



INTERNATIONAL GRANTMAKING SYMPOSIUM

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# ACING AN AUDIT, PAINLESSLY

Presented by:

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AN EDUCATIONAL COLLABORATION BETWEEN



THE CENTER FOR  
HIGH IMPACT PHILANTHROPY  
The University of Pennsylvania

# WHY PREPARE?

- An “audit” is a formal examination of accounts, financials, records, and/or procedures.
- Why prepare? Because an audit of cross-border grants is inevitable, whether by a
  - Government agency, e.g., IRS, state Attorney General, U.S. A.I.D.,
  - U.K. Charity Commission, France’s Cour des comptes
  - International agency, e.g., World Bank, U.N.
  - Funder
  - Internal audit



# WHY PREPARE? (cont'd)

- The IRS Tax Exempt and Government Entities Commissioner in the FY 2016 Priorities Letter identified as one of 5 areas of IRS focus:
- “International--Issues include oversight on funds spent outside the United States including funds spent on potential terrorist activities, *exempt organizations operating as foreign conduits*, and Report of Foreign Bank and Financial Accounts (FBAR) requirements, enforced through compliance reviews, compliance checks, correspondence audits, and field examinations.”  
[emphasis added]
- Being prepared reduces the pain & expense of audits.



# IRS SHOWS EXACTLY HOW “FRIENDS OF” AUDITS WILL HAVE ADVERSE OUTCOMES

- See IRS LTR 201511033 (March 15, 2015)[Google it!]:
- Revoking exemption of a “Friends of” organization because more than an insubstantial part of its activities were not in furtherance of exempt purposes, and
- Canceling deductibility of donor contributions to the “Friends of” organization because the organization failed to exercise control & discretion over donations, such that it was a “conduit” from donors to the foreign charity which is not eligible to receive U.S.-deductible \$\$\$



# EVIDENCE OF ADVERSE AUDIT OUTCOMES (cont'd)

- The U.S. grantor organization did not maintain appropriate records showing how specific grants were to be used by the foreign charity
- The U.S. organization did not maintain appropriate records showing how specific grants were actually used by the foreign charity
- The U.S. organization “made other questionable payments and transactions totaling 50 percent of distributions for which no substantiation was provided to establish whether funds were used” for qualifying purposes.
- The U.S. organization failed to maintain contemporaneous written records.



# Evidence of Adverse Audit Outcomes (cont'd)

- The U.S. organization had no contemporaneous written records to show that it exercised control & discretion over the funds it granted.
- The IRS said that payments to the foreign organization were sent “not for specific projects, but for the general operating expenses” of the foreign organization. Given that:
- The IRS found that the U.S. “Friends of” ceded discretion to the foreign organization “in effect making [the foreign organization] the actual donee organization.”
- The U.S. “Friends of” organization could “not establish that it funded specific projects reviewed in advance” as required by the 2 seminal anti-conduit authorities, Revenue Rulings 63-252 and 63-79.



# AVOIDING AN ADVERSE AUDIT OUTCOME

- LTR 201511033 is the first time IRS explained the problems it sees in paying general operating support to a foreign organization without first reviewing and pre-approving the components of that support.
- These problems are easily avoidable by having procedures AND e-files of contemporaneous writings showing:
  1. U.S. Board pre-approval of projects + general operating-support budget components: e.g., rent, utilities, teacher salaries and fringe benefits as qualifying exempt purposes/activities AND
  2. a written grant award contract, AND
  3. reports back to the U.S. grantor showing grants spent as pre-approved.



# EFFICIENT RECORD-KEEPING

- Organize records in real time before audits in e-files:
- Keep digital copies of the original certificate of incorporation or trust instrument and any amendments, including approving minutes
- Original by-laws and any amendments, including approving minutes
- IRS Form 1023 Application for Exemption & any IRS correspondence
- IRS determination letter & any IRS correspondence
- IRS Forms 990 or 990-PF for every year & state & local filings
- Any IRS audit documents, such as IDR requests & responses



# EFFICIENT RECORD-KEEPING (cont'd)

- Form 8940, Miscellaneous Determination Requests, if any
- Private letter ruling requests & replies, if any
- Accountable plan, convenience of the employer, or any other policies related to compensation or exclusion of amounts from compensation
- Rebuttable-presumption-of-reasonableness, related-party, or interested-director approvals including appraiser reports, minutes
- Composition of the U.S. Board for every year showing a majority were U.S. directors, not foreign-organization-beholden directors



# CHECKLIST E-FILE RECORDS OF EVERY GRANT

- Keep for every grant the formulaic RESOLUTION pre-approving each grant request & its budget items as being in furtherance of the U.S. organization's exempt purposes and authorizing solicitation,
- Keep the written GRANT-AWARD AGREEMENT for every grant limiting spending to the attached copy of pre-approved projects & budget items & requiring reports back to the U.S. organization, and
- Keep for every grant every written REPORT BACK showing how the grantee spent the grant funds in furtherance of the grant-award budgets.
- If reports back fail to appear, DOCUMENT EFFORTS TO GET THEM.



# HOW U.S. ORGANIZATIONS SET EXPECTATIONS

- Educate your grantee organizations in advance about the required steps and what to expect
- Explain the detail you will expect in grant requests & budgets
- Explain how long your Board will need to review & approve grant requests (e.g., unanimous emails) and to produce the written grant-award agreement, which the grantee's representative must sign & return
- Explain your need for spending detail in the annual reports back until the grant funds are expended in full
- Explain that you could need to cancel future funds & could require repayment if you fail to receive adequate or appropriate reports back.



# SUCCESSFUL MONITORING & EVALUATION

- Were the grant funds spent for pre-approved budget items?
- If not, was advance approval granted for reallocation to another pre-approved use?
- If not, were unexpended funds returned to the foreign grantee or the U.S. “Friends of” grantor?
- If not, did the U.S. grantor investigate any diversion of grant funds?
- If diversion was found, what steps did the U.S. “Friends of” take to recover the diverted funds? Were they recovered? To whom?
- Did the U.S. “Friends of” need to cancel future grantmaking?



# QUESTIONS?



# THANK YOU!

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