organizations which may have representatives in-country, and carefully calibrated installment payments that are contingent upon receiving appropriately detailed reports as to how the grantee used previous distributions.

If reports are not provided, or if reports are incomplete or unsatisfactory, all of the public charity grantmakers surveyed for these comments suspend further distributions and follow up with the grantee to learn what became of the funds. Some will reconsider a grantee for future funding if the missing information is provided to the grantmaker's satisfaction; others terminate the relationship entirely.

U.S. religious organizations generally require foreign recipients to provide periodic reports (which may be annual, biannual, quarterly, monthly, and sometimes even weekly) on their use of grant funds. The type and frequency of the periodic reports depends on various factors such as the size of the grant. In some situations, a detailed annual report is required along with less detailed quarterly or monthly reports. The periodic reports typically contain financial information (sometimes audited) and other evidence that a particular project is being accomplished, such as photos or written reports from third parties. Periodic reports often require information about the progress of the project as a whole and how that progress compares to the initial grant request. If a grant from a U.S. religious organization is not funding an entire project, then periodic reports (as well as the initial grant application) may require information about other funding sources and how the recipient has used the U.S. grant in relation to the other

funding sources. Often, foreign grantees and projects will lose funding if they fail to file the required reports or if the report does not indicate sufficient progress, or at least the U.S. religious organization will suspend funding until the report is properly filed or sufficient efforts have been made to advance the project in a satisfactory manner. Also, if a foreign recipient needs more than the amount initially requested, further grants are often made only if an additional formal request is made in writing explaining why the additional funds are needed.

U.S. religious organizations will also often take more involved steps as the amount of funds becomes more significant and the activities in a specific country become more substantial. In such instances, the scale of the international activities and expenditures allows for such steps without decreasing the value of the activities and expenditures to the point that they are no longer worthwhile.

Some U.S. religious organizations with large international operations perform internal annual audits to verify that a foreign recipient has used the funds granted by the U.S. religious organization for the intended purpose or that a foreign project is being completed in a timely manner. These audits include site visits by U.S. staff, interviews with foreign staff, interviews with independent third parties, and an internal review of the books of the foreign recipient or operation. In some instances, donors to the U.S. religious organization will travel to the foreign country to observe how their donations are being used.

If the scope of a U.S. religious organization's activities become expansive enough, it will often employ field staff in those particular countries or regions to routinely monitor the progress of particular projects and activities. The field staff may be direct employees of the U.S. religious organization or persons with a relationship similar to that of an independent contractor under U.S. law. Some field staff serve under salary while others serve as volunteers. The field staff will often compile field reports from persons in country and then report back to U.S. headquarters. U.S. religious organizations with substantial international activities might also have a policy of not issuing grant funds directly to non-U.S. individuals or organizations. Rather, the organizations will make grants through their in-country affiliates.

Furthermore, many U.S. religious organizations work in foreign countries through national organizations similar in type to U.S. nonprofit organizations, which they control through board appointments and other ministry covenants. In these arrangements, grants are made to the foreign organization and the officers and directors of those organizations are vested with the authority to disperse grants in a manner consistent with the U.S. organizations' exempt purposes. The officers and directors serving the controlled foreign organizations also have the responsibility of making reports to the U.S. religious organization similar in scope to those periodic reports discussed above. In other circumstances, instead of a controlled organization for a particular country, the U.S. religious organization will establish foreign organizations that serve particular world regions instead of a particular country.

Some U.S. religious organizations also prepare status reports at regular intervals which detail how funds have been distributed and how various projects have progressed in relation to one another. This provides U.S. religious organizations with an opportunity to

compare how similar projects have progressed in the same countries or regions, whether that progression has been in a timely manner, and whether a particular project has been significantly costly in relation to other similar projects. This information, when shared throughout the organization, often proves extremely valuable in supervising particular international grants and projects. One U.S. religious organization actually grades certain grantees on the basis of the information gathered from an audit. If a particular grantee grades poorly, further auditing will be required and funding may be stopped or suspended.

D. If a public charity makes repeated grants to the same foreign grantee, how often does it perform renewed due diligence on the grantee?

Grantmakers contacted for these comments confirm that they perform renewed due diligence for subsequent grants. These subsequent reviews are generally simplified; for example, rather than requiring additional copies of governing documents, the grantmaker will ask the grantee whether the governing documents have been changed since last provided and will only require new documents if there have been changes. Updated financial and operational information is generally requested. If the grantmaker has reason to believe that the information on which it originally relied has changed, or if the information is over two years old, grantmakers will generally gather complete new information. In any case, it is common to request complete proposals for new projects even where the grantee itself is a known quantity.

Many U.S. religious organizations intentionally develop long-term relationships with foreign recipients. The ability to work with a foreign recipient on a more routine basis allows U.S. religious organizations to form closer and more trusting relationships, which increases communication between the parties and thus allows U.S. religious organizations to account more accurately for, and to supervise more closely, their international activities. However, as one organization stated, a long-term relationship with a foreign grantee is not a "free pass." These grantees must continue to file periodic reports with regard to ongoing grants and provide the U.S. religious organization with additional information if they use a grant for a new or different purpose.

By definition, an "American Friends of" organization must know its foreign recipient(s) very well indeed. The authors of these comments have specific experience with relationships where the Friends-of public charity declined to release full payments until requested changes were implemented or new contracted-for goals were negotiated. It is fair to describe our experience of due diligence in this context as ongoing and continuous.

E. Are grant agreements, reports, and other significant correspondence written or accurately translated into English?

Grant agreements are nearly always written in English, although the U.S. charity's staff may translate them into the local language if they believe it is necessary in order for the foreign recipient to fully understand its obligations. Both secular and religiously affiliated public charities that make cross-border grants or conduct cross-border programs generally seek to hire staff who are multilingual. For example, the small public charity described in Example 1 above

includes staff fluent in Spanish, Arabic, French, Russian, and Hindi. The large public charity described in Example 2, through its multiple field offices, has staff members who speak the primary language in each of the countries in the continent that it serves. The large public charity described in Example 3, with a larger staff, has staff fluent in Spanish, French, Portuguese, Italian, Japanese, and Russian and uses professional translators (both volunteer and paid) to review materials submitted in other languages, such as Arabic or Chinese. The "Friends of" public charity described in Example 5 has staff who are fluent in the languages of the countries where its primary partners are located. Most religiously affiliated public charities with overseas programs make a point of providing language training to their staff and volunteers who will serve outside the U.S. or work closely with non-U.S. colleagues.

Grantees are most often required to report in English. Where grantees are allowed to report in their own language, grantmakers include translations or summaries in the file, prepared either by outside translators or by staff members fluent in both the grantee's language and in English.

F. Are grant funds disbursed by check? By electronic funds transfer? By cash?

Grant funds are most often disbursed by electronic funds transfer. Checks are used much less frequently. Cash is used only where the banking systems in the grantee's country are corrupt or otherwise unreliable.[11] Most grantmakers require grantees to confirm in writing when grant funds are received and, if grants are transmitted in U.S. funds, to report the amount of the grant when converted to local currency; grantmaker staff members then check the exchange rate for any discrepancies.

One operating public charity made available to the authors CD-ROMs of its Financial Management Manual. Running into hundreds of pages, this Manual included protocols for dozens of situations, including handling cash in unstable countries and in evacuations and other dangerous situations. The chapter on "Security of the Money Chain," for example, reviews options for alternatives to cash payments such as having the headquarters office pay as many invoices as possible through secure agents outside the country. Cash deliveries to the field require that the cash be counted by two people, each of whom signs two receipts and takes away one receipt, which is subsequently delivered to and reconciled by the appropriate financial officer. Cash is not permitted to be disbursed unless and until the person responsible for the cash box has in hand the required invoice or payment form signed by an authorized official of the organization. The amount of cash permitted to be carried in any one cash box is limited to a set U.S. dollar amount in order to limit the risk of loss of donor funds in the case of an accident, loss or theft. These protocols are but a few examples drawn from many which cover, among other things, security of and payments for freight shipments, inventories of goods and supplies, vehicles, radios, and storage facilities.

[11] We note that even the U.S. government has disbursed cash grants in war zones, most recently in post-Taliban Afghanistan and post-Saddam Iraq.

Religiously affiliated public charities also prefer to transfer funds electronically where possible. In many regions of the world where religiously affiliated public charities are especially active, however, reliable methods of electronic funds transfer are not available. For example, Hindu-, Buddhist-, and Muslim-affiliated charities in the U.S. may all find it difficult to use wire transfers to provide funds for humanitarian aid in the disputed border region of Kashmir because sectarian violence has disrupted normal commerce. This is, of course, an issue common to all cross-border funders. When cash is used, the charity typically selects a trusted employee or volunteer to carry the cash across the border and requires a detailed accounting. Moreover, the use of cash is typically restricted to organizations that are very well known to the U.S. funder.

Private Foundation Grantmakers

Private foundations are as diverse as their donors, both in their charitable purposes and in the means by which they work to achieve those purposes. While the authors found a number of similarities among the practices of the grantmakers interviewed, every foundation is different – different priorities, different practices, different skills among personnel, substantially different resources. Thus, as with our discussion of public charity due diligence practices, the reader should bear in mind that there is a wide range of effective practices (and no single best practice) by which a foundation may know its grantee. Of course, private foundation grants to foreign recipients are informed by more than thirty years of experience with expenditure responsibility under Treas. Reg. Sec. 53.4945-5(b)-(f).

A. <u>What kind of due diligence investigation is done in advance of grantmaking?</u>

In all cases among the private foundations interviewed, private foundation personnel or reputable contractors acting on their behalf (e.g., a U.S. accounting firm with international offices) conduct a pre-grant evaluation of the foreign grantee, regardless of whether the grant will require expenditure responsibility. This pre-grant evaluation may also allow the private foundation to determine that the foreign recipient is the equivalent of a public charity.[12] Where possible, pre-grant evaluations are done by individuals fluent in the language and familiar with the customs of the region. The pre-grant evaluation is generally a written report that records the evaluators' conclusions as to whether the grantee is capable of accomplishing the purposes of the grant.

