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BLOG POST

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Doing Right by the Projects: Fiscal Sponsorship after IHC

Recent news in the nonprofit press about the reported collapse of International Humanities Center (IHC), a fiscal sponsor organization based in California, has raised real concerns in the philanthropic world. Projects sponsored by IHC received correspondence from IHC indicating that it was unable to make disbursements in response to their check requests for money to cover current project expenses. Donations made to IHC, restricted to the purposes of certain charitable projects, were not available when needed by the projects.

The most extensive coverage has appeared in a two-part article by Rick Cohen, published in *Nonprofit Quarterly* earlier this month. The story also ran in the *Los Angeles Times*.

This is not the first time such a thing has happened. In my book, *Fiscal Sponsorship: 6 Ways To Do It Right*, at page 73, I cite the case of Media Network, a documentary film sponsor that collapsed in 1997 in similar fashion.

While the full story and the future of IHC may not be clear right now, many are asking: What can be done to prevent this from happening?

I suggest that sponsors take these precautions—and that projects watch to make sure they do:

1. Make it clear everywhere—in the fiscal sponsorship agreement, in writing to donors, and on Form 990—that the sponsor treats funds received for the purposes of a project as restricted under the charitable trust doctrine. The sponsor can obtain unrestricted funds by charging administrative fees, but otherwise the funds dedicated to the purposes of one project may not be used to pay the expenses of another, or to pay the sponsor's general overhead.

To be clear: a fiscal sponsor is not a bank. Each restricted fund belongs to the sponsor, not the project. However, each project fund is impressed with a trust commitment "for the charitable purposes of" the project, and the sponsor has the legal duty to honor that trust. Within the limits of those purposes, the sponsor has discretion and control over spending decisions. But if the sponsor breaches that duty, the state attorney general can intervene to enforce the charitable trust in the public interest.

2. The sponsor's board should set a reserve policy to maintain a strong minimum of general, unrestricted funds, so that the sponsor can meet its overhead expenses even if administrative fees from projects were to take a sudden drop.

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3. The sponsor should have internal financial controls that would discourage any one person from invading project funds. Since many fiscal sponsors centralize check-writing authority for all projects in a few top managers, major disbursements should require a second signature or a second pair of eyes. Where required by law, the sponsor must have a board-level audit committee and an annual independent audit by a CPA firm. The accounting firm can issue a management letter to the board to address defects in internal controls.

4. The sponsor's board of directors needs to pay attention and oversee the program. Among other things, the Board should receive frequent financial statements showing the condition of the fiscal sponsor's unrestricted general fund, to make sure that reserve requirements are met and that there is no improper "borrowing" from project funds.

5. Strive for transparency. Project directors should receive frequent (or have immediate online access to) internal financial statements showing the condition of their project fund. The project's fund accounting should always show cash on hand in excess of incurred expenses. A positive balance that relies on a "receivable" from the sponsor's general fund is a danger sign; the project director should jump on that immediately.

6. The sponsor cannot afford to be too soft-hearted. General funds should not be advanced to projects. If the cash in the project fund isn't sufficient to meet payroll or other costs, employees will need to be laid off and project expenses curtailed. Reliance on grants receivable, loans, and pledges is risky business. And some sponsors may need to revisit their administrative fee structure if not enough unrestricted money is being generated to meet the costs of audits, controversies, full insurance coverage, and other elements of risk management.

7. Some fiscal sponsors, in the public health field, for instance, must rely heavily on government grants that are paid on a reimbursement basis. In those cases, projects may need to incur or pay expenses before receiving grant funding. Operating such a fiscal sponsorship system successfully requires very careful, professional planning by experienced grants managers, but it can be done.

8. The sponsor's annual IRS Form 990, accessible to the public via Guidestar, can reveal that a fiscal sponsor is in trouble. Look at Part X, the Balance Sheet, Lines 27, 28, and 33. If unrestricted net assets are negative, and total assets are less than temporarily restricted (project) assets, it can mean that the sponsor has borrowed from or misspent funds held in charitable trust for the projects' purposes. The sponsor may not have the cash to cover all the projects' check requests. The Form 990 might not be filed until almost two years after the sponsor goes in the hole to its project funds, so projects should demand more frequent balance sheets. IHC's unrestricted net assets went negative back in 2008; its projects could have transferred to another sponsor or taken other protective action in 2009.

9. The sponsor needs to be adequately insured. When I was on the board of Community Initiatives in San Francisco with Jan Masaoka and John Kreidler, our motto was "buy insurance by the truckload." Besides general liability and directors' and officers' insurance, consider employee dishonesty and theft, non-owned auto, special event coverage, discrimination, harassment, molestation, and employee claims.

10. The National Network of Fiscal Sponsors has published guidelines for best practices. These are a valuable resource for all concerned to determine whether a sponsor's program is up to the industry standard.

Are fiscal sponsors inherently weak? Not at all. By sponsoring a range of projects, the whole can be stronger than the sum of its parts. But just like any other charity—a hospital, college, museum, church, or social service group—it may fall into a deficit position for any number of reasons, pulling down all of its departments, scholarship funds, and special programs.

For more tips on doing fiscal sponsorship right, see www.fiscalsponsorship.com.