

EARLY DUE DILIGENCE CHECKLIST

What is “due diligence,” and why is it important?

With origins in the world of business and finance, “due diligence” refers to the process through which an investor (or grantmaker) learns more about an organization’s financial and organizational health to guide an investment or grantmaking decision. For a grantmaker, the decision to invest is based on a balance of strategic fit with the grantmaker’s mission and priorities, objective data analysis, insight into the general state of the nonprofit’s health and stability, and intuition based on grantmaker experience.

– From “Due Diligence Done Well,” published by GEO and LaPiana Consulting

Grant proposal cover sheets are the culmination of a program officer’s due diligence. In those documents, we are asked to establish the capabilities of the grantee, discuss the work to be funded and how it aligns with the Foundation’s strategic priorities, assess risks, and offer our best thinking about how to mitigate those risks and avoid (or lessen) a grantee’s dependency on the Foundation as we approach sunset. But there are some issues that affect the fundability of an organization that it is better to uncover early in the due diligence process – before a lot of time is spent and expectations are raised.

GRANT STOPPERS AND STALLERS

Charitable Purpose. Every grant must be made for a legitimate charitable purpose. These include education, science, relief of the poor, protection of the environment, disaster relief, and preventing cruelty to children and animals, among others. Although there have been some abuses and questions about hospitals/health care and business activities, the Foundation is generally safe in making grants to charities with 501(c)(3) status conferred by the IRS. However, it is good to remember that there is a strict prohibition against private inurement. The Urban Institute published a helpful publication in 2013 entitled “[Do we need a new definition of charity?](#)” of which the first nine pages are devoted to explaining current law. Lex Mundi, a large network of independent law firms, operates the online resource website hg.org, which includes a comprehensive section on nonprofit law and links to specific sections of the IRS website and other legal resources.

Fiscal Sponsorship. Fiscal sponsors provide charitable legal status (and possibly other services) for the projects they sponsor. The sponsor has legal and fiduciary responsibility for the projects, which means that they are accountable for ensuring proper use of funding for the charitable purposes intended by the donor. When the Foundation supports a sponsored project, the grant is made to the sponsor and the sponsor has discretion over the use of the funds – within the purposes of the grant. The governing board is the board of the sponsor. Any project-specific board is merely advisory. Beyond ensuring the project’s alignment with the Foundation’s goals and the quality of the project, due diligence must be conducted on the sponsoring organization. Program staff should (1) review the sponsor’s by-laws to confirm that it is legally qualified to sponsor the project; (2) verify that the sponsor has a well-developed fiscal sponsorship program, qualified staff to manage the program, and approved policies and practices governing fees, legal agreements, and reporting and oversight; (3) review the sponsor’s audited financial statements; (4) check the sponsor’s reputation; (5) investigate how many projects the organization sponsors and its capacity to give appropriate attention to the project proposed; and (6) review the MOU between the sponsor and the project the Foundation is interested in supporting. You can find resources on fiscal sponsorship on the shared drive and in the library, including:

- A due diligence checklist, which includes key questions you should ask when considering a fiscally sponsored grant, and a cheat sheet on the most common models of fiscal sponsorship;
- *Fiscal Sponsorship: 6 Ways to Do It Right*, the authoritative text on the topic; and
- Key reference materials from the [National Network of Fiscal Sponsors](#), including best practices for the most common models of fiscal sponsorship.

Self-dealing and Conflicts of Interest. The first step in managing conflicts and self-dealing is to be aware of the potential. Self-dealing occurs when there is financial or other tangible benefit to a “disqualified person” (e.g., trustee, family member, staff). This can often be managed by full disclosure and recusal of the disqualified person from decisions related to their compensation. However, even the appearance of conflicts can be damaging to the reputation of the Foundation and should be very carefully managed.

Also, there may be times we see or suspect a conflict on the part of a grantee, as when a grantee hires a board member to do contract work without an open bidding process. You can request a copy of a grantee’s conflict of interest policy and should openly discuss any potential conflict you are concerned about. Linked [here](#) (IRS website) are some definitions and examples illuminating self-dealing; [conflicts of interest](#) are discussed, with helpful resources, at the Council of Nonprofits site.

Reputation. It is our responsibility to be aware of news related to existing and potential grantees. It can be embarrassing or worse to find out that an organization is declaring bankruptcy soon after a grant was awarded, or to discover that a grantee is under investigation. On the shared drive, you’ll find a helpful memo with resources to guide you in conducting a reputational check.

Intellectual Property. Grants can sometimes include funding for developing reports, publications, tools, and/or curricula. If you anticipate making a grant that will result in the development of intellectual property, think it through and discuss the ownership of the IP with the potential grantee early in the due diligence process. Be specific if the Foundation will own or control any aspect of the IP or if we want the right to review materials pre-publication. And, of course, be familiar with the IP provision in the Foundation’s standard grant agreement.

Lobbying. When you are considering inviting a proposal that might include advocacy activities – things that include legislative milestones, appropriations and budget discussions, direct contact with government officials and policy makers, and campaign-like communications with the public – think carefully about the grant structure and the sophistication of the grantee. For example, if a grant targets federal legislators, grants must be structured as general operating support, or project support where the amount of the grant < non-lobbying expenditures. If the grantee has not engaged in advocacy activities before or doesn’t seem particularly sophisticated on the laws and regulations associated with lobbying, consider capacity support and include legal counsel as part of the grant.

And finally, be mindful that your documentation of the grant development process should comply with the spirit as well as the letter of the law. Questions about any of these issues can be brought to the Organizational Effectiveness team at any time.