While the content and objectives of the pre-grant evaluation vary, generally the evaluation focuses on assessing the grantee's ability to accomplish the charitable purposes of the grant. To that end, the evaluator commonly examines organizational and registration documents, financial statements, and books and records; solicits anecdotal comments from other foundations that have funded or worked with the potential grantee; and interviews key personnel of the grantee. In many, but not all, cases, a site visit is made either by foundation personnel or representatives. The pre-grant evaluation may also consider whether the budget and proposal submitted by the potential grantee is realistic (too much or too little) for the proposed project and whether the potential grantee has adequate financial systems for tracking the grant funds and

[12] Reg. Sec. 53.4945-5(a)(5).

providing the required reports to the foundation. The pre-grant evaluation also helps the foundation assess whether a potential grantee can responsibly administer a grant of the size proposed. Foundations that do not have trained local staff may have the pre-grant evaluation assess whether the grantee can adequately report back in English. Depending on the size of the grant and other circumstances, the foundation may conduct or commission a site visit.

In addition to the formal and informal pre-grant evaluation of prospective grantees, the private foundations interviewed for these comments also take other due diligence precautions in advance of grantmaking. For example, large private foundations with international offices often limit their grantmaking to regions in which the foundation has a field office, a local affiliate, or a history of grantmaking activity, specifically because of their familiarity with the organizations in the region.

Similarly, the degree of scrutiny of a prospective grantee may vary based on factors such as the size and reputation of the organization (large, well-known and long-standing organizations tend to get less scrutiny than smaller, newly-formed entities with less well-known leadership) or the grantee's country of origin (e.g., organizations in the United Kingdom tend to get less scrutiny than organizations in Mexico; organizations in Mexico may get less scrutiny than an organization in eastern Europe).

Depending on the circumstances, the foundation may ask its legal counsel to review the pre-grant evaluation and the proposal. Legal counsel may also be consulted in connection with an equivalence determination.

Based on due diligence, including pre-grant evaluations and other means of assessing a potential grantee's ability to accomplish the charitable purposes of the grant, foundations have declined to issue grants in a variety of circumstances. Examples include (a) the grantee cannot report in English and the foundation does not have a reliable means of translating the documents; (b) the grantee does not have adequate financial systems for tracking the grant funds or a reasonably reliable means of maintaining communication with the foundation; (c) the grantee is so remote that maintaining communication or monitoring the grantee's activities is so difficult as to be nearly impossible; (d) there was no basis for the grantee's budget; and (e) the grantee's staff and governing body overlap so closely that there is insufficient independent oversight of the activities of the grantee's personnel.

In addition to the pre-grant evaluation described above, generally foundation program officers spend significant time reviewing grant proposals and talking with grantees regarding the substance of grant proposals. For example, in some cases scientists employed by a foundation may evaluate whether a grantee's research proposal is based on sound scientific procedure or whether a proposed vaccine delivery mechanism will be adequate.

In response to the Act, some large foundations are buying or developing software that will enable them to check grantees against the relevant lists. Like public charities, private foundations are crying out for a consolidated list of persons and entities whom they may not fund or support under U.S. law. Some large foundations have confirmed that their banks are doing the

necessary checks independently before any wire transfers are made, but this is not yet widely available.

B. What provisions are used by grant agreements to ensure grants are used for their intended purposes?

Private foundations make grants to foreign recipients pursuant to the terms of a written grant agreement signed by the foundation and the grantee, in all cases where expenditure responsibility is required and in the great majority of cases where the foundation has determined that the recipient is the foreign equivalent of a public charity. It is the intent of these foundations that the grant agreement be a binding contract which the foundation can enforce, if necessary, through litigation. In general, a grant agreement between a private foundation and a foreign recipient will:

1. Describe the purposes for which the grant is made, usually by attaching or incorporating by reference a grant proposal and budget from the grantee.

2. Prohibit use of grant funds (and any earnings generated by the grant funds) for any purposes other than that for which the grant is made, with specific language barring use of grant funds for certain specified purposes, e.g., the prohibited purposes under the taxable expenditure rules – lobbying, political activity, re-granting to individuals or other organizations unless in compliance with the taxable expenditure rules (or without consent), and non-charitable uses.

3. Require the foreign recipient to return grant funds, with any related earnings, that are not used for the purposes of the grant.

4. Require either separate accounting for grant funds or, where circumstances warrant and the laws of the grantee's country permit it, a physically separate bank account to hold the foundation's grant funds and any related earnings. In some cases, especially when physically separate bank accounts are not possible, the foundations require foreign recipients to segregate grant funds on their books and records for ease of tracking.

5. Require the grantee to provide periodic, usually annual, reports to the foundation on the use of the grant funds and any related earnings, including a financial report based on the budget proposal, and the progress made toward achieving the goals of the grant. In some cases, reports may be required more frequently than annually, but in no case were reports required less frequently. In many cases, foundations pay grants in installments and satisfactory reports must be received before a subsequent payment is made. (Internal procedures for review of grantee reports vary widely, but in most cases at a minimum, program officers review reports

to determine whether the grantee is making progress on the funded project.)

6. Reserve the right to conduct audits or compliance reviews of the grantee and to observe the grantee's procedures.

7. Reserve the right to discontinue funding and terminate the grant if the foundation is not satisfied with the progress of the project or the content of any written report.

Foundations may also include other provisions. Some grantmakers require the foreign recipient to notify them if there is a change in key personnel in cases where the foundation believes that the technical expertise or leadership of a particular individual is essential to accomplishing the purposes of the grant. In addition, some grantmakers may allow grantees to vary a line item in the budget, but require the grantee to obtain prior approval from the foundation for any variance over a percentage stated in the grant agreement.

C. What reports or other mechanisms are used to track use of the grant funds?

Some private foundation grantmakers will make general charitable support grants if they have first determined that the foreign recipient is the equivalent of a U.S. public charity or a U.S. private foundation. Most, however, prefer to make project grants to accomplish a specific objective described in a foreign recipient's proposal instead. These foundations want their funds to be used only for the specified grant purposes consistent with the foundations' mission, and they do not wish their grants to be applied to any other purpose, no matter how charitable it may be. For example, if the grant is to deliver vaccines, the foundation does not want the funds to be used to build a school. These foundations have, thus, developed fairly rigorous compliance monitoring procedures. They routinely monitor compliance with the terms of the grant to ensure that funds are not diverted from the purposes of the grant for *any* other purpose, including any other charitable purposes. While their practices and procedures are not necessarily designed to stop diversion of funds to terrorism specifically, they are designed to stop diversion of funds in general.

In many cases, foundations have internal procedures that prevent their accounting/finance departments from disbursing an installment payment of grant funds if a report has not been received from the grantee or until a program officer has signed off on the grantee's report. Most foundations also have procedures for pursuing grantees who may be delinquent in their reporting, usually beginning with "soft" communications – program officer letters, emails or phone calls with reminders – escalating to lawyer letters demanding reports, asking for the return of grant funds or notifying the grantee that it will not be considered for future grants.

Many foundations make site visits to foreign grantees to meet with grantee staff and to assess the progress of the project. Large staffed foundations may send employees or consultants, while smaller foundations may work with volunteers. Some foundations collaborate to share the costs and results of site visits to jointly funded projects. In most cases, site visits

focus on determining whether the grantee is accomplishing the charitable purposes of the grant. Personnel making site visits are generally experts in the charitable field of the grant, e.g., science, education, relief aid, etc., and well qualified to determine whether a grantee is making progress with the project. It is important to remember that these individuals are not government agents and are not trained in investigatory methods more common to government intelligence agencies, nor are they forensic accountants.

Some foundations have engaged independent consultants or external auditors to conduct interim or post-grant evaluations of a grantee. These investigations are often routine with very large grants and may be specifically requested when a grantee's report suggests an irregularity or no reports are received. Some foundations conduct site visits before a second installment is paid on a grant. In describing their efforts in this regard, however, these foundations emphasized to the authors that they did not believe these procedures should be required by law and should certainly not be imposed on charities that make more modest grants.

Several foundations have developed their own internal lists of entities and individuals, both domestic and international, that they will not fund in the future because of the difficulty they had in getting reports or because other events warrant. This is entirely aside from the anti-terrorist-financing lists promulgated by various U.S. government agencies.

In the rare cases where grant funds have been diverted by grantee personnel, private foundations have often helped the grantee work with the local authorities to pursue action against those responsible for the diversion or have helped the grantee to develop better internal controls. In very rare cases, foundations have engaged in litigation against a grantee to seek the return of misappropriated grant funds.

D. If a private foundation makes repeated grants to the same foreign grantee, how often does it perform renewed due diligence on the grantee?

Frequently, private foundation grantmakers that are active internationally choose to develop, or find themselves developing, long-term relationships with foreign recipients. As a result, they believe they know their grantees – who they are and how they operate. Nonetheless, private foundations contacted for these comments reported that in most cases they asked foreign recipients to provide updated financial information before a new grant is made. Where the foundation has determined (by obtaining legal advice or by performing the review on a staff level) that the foreign recipient is the equivalent of a public charity, the foundation will confirm that the organization continues to qualify before issuing a new grant. In some cases, foundations will conduct a post-grant evaluation of a grantee before a new grant is made.

E. Are grant agreements, reports, and other significant correspondence written or accurately translated into English?

In most cases, English is the primary means of communication. Some private foundations with active programs in specific countries or regions, like the public charities discussed above, engage staff members or consultants who are fluent in the language of those

regions or countries to review, translate, and summarize a foreign recipient's proposal, budget, and reports from the foreign recipient's language into English. Some unstaffed family foundations rely on family members or friends who are fluent in the language of the grantee. Company foundations are often able to turn to volunteers from the sponsoring corporation who are fluent in the local language.

F. Are grant funds disbursed by check, electronic funds transfer, cash?

In most cases, grant funds are disbursed by wire transfer but it does not appear that any foundation exclusively uses wire transfers. In many cases, smaller grants are paid by check. It would be extremely rare to find grants paid in cash, although certain foundations can cite examples where the banking system of a country has collapsed and certain grants had to be paid in cash. It is certainly not the norm or even common.

