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Making Charitable Gifts - What Donors Should Know

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Due diligence is as vital when making donations to a charity as it is when investing in a company. An expert in philanthropy takes a walk through the issues.

Recent controversy around international anti-poverty charity Oxfam has put actions of non-profits in focus. (Some of the charity's staff have been accused of sexual misconduct in countries such as Haiti, prompting sharp criticism about how Oxfam has been run, and even raising the specter of it losing public funding in the UK.) Clearly, the risks of a charity's staff "going rogue" is the kind of problem that donors and their advisors must bear in mind. The kind of due diligence checks involved in an investment or project apply with as much force or even more so in philanthropy where the assumption may be that the parties involved have high motives. There are a variety of considerations in play such as the conduct of groups operating outside a home country.

An expert around philanthropy who is based in Chicago, Susan Winer, writes on the issues donors should consider to ensure persons to whom money is entrusted do the right thing. Susan is chief operating officer of Strategic Philanthropy and a frequent writer in these pages on the subject. (See a recent case here.)
For anyone who wishes to respond with observations on this article, email the editor at tom.burroughes@wealthbriefing.com

Recently an advisor with whom we work closely called to discuss a question his client had asked. The client had made a significant charitable gift to an organization whose mission he felt strongly about, only to discover that the organization was under federal investigation. The client was deeply concerned about whether he would somehow be implicated and could he get his charitable gift back given the situation.

The answers to both questions was no. No - he would not be implicated simply for having made a grant to the organization, and no - he could not ask for his money back, unless the grant award letter specifically addressed certain exceptions, expectations, or conditions that directly related to the problem facing the organization (e.g. whether and when the grant must be returned). Since clearly the donor had no evidence of wrongdoing or that any legal matters were pending when the gift was made, the organization was not required to, nor could it be expected to, return any funds.

According to the National Center for Charitable Statistics, there are upwards of 1.5 million non-profits in the US alone. Most of these are relatively small, and the majority are honest, law-abiding organizations often struggling to stay afloat. While there is no way to anticipate problems at any organization, there are certain things a donor can do to learn as much as possible about an organization, before making any financial commitments.

This is particularly important because in recent years there have been several high-profile situations wherein a non-profit organization has faced serious legal and reputational problems. Most recently Oxfam, AmFAR, and Wounded Warrior - all respected organizations - have faced challenges to their ethics, management, fiscal accountability, and donor relations.

As demonstrated in the Oxfam case, the issues plaguing organizations are not limited to the US. Not even the highly respected President's Club in the UK is immune, despite its 33-year history of raising significant funds for charity at its annual black tie charity dinner. This past January, it came under scrutiny for hosting a men-only dinner, which featured allegedly questionable behaviors by its prominent male guests and event organizers.

In 2016, both the Clinton Foundation and the Trump Foundation were subject to investigation for misuse of donor contributions. Even the actor Leonardo DiCaprio, whose charity funds support environmentally-related issues, was accused of being involved in a $3-billion Malaysian embezzlement scandal. Over the past 10 years, a variety of venerable institutions and organizations from the Smithsonian to American University to the Sierra Club, from the Red Cross to the Boy Scouts, among others, have come under public scrutiny for everything from improper use of funds to accusations of sexual assault by executives.

So what is a donor to do and how can you, as the trusted advisor to these donors, simultaneously protect their charitable investments to some degree while still helping them make thoughtful investments with their charitable dollars? One way is to advise them to do the necessary due diligence before they make any financial commitments. You can help them make informed decisions, and in so doing, deepen your relationship with them.

Meaningful philanthropy is a partnership between the donor and the organization. It requires transparency by both parties, as well as a commitment to open communication. While there are no guarantees about whether an organization will have financial, operational, or reputational problems going forward, it is possible to ensure that a charitable gift is going to be used the way the donor intends, and know whether the organization has the capacity and sustainability to continue to be responsive to its stakeholders.

A good starting point for any donor is to ensure that the organization is aligned with his or her interests and expectations. Knowing an organization's goals and mission is a start, along with determining what constitutes impact for the organization. How such impact is measured and reported is important. Not everything can be "solved" or eradicated.

Then there are certain critical due diligence steps a donor should take before making any commitments:

-- Check the organization's tax-exempt status, and confirm that it is in good standing. The IRS maintains a list of organizations that qualify for tax-exempt status. You can also see whether there are any tax-related issues pending;

-- Review the nonprofit's financials. Online tools such as the Foundation Center's 990;

-- Finder allow users to review copies of a nonprofit's most recently-filed Form 990. The 990's contain useful information on a nonprofit's assets, liabilities, reserves, expenses, and revenue sources. Another option is to request annual reports from organizations. Not only do annual reports contain important financial information, but they often address programs and activities for the year, specifically in relation to their stated mission objectives;

-- Ensure that expenses are reasonable given projected income and the scope of the organization's work. Look carefully at current and recent fiscal budgets. An overhead (or expense) ratio measures how much of each donation is spent on programs vs. administrative and fundraising costs. These ratios alone do not tell the whole story, but they are one element to examine in an organizations overall fiscal health;

-- Pay attention to the diversity of funding sources. What comprises the revenue base? Is the Board contributing to the organization? Are they growing and continuing to diversify sources of revenue over year? Overreliance on one revenue source can put the organization in a compromised situation. Be sure to look two or three prior years of funding as well as projected funding plans;

-- Review the organization's investment policies. Find out the track record of the investment manager(s). Ask if a conflict-of-interest policy is in place. Such a policy comes into play if the investment manager(s) sits on the board of directors or is an officer. Financial information and/or annual reports often indicate who manages the organization's funds and investments. Investment manager track records usually are available through various sources;

-- Evaluate the organization's mission. Are programs and services aligned with the both the organization's mission and your client's philanthropic agenda? Check the nonprofit's website for a mission statement. If it is not there, ask the organization for it;

-- Visit the organization; meet the leadership and staff; talk to members of the board of directors.

o How experienced are leadership and staff relative to the programs and services they deliver?

o What professional and technical resources are in-house? What is outsourced and to whom?

o Confirm whether strategic and fundraising plans are in place and how they are being implemented.

o Why are individuals on the board of directors and how long have they been serving? What are the criteria for being on the board? And

-- Google the organization. How is it perceived by the media and public? Pay careful attention to who is speaking on behalf of an organization and what kind of fundraising it is doing and who attends events on behalf of an organization. This is an excellent way to better understand the stakeholders and thought leaders in the organization.

As the trusted advisor to your clients, they expect you will help them navigate unknown territory, avoid pitfalls and be successful. When it comes to their charitable giving, by providing them with some important tools and a process for decision-making, you are truly demonstrating your investment in their ultimate success.