II. In the aftermath of September 11, 2001, what review or changes in practice have organizations made to ensure that grants are not diverted to support terrorism or other non-charitable activities?

Charitable organizations that were active internationally before the September 2001 attacks have made relatively few changes in their practices since that time. This is because existing law and good practice already required them to pay close attention to cross-border charitable activity. The effective practices described in Part I (other than the list-checking function, which did not exist before September 11) were designed to focus charitable assets on public benefit activities and to prevent diversions of these assets to non-charitable purposes, whether those diversions were for personal gain, political advantage, or violence and terror.

The changed practices of charitable organizations owe more to growing awareness among U.S. charities that their activities are affected by the USA Patriot Act (the "Act") and Executive Order 13224 (the "Order"). While the great majority of charities appear unaware that the Act and the Order exist, the educational efforts of organizations such as the Council on Foundations and its affinity group U.S. International Grantmakers[13], United Way International, Independent Sector, InterAction, Grantmakers Without Borders, and others (including this Committee) have begun to raise the general level of awareness. In addition, individual exempt organization lawyers and accountants have worked to alert their grantmaking clients in many cases. Nonetheless, much ignorance remains. For example, the authors have been advised that some charities that make grants to organizations in Canada or Mexico, where tax treaty provisions enable U.S. funders to treat qualified local charities as the equivalent of Section 501(c)(3) organizations, reportedly believe that less due diligence is required of them because of the treaty provisions.

[13] See, e.g. www.usig.org, which contains information on the Act, the Order, the Treasury Guidelines, the various U.S. government lists of persons and organizations ineligible for funding or aid, and related matters as well as general information to assist international grantmakers use their charitable assets effectively and with knowledge of the legal framework.

The two primary post-9/11 changes appear to be the addition of a list-checking function to the normal pre-grant due diligence inquiry, and the adoption of more stringent grant agreement language.

Checking the lists. Once aware of the legal obligation to avoid transactions with persons or organizations identified, charities attempt to comply by adding the list-checking step to their pre-grant procedures. Charities have, however, encountered difficulties with the lists as currently available to the public. Those difficulties include the multiplicity of lists issued by different government agencies,[14] the inconsistent spelling of names transliterated from non-Roman alphabets,[15] the lack of information as to why a particular person or organization is listed, and the lack of guidance as to how to verify (and how much verification is required) that a partial match is or is not an actual match. Charities vary in the extent to which they check persons and organizations associated with potential grantees against the various governmental lists. Those charities that are aware of their obligations under the Order and the Act check the lists for the name of the potential grantee and those individuals directly involved with the grant; some (though certainly not all) also check the names of those who serve on the governing body of the potential grantee.

Some larger and technologically sophisticated charities have developed automatic checking processes, and several vendors are attempting to sell packages to address the need for manageable list-checking. However, the challenge of dealing with apparent matches and distinguishing false-positives from actual matches – not to mention what charities may be obligated to do if they discover an actual match – remains unresolved at this writing. Practical guidance on these points, as well as a single consolidated list, would be welcome.

Certifications and grant agreements. A number of international grantmaking charities are now requiring grantees to confirm, either as part of the written grant agreement or as a certification in the course of the pre-grant review, that they do not support or fund violence or terror. One large U.S. public charity grantmaker has added the following language[16] to its grant agreements:

> "[grantee name] certifies that it has not provided and will not provide support or resources to any individual or entity that advocates, plans, sponsors, engages in, or has engaged in terrorist activity; or to anyone who acts as an agent for such an individual or entity. Support or resources include currency or other financial

[14] The General Accounting Office recommended in April 2003 that the many "watch lists" should be consolidated. *See* GAO-03-322, available at www.gao.gov/cgi-bin/getrpt?GAO-03-322.

[15] When a name is transliterated from another script to the Roman alphabet, the name may be spelled differently depending on the language spoken by the person doing the transliterating. For example, the same Chinese name may be written as Wang, Wong, Huang, Hong, Won, Huan, Wan, Ng, etc. This is entirely aside from questions of accuracy, which are serious enough in themselves.

[16] We have been advised that the U.S. Agency for International Development requires a similar certification.

> instruments, financial services, lodging, training, safe houses, false documentation or identification, communication equipment, facilities, weapons, lethal substances, explosives, personnel, transportation, and any other services or physical assets. Any violation of this certification is grounds for immediate termination of the Letter of Agreement and return to [grantmaker name] of all funds advanced to [grantee name] under it."

Another large public charity requires its potential grantees to certify as follows before it will consider making a grant:

> I certify that the Organization complies with the laws of the country or countries in which it is registered and/or operates; that all information and documentation provided for this grant application is complete and accurate to the best of my knowledge; that the Organization takes reasonable steps to ensure that grant funds are not ultimately distributed to terrorist organizations or for violent purposes; and that the organization takes reasonable steps to ensure that staff, board, and other volunteers have no dealings whatsoever with known terrorists or terrorist organizations.

Other public charities and private foundations, after serious thought, have concluded that certifications are of little use in the fight against terrorism because anyone willing to commit a terrorist act is also willing to violate a contractual provision. Instead, these charities believe that the most effective anti-diversion strategy is the exercise of good grantmaking due diligence generally.

In addition to these two practices, we note several other practices which some charities (though certainly not all) have begun to implement since 9/11. Several internationally active charities have begun to require their financial institutions to conduct due diligence on their grantees' financial institutions before transmitting funds electronically. Disbursing grants in local currency where possible[17] obviates the possibility that a grantee might convert dollars to local funds in a manner susceptible to fraud or abuse. In addition, many charities modify their due diligence procedures depending on their assessment of the risk of diversion to non-charitable ends in particular circumstances.

In this context, it is important to note that one consequence of 9/11 and the laws and guidance that followed is the suspension and, in some cases, termination of international funding by some grantmakers that were previously active across borders for the public good. These grantmakers have concluded that it is not possible to continue funding organizations in particular regions of the world, despite continuing need, because the grantmakers believe that in light of the Act, the Order, and the Treasury Guidelines, there is no legal safe harbor. While the Regulations to Section 4945 describing expenditure responsibility[18] make clear that the grant-

[17] In some countries, e.g. Vietnam, Cambodia, and Ghana, the local currency is not convertible.

[18] Reg. Sec. 53.4945-5(b)(1).

maker is not the insurer of its grantee's activities, and that a grantmaker that has properly exercised expenditure responsibility will not be liable for grantee misdeeds or mistakes, these post-9/11 provisions contain no such assurance.

Other charities appear to believe, rightly or wrongly, that if they operate in parts of the world where the risk of diversion to non-charitable ends is historically low, no changes are necessary because 9/11 did not increase their risk. Some of these charities have added a list-checking step to their normal "know your grantee" review, but many charities have not done so. Among those organizations, there appears to be a sense that it is a waste of time and effort to add more steps to what they believe is already a thorough review, since they cannot ultimately control the risk of diversion by someone two or three steps down the charitable path. Instead, they are limiting their activities to what they believe are lower-risk geographic and program areas. This is an unfortunate and, we believe, unintended consequence of the Voluntary Guidelines that we discuss in Part V.[19]

III.A. What difficulties have public charities and private foundations encountered in monitoring how international grants are actually used, or how international activities are conducted?

The primary challenge in monitoring how international grants[20] are actually used is, as one might expect, communication. The challenge is not one of language, since most international grantmakers (as noted above) have multilingual staff members. Rather, it is the physical and practical difficulty of transmitting and receiving information. Many grantees have very limited access to dependable means of communication. The postal service may be unreliable or corrupt; telecommunications services may be costly, unreliable, or simply unavailable; electronic mail access may be nonexistent. Fortunately, nonprofit organizations and their funders are resourceful and these problems can be resolved with effort and patience.

Another challenge is the need to obtain financial information from grantees in a form suitable for U.S. accounting and reporting purposes. Smaller organizations, or organizations of whatever size in countries whose accounting standards are different, are not likely to be familiar with U.S. accounting standards. In this situation, grantmaker staff members work closely with the numbers and the narrative to determine whether the funds have in fact been used for charitable purposes, and they follow up with the grantee as needed. Some grantmakers make a point of providing technical assistance to their grantees so that the grantees can develop and implement effective financial reporting systems.

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[19] At this writing, the House of Representatives is considering legislation that would amend Section 4942 to exclude reasonable administrative expenses from the definition of qualifying distributions. If this proposal becomes law, the additional compliance costs will further discourage private foundations from international activities.

[20] For purposes of this discussion, "grants" includes program-related investments described in Section 4944(c) and Reg. Sec. 53.4944-3(a)(1).

Differences among countries, cultures, and regions poses another set of challenges. While U.S. charities have developed a wealth of experience in insuring that their international grants and activities further their exempt purposes, their experience in one country or region may not generalize at all to another country or region. What may be helpful to insure proper use of a particular international grant in Australia or Brazil may not be beneficial or at all possible in Indonesia or Vietnam. In some countries, this is a function of the U.S. organization's religious doctrine. For example, working directly and openly with government officials to get status reports on proper use of funds for disaster relief may be possible for a Christian-based (or, for that matter, Islam-based or Hindu-based) organization in some countries, but not others. In other countries, the difficulty may be a consequence of the U.S. organization's programmatic agenda. For example, a government that believes its citizens are best served by strict control of information will not be inclined to cooperate with a U.S. charitable organization that promotes freedom of the press and the free flow of information in general.

Some charities have experienced difficulties with long-term projects because staff turnover on both sides may disrupt the reporting process. This may, of course, occur with domestic recipients as well.

Still another challenge is, sadly, safety. Both secular charities and religious-affiliated charities have advised the authors that asking questions about the use of funds, the identity of employees, the background of beneficiaries, and the like can be dangerous to both the recipients of aid and the providers of aid. A health care worker may be mistaken for a missionary from a faith other than the dominant religion in a particular area; a missionary may be mistaken for a spy for the government of the host country or the funder's country; a grantmaker may find that it is physically perilous to seek answers to certain questions. One public charity operating in pre-war Iraq reported that two of its volunteers were kidnapped and jailed by Saddam Hussein's secret police because the brand of satellite telephone they used was believed to be unique to the CIA. Choosing not to get involved in countries where aid workers are at risk is not always possible. If the choice is between withdrawing from a country in desperate need of aid or doing the best job possible within practical constraints, charities tend to stay where they are and help those in need, regardless of what the aid providers frequently view as mere paperwork. This problem existed before September 11, 2001, and has not lessened since then.

Finally, and obviously, it is far more difficult to monitor grantees that operate in countries where armed conflicts are in progress, whether between armies or among criminal gangs, or where the government of the host country is opposed to the foreign recipient's work.[21] Yet it is in precisely these areas that humanitarian aid and other kinds of services most commonly provided by NGOs are most needed. Where site visits are unsafe, grantmakers rely more heavily on references, grantee reports, or collaborative funding efforts with other grantmakers who may have more ability to monitor activities closer to where they are conducted.

[21] Examples include human rights advocates in various nations, religious-identified workers (whether they proselytize or not) in countries where the state endorses a different religion, advocates of democratic reforms in authoritarian states, and the like.

III.B. Are there particular types of grants, recipients, or activities that are easier to monitor than others?[22]

Different grantmakers would answer this question differently. For example, some grantmakers report that smaller, locally-based organizations are easier to monitor because they have fewer "moving parts" and there are less opportunities to hide diversions of grant funds since the overall budget is smaller. Other grantmakers believe that larger organizations are safer, since they are more likely to have conventional accounting systems and more resources with which to police themselves. Almost all "American Friends of" grantmakers would consider their grants and recipients easier to monitor because of their close ongoing relationships with their grantees and the grantees' reliance on the U.S. funder for critical support. Similarly, many grantmakers have come to rely on domestic public charities with international capacity, such as Examples 3 and 5, to conduct the necessary due diligence.

Similarly, the age of a potential grantee organization cuts both ways. Some grantmakers believe that older and more established charities, whether foreign or domestic, are easier to monitor because such charities are more likely to be familiar with the reporting and monitoring process. However, a newer grantee may be more responsive to its funders, and more willing to modify its procedures and operations at a funder's request, because it does not yet have an entrenched structure or bureaucracy.

Whether a foreign recipient is recognized by its own government as charitable is not necessarily decisive either. If the foreign recipient's government has charitable registration procedures that are consistently and fairly administered, and if registration is not excessively costly or time-consuming, a U.S. charity might reasonably draw a negative inference from a potential grantee's failure to register. But in many countries where U.S. grantmakers are active, this is not the case. In many developed nations as well as in nations with less developed economies, the charitable registration process is erratic, mysterious, costly, and time-consuming. In too many places, an attempt to gain government recognition as a charitable entity may bring unwanted attention from local police and politicians. Thus, although one might reasonably assume that a foreign recipient that was a registered charity in its own country would be easier to monitor, this assumption is not always correct. For example, in countries suffering from governmental corruption, repression, or arbitrariness, governmental recognition may be available only to those who cooperate with such abuses. This Committee respectfully suggests that no negative inference should be drawn from a potential foreign recipient's failure to obtain governmental recognition of its charitable nature in such countries.

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[22] At this writing, as noted elsewhere, the House of Representatives is considering whether to amend Section 4942 to exclude administrative expenses from the definition of qualifying distributions. Should this proposal become law, the relative ease or difficulty of monitoring particular types of grants, recipients, or activities will become a threshold issue for private foundation grantmakers that may well trump the merits of a particular proposal. This Committee respectfully suggests that imposing significant administrative requirements on charities while effectively de-legitimizing administrative expenses for the private foundation community is a policy discrepancy with serious consequences for philanthropy generally.

The tax law distinction between public charities and private foundations is relevant to this discussion. Under federal tax law, private foundations may choose either to exercise expenditure responsibility over a grant to a foreign recipient or to determine, before approving the grant, that the foreign recipient is the equivalent of a U.S. public charity. The level of monitoring required for an expenditure responsibility grant is more detailed than the level of monitoring required for a grant to a public charity or its foreign equivalent. Thus, private foundations sometimes make general charitable support grants to foreign equivalent organizations in reliance on the legal and practical information gathered during the equivalence determination process. Some public charities also make grants for general charitable support. Monitoring such grants is far less burdensome, these funders believe, than expenditure responsibility or, indeed, than monitoring a grant for a specific project.[23]

The argument for project grants is that the project proposal, together with any modifications in the grant agreement, serves as a clear yardstick against which to measure the success or failure of the grantee's efforts. But not all projects lend themselves to clear metrics. Some project grants support actions and programs that may be clearly quantified, such as the construction of a school building, national park, fresh water well or electric generating facility. It is relatively straightforward to verify that the goals of the project were in fact achieved. Other project grants support less quantifiable or tangible products, such as the conduct of research whose accuracy or utility may be years away from verification, or providing training where students can be counted but the effectiveness of the training may be difficult to measure.

The key issue for many grantmakers is, as noted above, communications. Reliable communications systems are more likely to be available in urban areas than in rural areas. Thus, it is often easier for grantmakers to monitor the activities of grantees located in urban areas. However, this is not always the case. The key is whether the grantee has access to communications systems that are affordable and dependable. In some countries, the rural/urban distinction is not a reliable predictor of whether it will be easy or difficult to monitor a grantee.

Finally, as one experienced grantmaker advised the authors, if the grantmaker knows the grantee well enough, monitoring an overseas grant is essentially no different than monitoring a domestic grant. With in-country staff, consultants, or volunteers who speak the local language and are familiar with local customs and laws, and with appropriate pre-grant due diligence, the follow-up process – barring war or natural disaster – is no more challenging than monitoring a grantee located in the U.S.

[23] Typically, the purposes of program-related investments ("PRIs") are spelled out quite clearly. This follows from the express requirement of Section 4944(c) that the primary purpose of the investment "is to accomplish one or more of the purposes described in section 170(c)(2)(B)." Therefore, it is usually not difficult to monitor compliance of the borrower or "investee" with the purposes of the PRI.

IV.A. Are there additional requirements that should be added beyond those already specified in Rev. Rul. 56-304, Rev. Rul. 63-252, Rev. Rul. 66-79, and Rev. Rul. 68-489 to reduce the risk that charitable assets may be diverted to non-charitable purposes? Please also comment on how any burden associated with any new requirements might be mitigated.

A. We Believe Existing Requirements Should Be Clarified and We Respectfully Request the Service to Issue New Guidance.

Revenue Rulings 56-304, 63-252, 66-79 and 68-489[24] are decades old. Many charitable organizations and practitioners are not familiar with these authorities, or consider them to be of academic interest only. They were created in an era that preceded personal computers, wire transfers, online banking, global travel and other mechanisms that make fund diversion and fraud generally a very different issue today than it was in the past.

Additionally, most of these authorities address deductibility under Section 170, namely whether a contribution can be claimed as an income tax charitable deduction. In so doing, the guidance focuses on the relationship between the organization and its donors to ensure that donors will be entitled to claim income tax charitable deductions. Most of the guidance in these authorities does not focus on the Section 501(c)(3) operating aspect of exempt organizations, except for very limited circumstances.

Rev. Rul. 63-252 and Rev. Rul. 66-79 address tax deductibility when funds are going overseas (and thus may be enforced by the IRS's Income Tax division rather than the Tax Exempt and Government Entities division). Rev. Rul. 56-304 and Rev. Rul. 68-489 deal with distributions to individuals and to non-exempt organizations, respectively. Neither addresses core operating or grantmaking issues, nor do they address foreign-recipient issues.

In the context of determining deductibility, Rev. Rul. 66-79 offers limited indirect advice on operations. Specifically, Rev. Rul. 66-79, which amplifies Rev. Rul. 63-252, offers guidance as to when funds contributed to a domestic organization that subsequently distributes the funds to a foreign organization are considered earmarked for the foreign organization so as to prohibit a charitable income tax deduction under Section 170. Rev. Rul. 66-79 states that the "test in each case is whether the domestic organization has full control of the donated funds, and discretion as to their use, so as to insure that they will be used to carry out its functions and purposes." The ruling illustrates by example, noting that contributions will be deductible when:

- The domestic organization solicits for specific projects after reviewing and approving them as being in furtherance of its purposes;

[24] General Counsel Memorandum ("GCM") 35319 (April 27, 1973) reflects how the Service's counsel viewed certain issues of international philanthropy 30 years ago. The GCM is not, of course, precedential guidance, and we mention it only as it may contribute to the discussion.

- The bylaws of the domestic organization allow such solicitations only on the condition that it shall have control and discretion as to the use of funds:

    - The board of directors has the right at all times to withdraw approval of the grant and use the funds for other charitable purposes;

    - The organization refuses to accept contributions earmarked so that they must go to the foreign organization in any event; and

    - The board of directors requires that the foreign organization provide a periodic accounting to show the funds were expended for the purposes for which they were approved.

Again, however, this guidance is proffered in the particular context of Section 170 and does not advise the reader whether this guidance also applies in Section 501(c)(3) determinations. It also does not address whether a particular activity is or is not an appropriate activity within the meaning of Section 501(c)(3). As a result, organizations that are not concerned with deductibility (whether because they are non-reporting entities or because they are not well-informed on the importance of these practices to their donors' tax deductions) might never consider looking at or applying these principles to their operations.[25]

Only two of the authorities in question, Rev. Ruls. 56-304 and 68-489, address Section 501(c)(3) matters. Rev. Rul. 56-304 describes the circumstances under which organizations organized and operated under Section 501(c)(3) may make distributions to individuals. Specifically, the ruling states that organizations are not precluded from making distributions to individuals provided they are made on a charitable basis in furtherance of the organization's purposes. The organization should maintain adequate records relating to the identifying

[25] IRS Announcement 2003-29 does not list General Counsel Memorandum 35319. This 30-year-old memorandum, which is not precedential, also addresses deductibility under Section 170, rather than operations under Section 501(c)(3). Nonetheless, it, too, gives limited indirect advice on operations. Specifically, GCM 35319 states that contributions to a domestic organization that distributes funds to foreign entities not organized and operated exclusively for charitable purposes may be tax deductible under Section 170, as long as the domestic organization retains control and discretion over the use of such funds. To demonstrate retention of control and discretion, according to the drafters of the GCM, the domestic organization must review and approve specific projects before distributing the funds to the foreign entity; exercise control to insure the funds are used for charitable purposes; and keep records to establish evidence of its full retention of discretion and control over the expenditure of the funds.

According to GCM 35319, the organization should also ascertain the identities of the ultimate grantees before distributing funds to the foreign entity. However, the domestic charitable organization may be able to establish that its control responsibilities will be met without advance identification of the ultimate foreign grantees, for example, by showing that its operating methods include procedures for retention of control and discretion over funds distributed. The GCM states that the mere promise by the foreign entity to expend funds for humanitarian purposes and to provide periodic expenditure reports is not sufficient to assure that the domestic organization will retain adequate discretion and control over expenditures, but the GCM does not explain what would be sufficient, nor does it explain what "ultimate grantee" means. While the GCM's guidance may be the most extensive, it is neither precedential nor adequately specific.

information of each recipient of aid; the amount of funds distributed to each; the purpose of the funds; the manner in which the recipient was selected; and the relationship, if any, between the recipient and the organization.

Rev. Rul. 68-489 states that an organization that distributes funds to nonexempt organizations will not jeopardize its exemption under Section 501(c)(3), as long as it retains control and discretion over the use of the funds and maintains records to show the funds were used for Section 501(c)(3) purposes. The domestic organization can make such a showing by:

- Limiting distributions to specific projects that are in furtherance of its own exempt purposes;
- Retaining control and discretion as to the use of funds; and
- Maintaining records to establish that the funds were used for Section 501(c)(3) purposes.

While Rev. Ruls. 56-304 and 68-489 address Section 501(c)(3) operating practices, each offers limited guidance. Neither explicitly addresses distributions to foreign recipients, or the difference in responsibilities, if any, depending on whether the foreign recipient is a charity, a non-exempt organization, or an individual.

In summary, this survey of the existing guidance shows that none specifically provides Section 501(c)(3) guidance in a foreign context for paying either charitable grants or charitable operating expenses. Therefore, we recommend issuance of new guidance under Section 501(c)(3). For the reasons discussed below, however, we believe that such guidance should be flexible enough to give practical instruction to the vast array of Section 501(c)(3) organizations, including churches, that either grant funds or expend funds on operations outside the United States. Stated differently, we recommend focusing on protective processes, rather than a list of required steps, to instruct domestic organizations on the kinds of factors the IRS and the field take into account when funding foreign recipients and operations. In the context of public charity insider transactions, Section 4958's process-oriented approach has proven very useful, on a practical daily level, to public charities that wish to benefit from such transactions while reducing the risk of improper activity; we suggest that the same focus on process may be equally useful here.

B. Reasons for a Risk-Based Approach to New Guidance.

As a practical matter, the international grantmaking and operating sector is broad and diverse. Various types of domestic organizations of all sizes and budgets distribute funds outside the United States. Some distribute funds by way of grantmaking. These organizations may make grants to foreign recipients incidental to principal operations in the United States, grants to affiliates and partners abroad, or grants to match employee gifts. Grantmakers can be public charities, private foundations, and corporate foundations.

In contrast, some domestic organizations distribute funds by way of operations outside the United States. These organizations may operate their own programs or branch offices in foreign jurisdictions and make expenditures accordingly. Operators can be public charities, private operating foundations, private foundations, or corporate foundations. The foreign recipients of grants and expenditures from the United States also vary widely. These recipients include foreign charities and exempt organizations, foreign non-exempt organizations, and individuals residing in foreign jurisdictions ("foreign recipients").

Potential risk of fund diversion varies within the sector. The broad spectrum of grantmakers and operators, and the broad spectrum of foreign recipients to whom they disburse funds, present varying levels of potential risk of fund diversion to non-charitable purposes. We believe from our experience that very few grants and expenditures from U.S. charitable organizations are susceptible to diversion for private benefit and even fewer for terrorist activities. Nonetheless, we share the government's concern that no funds be diverted from their charitable purposes for any reason.

Given the diversity of the sector, we believe it will be difficult and, indeed, counter-productive to craft a "one-size-fits-all" approach. Therefore, we recommend a risk-based procedural approach instead. We believe that a risk-based approach could help minimize the burden on charities in cases where increased oversight and due diligence is not justified from a risk-analysis perspective. It is not unreasonable, however, for payments that the U.S. payor determines are higher-risk to be more closely documented and monitored by the U.S. payor. The level of attention to detail should be linked to the level of risk presented. Therefore, we recommend practical, flexible guidance that informs the sector how better to "know your grantee" without prescribing overly burdensome requirements that may be costly without being effective.

A risk-based approach is consistent with Treasury Department regulations. Additionally, we recommend a risk-based approach because it would be consistent with the Treasury Department's continuing efforts with financial institutions to prevent money laundering, terrorist financing, identity theft and other forms of fraud. In particular, we note the recent rules and regulations issued by the Treasury Department regarding the implementation of Section 326 of the USA PATRIOT Act. According to Federal Regulations Section 103.121, financial institutions are now required to implement Customer Identification Programs ("CIP"s). CIPs essentially contain four required elements in order for a financial institution to "Know Your Customer":

1. Collection of identification information;

2. Verification of identification information;

3. Record-keeping of all material information for five years; and

4. Comparison with relevant government lists of known or suspected terrorists and terrorist organizations.

A CIP has flexibility to use alternate verification methods, if justified by the financial institution's risk assessment of the customer, type of account opened, and other circumstances at hand.

These new regulations, aimed at protecting the U.S. financial system from terrorist financing and other forms of fraud, allow for flexibility in implementation to eliminate unnecessary burdens on financial institutions. While there are some similarities between exempt organizations and financial institutions, there are also many important differences, not the least of which are the charitable sector's distinctive purposes and its significantly smaller financial and personnel resources. We do not believe that charitable organizations should be held to stricter standards than financial institutions, but neither should they be held completely unaccountable. Therefore, we believe that a flexible system could be created and guidance issued to advise charitable organizations regarding CIP-like procedures – appropriate to the charitable sector's activities and resources – to "know your grantee" for expenditures destined for non-U.S. recipients.

A risk-based approach is consistent with recent IRS publications. We note that the September 11, 2001, attacks precipitated a detailed review in the United States of delivering disaster relief. An excellent summary is found in IRS Publication 3833, "Disaster Relief: Providing Assistance Through Charitable Organizations." In particular, guidance in the Publication stresses flexibility for charitable organizations assisting individuals in a crisis situation. For example, those organizations distributing short-term emergency assistance are not expected to maintain the more detailed records usually associated with delivery of longer-term assistance.

These measures acknowledge that flexibility is often required when providing charitable assistance to the distressed and needy, and that charitable organizations are best positioned to judge the circumstances under which such grants should be made and such programs operated. A risk-based approach for grants and operations outside the U.S. would be consistent with these flexible standards for grants and operations within the U.S.

C. A Risk-Based Approach

Organizations that we spoke with generally believe that the best protection against diversion is to "Know Your Grantee." Therefore, we have identified four elements of that exercise. A risk-based approach to fund distribution to foreign recipients would involve a four-step process comprised of these elements.

"Know Your Grantee" Process
Step 1: Perform risk assessment;
Step 2: Review risk assessment results to determine whether a particular payment is high, medium, or low risk;
Step 3: Select and implement anti-diversion steps appropriate to the payment's level of risk; and
Step 4: Document risk assessment and retain records for the period the U.S. organization's return is open.

Step 1: Risk Assessment. In the first step of the process, the U.S. organization would assess the risk of potential fund diversion for the particular payment and foreign recipient in question. To this end, new guidance could provide U.S. organizations with payment-related factors that may be associated with a greater risk of diversion. We have assembled a non-exhaustive list of risk factors, outlined in Table 1, which could be adapted to create new guidance.

We believe that there is a continuum of risk and that experienced grantmakers are best placed to make thoughtful and informed judgments as to where on that continuum a particular payment belongs. While all payments should be reviewed, payments above a certain threshold might merit more review than payments below that threshold. On the chart that accompanies these comments, "Continuum of Risk Factors," we present a non-exhaustive list of potential risk factors, clustered in four main areas: (1) the domestic organization's familiarity with the foreign recipient ("FR"); (2) limitations on fund use through various means; (3) internal and external financial accounting mechanisms; and (4) identity verification and identification of known supporters of terrorism.

Step 2: Risk Evaluation. Once a risk assessment has been performed, the domestic organization would be expected to use ordinary business judgment to evaluate whether the proposed payment presents a high, medium or low risk of potential fund diversion. This determination, the second step in the process, would be a subjective weighing of factors by the organization reviewing the payment. We do not suggest a specific number, and we do not believe it would be helpful for the Service to suggest a specific number. However, we believe that the presence of several risk factors or an accumulation of risk factors should alert the organization reviewing the payment to a greater or lesser potential for fund diversion and thereby identify those grants needing more detailed attention and oversight.

Step 3: Anti-Diversion Procedures. In the third step of the process, the domestic organization would decide what additional diligence and oversight, if any, is required for the payment and foreign recipient in question. To this end, new guidance could provide organizations with instruction as to what steps to take once the organization determines that a potential risk of fund diversion exists for a particular payment. We have assembled a non-exhaustive list of procedures for additional due diligence and oversight to minimize the possibility of diversion. This list, outlined below, could be adapted in creating new guidance.

As we note in connection with the continuum of risk factors, we believe that U.S. charitable organizations should adopt those anti-diversion procedures that they conclude are likely to be most effective in particular circumstances. Therefore, we recommend against any list containing mandatory steps other than those that may be required by applicable non-tax law. With that in mind, we offer the following non-exhaustive list of possible steps to reduce the risk of fund diversion:

- Verify the identities of the recipients and the person(s) who will administer the funds.

- Determine whether the foreign recipient appears on an official U.S. government or other appropriate agency list of suspected terrorists or terrorist organizations (e.g., Office of Foreign Asset Control lists, www.ustreas.gov/offices/enforcement/ofac). In this regard, we note that charities will be more likely to adopt this practice if the various lists are consolidated and guidance is readily available as to what to do if a partial or apparent match is discovered.

- Obtain and review information regarding the foreign recipient's internal oversight and accounting procedures for funds and projects.

- Obtain and review references from local organizations in the foreign recipient's country (e.g., advisory boards, non-governmental organizations, reputable charities) or other trusted sources regarding the foreign recipient's past charitable activities.

- Enter into a written grant agreement with the foreign recipient limiting the use of funds to the charitable purposes specified, and retain the right to inspect books and records. A "written grant agreement" might be a grant-award contract for larger grants or a simple transmittal form for smaller grants, such as corporate matching grants, containing the basic obligations on use of funds and the U.S. charity's rights.

- Where appropriate, offer a project-specific grant, rather than a general charitable support grant, so fund use will be easier to track. A project-specific grant could include a grant specifically for general operating expenses such as salaries, utilities, and rent.

- For larger, long-term payments, disburse funds in smaller increments or on a periodic basis, and require a written report on the use of funds previously granted as a condition of receiving the next disbursement.

- Where practicable, use formal financial channels for transferring funds, as opposed to cash or other unregistered means that are not consistent with

international standards of banking regulatory systems. Where funds are disbursed in cash, keep appropriate records.

- Require a report on the foreign recipient's use of significant payments, or at least a report on the foreign recipient's general expenditures for the year.

- Maintain records of any information used to verify recipient identity information, as well as accurate information tracking the amount and actual use of funds granted.

- Conduct or commission a site visit to the location of the funded project to track program accomplishments when the costs of such a visit are reasonably justified by the circumstances and the size of the payment.

- In the unlikely event a potential diversion is identified, suspend payments unless and until the recipient provides adequate supporting documentation showing, to the U.S. organization's satisfaction, that the expenditures were appropriate or showing that the questioned funds were restored to the grantee for proper use.

- Where the U.S. organization believes it is appropriate to do so, consider sharing the U.S. organization's experiences concerning the foreign recipient with other U.S. charitable organizations with programs or projects in that field of endeavor, region, or country.

U.S. organizations making grants or operating payments overseas could employ various procedures depending on the circumstances. The type and number of procedures implemented may vary according to whether the U.S. organization determines that the payment has a high, medium or low risk of fund diversion. The type and number of procedures implemented could also vary according to the resources and structure of the domestic organization, as well as the size of the payment itself. Flexibility helps to ensure that additional diligence performed is cost-effective and well tailored to the particular domestic organization, payment, and foreign recipient in question.

We strongly encourage the Service to make clear, in any guidance addressing these matters, that there will be no negative inference from an organization's failure to adopt or implement any particular listed procedure. This approach is consistent with, for example, the regulations to Section 4958, which make clear that failure to qualify for the rebuttable presumption of reasonableness with regard to a particular transaction does not create a presumption that the transaction was not reasonable.

Step 4: Documentation. The fourth step of the process would involve documenting any risk assessment performed by the U.S. organization. Adequate documentation and record-keeping would allow domestic organizations to establish control and oversight over funds distributed to foreign recipients, and would be in line with the type of records to be

produced in the event of an audit. Files would be retained for the three-year period that the organization's return is open after filing. In the case of a non-filer (e.g., a church), the same three-year period could be required as if the organization did file.

Additional recommendations for a risk-based approach. Any new guidance could make clear that it applies to all public charities and private foundations making grants and operating overseas. To the extent that these procedures are subsumed within expenditure responsibility practiced by private foundations, no additional steps would be required. As public charities are not required to practice expenditure responsibility as such, their operating procedures could be better informed by the new guidance.

Where the U.S. government has seen fit to honor another country's charities laws for treaty purposes, e.g. Canada and Mexico, we would expect the new guidance to take that fact into account.

We also note that the IRS might need to issue separate guidance for grants and gifts from individuals to non-U.S. organizations and from U.S. individuals to other individuals outside the U.S. We suspect that diversions for terrorist purposes might be most likely to occur in the context of payments by individuals. We must emphasize that, contrary to confusion in the public mind and the press, such payments are not "charitable contributions" when paid to other individuals or to non-U.S. organizations.

Mitigating any burden associated with new requirements. In our view, the most effective way to mitigate any burden associated with new requirements is to create one or more "safe harbors" for charities that can document that they dealt with the risk that assets might be diverted by first assessing the risk and then implementing risk reduction procedures that were reasonable in the circumstances. As we note elsewhere in these comments by way of analogy, the safe harbor created by the rebuttable presumption of reasonableness under the Regulations to Section 4958 has caused a significant practical shift in the way that public charities deal with proposed transactions with insiders. The authors have not heard complaints from public charity clients about the burdens of obtaining comparability data; rather, the authors have heard relief that there is clear guidance on which they may rely. We recognize that federal tax law is not the only source of law governing international charitable activities. Nonetheless, by acknowledging that risk assessment and risk management procedures are legitimate and appropriate tools for preventing the diversion of charitable assets, the IRS could alleviate a significant portion of the burden of fear under which many charities currently labor. We note that charities that follow risk assessment and risk management procedures along the lines we describe above have not been among those identified by law enforcement agencies as having caused or permitted material diversions of charitable assets.

Additional Assistance. The ABA Tax Section Committee on Exempt Organizations would be pleased to assist the IRS by drafting model authority of the type outlined above dealing with operating procedures for public charities and private foundations distributing funds to foreign recipients.

IV.B. What specific changes to Forms 990, 990-PF, and 1023 would you recommend to allow for better monitoring of international grant-making and international activities by the IRS, and by other government agencies and members of the public who can review these forms as public documents?

A. Possible Changes to Forms 990 and 990-PF[26]

First, the Forms 990 and 990-PF grant-recipients schedule could be divided into a U.S. and a non-U.S. recipients portion. Any burden resulting from this change would be insignificant because this information is already required.

Second, the Forms 990 and 990-PF could be amended to ask whether the filing organization has obtained a signed grant agreement from each foreign recipient organization for all grants. In line with existing IRS guidance on disaster relief to individuals, we do not recommend requiring written grant agreements for emergency humanitarian aid to individuals, but Forms 990 and 990-PF might ask about documentation for other types of payments to individuals, e.g. for fellowships. The grant agreement could limit use of funds to charitable purposes, and prohibit use of funds to support or promote non-charitable purposes, including funding terrorist organizations and activities. If no grant agreement was obtained, Form 990 and Form 990-PF could require a filing organization to attach an explanation.

Third, the Forms 990 and 990-PF could be amended to ask if a filing organization maintains bank accounts outside the U.S., and, if so, to identify the countries where such bank accounts are maintained. Organizations with foreign bank accounts containing more than $10,000 are already required to file Form TD F90-22.1, Report of Foreign Bank and Financial Accounts, with the result that the IRS and other government agencies already have significant banking data from charitable organizations.

B. Possible Changes to Form 1023.

An organization reporting that it is likely to make grants or other charitable-purpose payments to foreign organizations or individuals could be asked to explain its plans and identify its expected partners, to the extent that they are known at this early stage of the entity's life. Currently, Form 1023 asks for detail regarding non-U.S. partners when a "supporting organization" relationship exists. This request could be expanded to include other types of relationships.

We note, however, that Form 1023 looks at the intent, as opposed to the actual practices, of charitable organizations. Changes to Form 1023 would be of limited value with regard to monitoring international grantmaking activities and tracking assets actually distributed overseas.

[26] This Committee previously submitted comments to the Service on possible modifications to Form 990 in response to Announcement 2002-87. Our suggestions here are based on these prior comments.

C. Additional Recommendations Regarding Reporting Requirements.

The federal government already requests information on the international flow of funds by means of the U.S. Department of Commerce Bureau of Economic Analysis Form BE-40. We would be interested in feedback on the government's experiences with that filing and whether its data is informative. Form BE-40 asks "religious, charitable, educational, and other nonprofit organizations" to report "all transfers to foreign residents and organizations." The Commerce Department requests annual reports from organizations remitting $25,000 or more, up to $1 million, annually, and quarterly reports from organizations remitting more than $1 million annually to foreign recipients.

Currently the information is given voluntarily and by law cannot be disclosed. Form BE-40 could be revised and made mandatory, perhaps with a reporting threshold similar to the $10,000 cash transaction threshold applicable to banks. However, it is not clear that the burden of filing these forms would be justified if U.S. government agencies other than the Commerce Department would make no use of these forms. Also, in keeping with the risk assessment approach, this burden may be appropriate only in nations or regions identified as high risk by the U.S. government.

Second, non-reporting organizations (such as churches and those organizations with assets less than $25,000) currently are not required to file Form 990. The overseas funding and operating activities of these organizations are largely undocumented, making their acts and omissions more difficult for the IRS, the press or the public to track. Several reporting charities have expressed concern to the authors that increased regulation of their sector will shift terrorist financing to non-reporting organizations, primarily churches and other religious institutions. As we discussed above in our response to Question 1, however, religious organizations perform their own risk assessment and oversight procedures and they, as well as other non-reporting organizations, could also be requested to submit the amounts of all transfers to foreign recipients on another form, such as Form BE-40.

In closing, we note that individuals intent on committing fraudulent diversions will not likely report them voluntarily on Form 990. Instead, this is criminal activity better tracked by law-enforcement officials than by the TE/GE Division of the IRS, much less by charities themselves. We imagine that identification of bank accounts by reporting organizations would be of most value to law-enforcement officials. We believe, however, that such reporting would be better done through banks than through the Form 990.

V. In November 2002 the Treasury Department released "Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities." These guidelines were developed to help a charity reduce the risk that the charity's funds would be frozen in connection with any ongoing anti-terrorism investigation. Recognizing that some of these voluntary best practices impose additional burdens on charities and may not be directly related to tax administration, the IRS is nevertheless interested in learning which of the best practices specified in the guidelines organizations currently use. The IRS is also interested in learning whether these currently used best practices are useful in achieving compliance with federal income tax requirements and appropriate for other public charities and private foundations to follow.

A. General Comments

On June 20, 2003, the Council on Foundations sent detailed comments on the Voluntary Guidelines to Treasury General Counsel David Aufhauser. These comments may be found at www.cof.org/files/Documents/Legal/Treasury_Comments_06.03.pdf (the "COF Comments"). We understand that the Council will also respond to Announcement 2003-29 and that it will provide the Service with its letter to General Counsel Aufhauser in connection with that response. While the Tax Section takes no position on the COF Comments, the individual authors of this Committee's response to Announcement 2003-29 generally agree with the COF Comments. For your convenience, we reproduce the Executive Summary of the COF Comments in full:

> The Council on Foundations welcomes the opportunity to comment on the Treasury Department's "Antiterrorist Financing Guidelines: *Voluntary* Best Practices of U.S.-Based Charities," released in November 2002. The stated objective of the treasury department – to guard charitable funds from diversion to terrorist organizations without "chilling legitimate good works" – is one we share. However, the Guidelines fail to accomplish this objective by adopting a "one size fits all" approach that would greatly increase the administrative cost of making all international grants, without helping U.S. charities identify and take appropriate precautions with respect to the very small number that are at risk for diversion. The unintended consequence would be to jeopardize a vast amount of "legitimate good works" by discouraging the making of all international grants, including (but by no means limited to) those in developing countries where the needs for humanitarian assistance are at unprecedented levels. Given the important issue that the Guidelines seek to address – and the equally important role of the charitable sector in addressing critical international needs, we request that the Treasury Department withdraw the Guidelines and reissue them after an opportunity to consider these and other comments.
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> Our comments are straightforward. We believe that the objective of the Guidelines can best be achieved by helping U.S. charities develop and apply a risk-based approach that (1) helps the grantmaker to identify those grants that may

present a greater risk for diversion, and (2) describes additional steps that the grantmaker may take to minimize the possibility of diversion for grants that are so identified. This two-step risk assessment process, which would replace the factors currently set forth in Section IV of the Guidelines, strikes an appropriate balance between the need to protect charitable funds from terrorist diversion and the equally important need to allow U.S. charities to continue providing humanitarian relief and helping to build free and democratic societies in chaotic nations that have been devastated by war, famine, disease and internal turmoil.

The Council also recognizes that governance, accountability and transparency are hallmarks of responsible philanthropy. Contrary to the approach taken in the Guidelines, however, there is no single set of "best practices" in these areas. Moreover, some of the "best practices" listed in the Guidelines are internally inconsistent and/or contrary to federal and state laws governing charities. Accordingly, the Council recommends that the list of "best practices" set forth in Sections I, II and III of the Guidelines be replaced by a list of general principles of governance and financial accountability that would be considered relevant in an investigation by the Treasury Department of the alleged use of funds to support terrorism.

Finally, the Council recommends that the title of the Guidelines and the preamble be revised to reflect the important legal context for the document: implementation of the USA Patriot Act of 2001 and Executive Order No. 13224. These revisions will make it clear that, although the Guidelines are denominated as voluntary, a charity's good faith compliance with them will help reduce the likelihood of a blocking order against the organization or its donors in the event of an investigation concerning the alleged diversion of funds to support terrorism (provided, of course, that there is no knowledge or intent to use funds for that purpose).

B. Which of the practices specified in the Voluntary Guidelines[27] do organizations currently use?

Table 2, which follows our narrative comments, compares the practices described in Part IV of the Voluntary Guidelines with the practices of those public charities and private foundations with which the authors are familiar. Table 2 should be read in conjunction with the descriptions of private foundation and public charity administrative practices in Part I, above.

Because of the great diversity of practice in the charitable sector, we emphasize that our response to Question 1 and the information in Table 2 are not exhaustive. Many organizations that are legally compliant take other steps to prevent the diversion of their

[27] For the reasons stated in the preceding discussion, we focus our comments here on Part IV of the Voluntary Guidelines.

charitable assets to non-charitable ends. One should not draw any negative inference from the omission of a particular charitable organization's practices from this paper.

C. Which of the practices specified in the Voluntary Guidelines and currently used by organizations are useful in achieving compliance with federal income tax requirements and appropriate for other organizations to follow?

Federal income tax requirements, of course, vary depending on whether the charity in question is a public charity or a private foundation. As we note in Part IV, more guidance is available for private foundations than for public charities regarding international charitable activities, but that guidance is of limited utility.

We believe, for the reasons stated in the COF Comments, that the Voluntary Guidelines should be withdrawn. In these comments, therefore, we focus not on the practices specified in the Voluntary Guidelines but on the effective risk assessment and risk management practices that many well-managed charities use today. We believe that guidance along the lines that we suggest in Part IV, reflecting many of these practices and informed by the anti-terrorist-financing concerns that prompted Treasury to issue the Voluntary Guidelines, would contribute significantly to achieving compliance with federal income tax requirements and, of equal importance, to the further reduction of opportunities for diversion of charitable assets to non-charitable ends.

We do not believe that it is useful or appropriate to extend expenditure responsibility obligations to public charities. Expenditure responsibility is one tool among many for the *management* of risk; it does not address the *assessment* of risk. While all U.S. charities would benefit from guidance on assessing risk, we believe that guidance should make clear that a range of appropriate tools is available for managing risk once assessed, in addition to those requirements already imposed on some sectors of the philanthropic universe by federal tax law.

Finally, we strongly recommend the development of one or more "safe harbors" so that charities are not effectively forced out of international philanthropy by fear of unlimited liability for the actions or omissions of the ultimate recipients of their funds.[28] Treasury has already expressly recognized, in the context of expenditure responsibility, that private foundations are not the guarantors of their grantees' use of grant funds.[29] A safe harbor provision will not only encourage the broader adoption of responsible risk assessment and risk

[28] We noted in Part II, above, that a number of U.S. charities have curtailed their international activities or suspended them entirely, believing that the absence of reliable guidance about the type and amount of due diligence leaves them in a position of unacceptable risk. We have also been informed that several large corporate matching gift programs, for example, have been suspended due to these concerns with regard to domestic charities. A safe harbor will go a long way toward preventing further erosion of this type.

[29] Reg. Sec. 53.4945-5(b)(i).

management procedures;[30] it will also alleviate the concerns of many charities that they will be held responsible for subsequent criminal diversions of assets from their grantees. We recognize that the IRS is one of many governmental agencies that are concerned with the possible use of charitable organizations as channels for funding or concealing violent or terrorist acts. Nonetheless, guidance from the IRS in this regard would provide a significant incentive for more charities to adopt the risk assessment and risk management approach that many have already adopted to prevent the diversion of charitable assets.

Conclusion

Many U.S. organizations that make grants or operate programs internationally already follow procedures for risk assessment and oversight as an integral part of responsible philanthropy. Nonetheless, we believe that all charities will benefit from IRS guidance that outlines risk assessment procedures and risk management options and allows charities to develop and implement processes and procedures that they believe are an appropriate response to the risks that they assess. Domestic charitable organizations have philanthropic expertise and a working knowledge of IRS guidelines and regulations. They are best positioned to exercise the requisite business judgment to assess the circumstances under which grants should be made and programs operated. Additional IRS guidance, along the lines that we suggest in Part IV, will enable them to do their valuable work even more effectively.

[30] To illustrate this point, we note that in the experience of the authors, public charities have paid far more attention to independent review of comparability data for insider transactions since the Regulations to Section 4958 provided a process-based road map for obtaining a rebuttable presumption that an insider transaction is not an excess benefit transaction but is, rather, reasonable.

TABLE 1
CONTINUUM OF RISK FACTORS

LESS RISK	SOME RISK	MORE RISK
The FR has an existing relationship with the U.S. organization.	The FR has an existing relationship with other U.S. organizations but not with this U.S. organization.	The FR has no prior history with U.S. organizations.
The FR can provide references from trusted sources.	The FR's references are from sources with which the U.S. organization is unfamiliar.	The FR has no references.
The FR has a history of legitimate charitable accomplishments.	The FR is newly or recently formed but its leadership has a history of legitimate charitable accomplishments.	The FR has little or no history of legitimate charitable accomplishments.
The FR has specific charitable objectives and is transparent as to fund use.	The FR has general charitable purposes and is transparent as to fund use.	The FR has general purposes and is not transparent as to fund use.
The FR has strong leadership and control mechanisms, including an on-site professional staff and record-keeping systems.	The FR has strong leadership and control mechanisms and relies primarily on trained volunteers rather than professional staff.	The FR has weak leadership and control mechanisms.
The U.S. organization and the FR create appropriate records on the identities of recipients and timely account for the use of funds. The types of records that are appropriate will vary with the circumstances of the grant.	The FR needs technical assistance in order to develop systems capable of creating and maintaining appropriate records of recipients and the use of funds but agrees to work with the U.S. organization to improve its systems.	The domestic organization and/or the FR do not create appropriate records on the identities of recipients or timely account for use of funds.
The parties have a written grant agreement which states how payments are to be used.	The parties have a written grant agreement with insufficient protective provisions.	The parties do not have a written grant agreement.
The grant agreement prohibits fund use for non-charitable purposes, including the promotion of violence or terrorist activities.	The grant agreement prohibits non-charitable uses but does not specifically ban the promotion of violence or terrorist activities.	The grant agreement does not prohibit fund use for non-charitable purposes, including the promotion of violence or terrorist activities.

LESS RISK	SOME RISK	MORE RISK
The U.S. organization disburses funds in smaller increments as needed for specific projects or expenditures.	The U.S. organization authorizes grantee discretion within specified limits.	The U.S. organization disburses funds in one large payment to be invested and spent over time or for unspecified projects selected by the FR.
More formal financial systems and registered channels for transferring funds are available and used by the FR, thereby subjecting it to the safeguards of banking regulatory systems consistent with international standards.	Formal financial systems exist but are unreliable or corrupt and the U.S. charity and the FR agree on alternative methods that they reasonably believe to be reliable, trustworthy, and not susceptible to diversion to violent, terrorist, or other non-charitable ends.	Reliable and non-corrupt formal financial systems or registered channels for transferring funds are not available or used by the FR, thereby offering little or no safeguard of banking regulatory systems consistent with international standards.
The FR is located in a country that is not now, and has not recently been, identified by the U.S. government or other appropriate agency as supporting or housing known terrorist organizations and activities, or maintaining links to terrorist financing.	The U.S. government or other appropriate agency has recently determined that the country where the FR is located is no longer supporting or housing known terrorist organizations and activities or maintaining links to terrorist financing.	The FR is located in a country that has been identified by the U.S. government or other appropriate agency as supporting or housing known terrorist organizations and activities or maintaining links to terrorist financing.
The U.S. organization determines that the FR does not appear on any U.S. government agency list of known or suspected terrorists or terrorist organizations, e.g., Office of Foreign Asset Control lists at www.ustreas.gov/offices/enforcement/ofac)	The U.S. organization identifies a partial match to a person or organization named on such a list and ascertains to its satisfaction that the FR or related person is not the person identified on the list.	The U.S. organization makes no effort to determine whether the FR is named on any U.S. government list.
Payments are not disbursed to individuals.	Payments are disbursed to individuals and records are kept.	Payments are disbursed to individuals and no records are kept.
Payments are remitted by wire transfer to a known account in a reputable financial institution.	Payments are remitted by check and deposited to a known account in a reputable financial institution.	Payments are remitted in cash.

TABLE 2
VOLUNTARY GUIDELINES AND CURRENT PRACTICES OF CHARITABLE ORGANIZATIONS

NUMBER	VOLUNTARY GUIDELINE	CURRENT PRACTICE
IV.A	The U.S. charity should collect the following information about a potential foreign recipient ("FR"):	
IV.A.1	The FR's name in English, in the language of origin, and any acronym or other names used to identify the FR	Public charities and private foundations obtain names in language of origin and, if different, in English, but most do not ask for acronyms or other names without specific reason to do so.
IV.A.2	The jurisdictions in which the FR maintains a physical presence	If the U.S. charity only proposes to support or conduct activities in one country, it is unlikely to ask about the FR's activities in other countries.
IV.A.3	The jurisdiction in which the FR is incorporated or formed	Private foundations that perform equivalence determinations always obtain this information in the course of reviewing the FR's governing documents; they often obtain it for expenditure responsibility grants as well. The practice varies among public charities but most obtain this information through reviewing the FR's governing documents.
IV.A.4	The address and phone number of any place of business of the FR	If the U.S. charity only proposes to support or conduct activities in one country or one location, it is unlikely to ask about the FR's places of business or offices elsewhere.
IV.A.5	The principal purpose of the FR, including a detailed report of the FR's projects and goals	Both public charities and private foundations obtain information on a FR's purposes, but will generally seek details only for projects and goals related to the activities that they propose to fund and not about the FR's other activities unless risk assessment results indicate that it is appropriate to do so.

NUMBER	VOLUNTARY GUIDELINE	CURRENT PRACTICE
IV.A.6	The names and addresses of organizations to which the FR currently provides or proposes to provide funding, services, or material support, to the extent known, as applicable	U.S. funders generally obtain and review this information where the sub-grantees or subcontractors are an integral part of the project for which the FR seeks funding. Where the U.S. charity proposes to rely on the expertise and administrative capacity of the FR for a re-granting project or other collaboration with local organizations and the other participants cannot be identified at the pre-grant stage, the U.S. charity will obtain this information from the FR in periodic written reports during the term of the project. U.S. funders generally do not seek this information for grantees or subcontractors of the FR that are not related to the project at hand.
IV.A.7	The names and addresses of any subcontracting organizations utilized by the FR	
IV.A.8	Copies of any public filings or releases made by the FR, including most recent official registry documents, annual reports, and annual filing with the pertinent government, as applicable	These documents are not always available, depending on the laws of the FR's country of origin; some countries do not require them and others will not release them. U.S. funders generally obtain and review at least some of these materials when possible, as well as media coverage, program reports, and other objective evidence of the FR's activities.
IV.A.9	The FR's existing sources of income, such as official grants, private endowments, and commercial activities	Private foundations must obtain this information if they are making a public charity equivalence determination. Some public charities and private foundations obtain and review this information as part of their pre-grant review, but as noted above, FRs may not be permitted to provide it, depending on local law.
IV.B.1	The charity should be able to demonstrate that it conducted a reasonable search of public information, including information available via the internet, to determine whether the FR is or has been implicated in any questionable activity.	The pre-grant evaluation practices of public charities and private foundations focus on information that the U.S. charity reasonably believes to be reliable and relevant. While the internet is a valuable information-gathering tool, much of what is available there can be rumor, innuendo, and rhetoric, and facts that were accurate when posted may not be updated to reflect subsequent developments. As lawyers, we note that the phrase "implicated in questionable activity" is so vague as to be unworkable. Moreover, legally compliant charitable organizations – like U.S. citizens – differ widely in how they define "any questionable activity."

NUMBER	VOLUNTARY GUIDELINE	CURRENT PRACTICE
IV.B.2	The charity should be able to demonstrate that it verified that the FR does not appear on any list of the U.S. Government, the United Nations, or the European Union identifying it as having links to terrorism or money laundering.	Most U.S. charitable organizations that are aware of the requirements of the Order and the Act now check the OFAC list and the lists included in Executive Order 13224, but other U.S. government lists are less widely known. Many charities are unaware of their legal obligations under the Act and the Order; we encourage the IRS to include information on these obligations in any published guidance. Some charities check the U.N. and E.U. lists but this is not yet common, in part because it is not clear which lists the Guidelines contemplate.
	The charity should consult the Department of the Treasury's Office of Foreign Assets Control (OFAC) Specially Designated Nationals List.	We commend the IRS for adding links to the OFAC list and the lists included in Executive Order 13224 to the "Search for Charities" section of www.irs.gov/eo.
	The charity also should consult the U.S. Government's Terrorist Exclusion List maintained by the Department of Justice, the list promulgated by the United Nations pursuant to U.N. Security Council resolutions 1267 and 1390, the list promulgated by the European Union pursuant to EU Regulation 2580, and any other official list available to the charity.	At this writing, charities that are aware of their obligations under the Order and the Act are checking all U.S. government lists. Some also check the U.N. list and the E.U. list. The reference to "any other official list available to the charity" is not only confusing but troubling. Is a U.S. charity obligated to check lists maintained by other governments? How is the U.S. charity to determine how much weight to give to another country's lists?

NUMBER	VOLUNTARY GUIDELINE	CURRENT PRACTICE
IV.B.3	The charity should obtain the full name in English, in the language of origin, and any acronym or other names used, as well as nationality, citizenship, current county of residence, place and date of birth for key staff at the FR's principal place of business, such as board members, etc., and for senior employees at the FR's other locations. The charity should run the name though public databases and compare them to the lists noted above.	U.S. charities that are aware of the lists are likely to check the names of key staff members involved with the project to be funded, as well as board members and officers, but we are not aware of any that request the nationality, citizenship, place of birth, date of birth, etc. of these individuals unless specific circumstances warrant this level of inquiry. U.S. charities are concerned that requesting this information will endanger the safety of their local staff as well as the FR staff because the U.S. charity will be perceived as an agent of the U.S. government, the local police, or both. It is also not clear what the charity must do if a partial or apparent match appears. Finally, the reference to "public databases" is unclear; charities do not know whether this refers to the U.S. government lists or to internet search engines such as Google.
IV.B.4	The charity should require the FR to certify that it does not employ or deal with any entities or individuals on the lists referenced above, or with any entities or individuals known to the FR to support terrorism.	Some U.S. charities require FRs to certify that they do not employ or deal with any organizations or individuals known to the FR to support violence or terrorism, but many U.S. funders question the utility of certification generally, since criminals will simply lie. U.S. charities that are aware of the lists generally do not require FRs to check the lists, since many FRs do not have the technological ability to do so, and indeed may not read English or the Roman alphabet.

NUMBER	VOLUNTARY GUIDELINE	CURRENT PRACTICE
IV.C.1	The charity should determine the identity of the financial institutions with which the FR maintains accounts. The charity should seek bank references and determine whether the financial institution is (i) a shell bank; (ii) operating under an offshore license; (iii) licensed in a jurisdiction that has been determined to be non-cooperative in the international fight against money laundering; (iv) licensed in a jurisdiction that has been designated by the Secretary of the Treasury to be a primary money laundering concern; and (v) licensed in a jurisdiction that lacks adequate anti-money laundering controls and regulatory oversight.	Some of the largest private foundations contract with major accounting firms to review the financial controls of FRs considered for significant grants or long-term relationships, but even these foundations do not use this approach for all FRs. For the majority of U.S. funders, such a level of review is not cost-effective. As for the specific elements stated in this Guideline, we believe that this function is most effectively performed by governments rather than by private charitable organizations. We strongly recommend against adopting this Guideline as either a recommended or a mandatory practice.
IV.C.2	The charity should require periodic reports from the FR on its operational activities and use of the disbursed funds.	All U.S. charities known to the authors require periodic reports from FRs as described, although the level of detail varies with the circumstances. The report for a project grant, a grant of material size, or a grant of any kind to a FR when the U.S. charity determines there is a risk of diversion will be more detailed than the report for a modest general support grant from a public charity to a FR that has satisfied the U.S. funder's pre-grant evaluation.
IV.C.3	The charity should require the FR to undertake reasonable steps to ensure that funds provided by the charity are not ultimately distributed to terrorist organizations. Periodically the FR should apprise the charity of the steps it has take to meet this goal.	The grant agreements customarily used by U.S. charities contain provisions designed to deter diversion of charitable assets to non-charitable ends. Some U.S. charities, as noted above, have added provisions to their grant agreements specifically barring the use of any grant funds to support violence or terrorism. Compliance is part of the FR's reporting obligation.

NUMBER	VOLUNTARY GUIDELINE	CURRENT PRACTICE
IV.C.4	The charity should perform routine, on-site audits of the FR whenever possible, consistent with the size of the disbursement and the cost of the audit.	Whether this Guideline refers to a formal audit of the FR's finances, a review of the FR's compliance with the terms of the grant agreement, or a forensic audit designed to detect possible criminal activity, few U.S. charities perform any of these activities on-site on a "routine" basis unless they have fully staffed field offices in the FR's country. The level of review in any case will depend on the U.S. funder's assessment of what is appropriate in the circumstances, considering the size of the payment, the risk of diversion to non-charitable ends, and the cost of the review.