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**Due Diligence: Comparing Current Best Practice at The Asia Foundation
with Part IV of the Treasury Guidelines (Anti-Terrorist Financing
Procedures)**

Barnett F. Baron
Executive Vice President
The Asia Foundation

Background

The Asia Foundation is a public charity under sections 501 (C) (3) and 170 (b) (1) (A) (vi) of the Federal tax code. It has operated through resident offices in Asia since it was founded in 1954, long before modern communications technologies and high-speed air travel were available. We believed then and continue to believe that long-term resident presence is essential to gain a deep and nuanced understanding of widely divergent cultures, economies, and political contexts, and to develop good long-term working relationships with the grantees we support. We currently have fully-staffed resident offices in sixteen cities in Asia: Bangkok, Beijing, Colombo, Dhaka, Dili, Hanoi, Hong Kong, Islamabad, Jakarta, Kabul, Kathmandu, Manila, Phnom Penh, Seoul, Tokyo, and Ulaanbaatar. In addition, The Asia Foundation in Taiwan (AFIT) is a separate, locally-incorporated entity that is affiliated with The Asia Foundation.

Foundation offices in Asia are typically staffed by an expatriate Representative, locally-hired program experts, and locally-hired accounting and administrative staff. The expatriate Representative plays an important role in program development and implementation, especially when he or she is fluent in the local language and has had significant academic and professional training related to the country and/or region. Even more important, the Foundation's long-serving national staff provide continuity and deep roots in local communities. Over the years, we have therefore been able to develop extensive knowledge about and contacts with a very broad range of government agencies, academic institutions, and nonprofit organizations in the countries in which we operate.

In a typical year, The Asia Foundation makes 700 – 800 grants to existing and new grantees. We publish a complete list of our project grants every year.

In addition to the large number of grantees, the Foundation operates in a number of currently “sensitive” countries, including Afghanistan, Bangladesh, Indonesia, Nepal, Pakistan, Philippines, and Sri Lanka, and its programs cover many sensitive areas, including governance and law, conflict management, alternative dispute resolution, Islam and Civil Society, women’s political participation, and international security. Careful attention to the due diligence process for prospective grantees and regular monitoring of grantee programs and finances has therefore been an ongoing concern of the Foundation, even before September 11. Because we operate through in-country offices, our due diligence is conducted through site visits to prospective grantees and extensive discussions with their principal staff throughout the life of a project.

Although we are a public charity, our due diligence process conforms to the expenditure responsibility rules set forth by the Internal Revenue Service:

- Pre-grant inquiries to determine the prospective grantee’s ability to comply with the terms of a grant and fulfill project objectives;
- A written grant agreement with specific provisions setting forth mutual responsibilities, signed by both parties;
- Maintenance of the grant funds in a segregated bank account;
- Periodic written reports from the grantee to the Foundation through the life of the project, typically on a semi-annual basis; and
- Disclosure to the IRS of basic information about the grant, in the Foundation’s annual 990 submission (as well as in a separate Foundation publication).

It may be particularly instructive, therefore, to compare our current due diligence processes, developed over years of on-the-ground experience, with the additional requirements proposed in Part IV of the Treasury Guidelines, the section dealing with Anti-Terrorist Financing Procedures.

STEP I. Review a Prospective Grantee’s Basic Organizational Documents

Current Practice

- Obtain basic organizational information: name in English and local languages, address, phone, fax, email, statement of organizational goals and objectives.
- Review the prospective grantee’s articles of incorporation and by-laws to confirm the prospective grantee’s
 - Charitable purposes
 - Governance structure

Provisions to re-distribute assets upon dissolution
Non-engagement in lobbying or political activity

- Obtain evidence of registration with government authorities where this is required by local law.

Comment: In some countries and for some types of local community organizations, official registration may not be required, particularly where privileged tax status is not available to nonprofit organizations or where the organization does not seek or receive government funding. Sometimes the more important practical issues are whether the organization is legally able to receive foreign funding and maintain a bank account in its own name.

- Obtain information about key staff positions and responsibilities related to the project being funded, primarily in terms of their professional experience and competence.

The Treasury Guidelines Add the Following Steps

- Obtain Copies of any public filings or releases made by the foreign recipient organization, including most recent official registry documents, annual reports, and annual filing with the pertinent government, as applicable.

Comment: If formal registration is required by local law, the prospective grantee can usually provide certification of their registration with the competent authority, as well as practical proof of registration (such as having a bank account).

No country in Asia currently has a unified, one-step process governing the incorporation and registration of nonprofit organizations. Instead, nonprofits have a choice of the laws or regulations under which they seek to register, and the different laws and regulations impose different standards of reporting and disclosure (e.g., Companies Acts, Societies Acts, Trust laws, religion-based legislation, etc).

In addition, no country in Asia currently requires a nonprofit to produce a *publicly available* annual report with detailed information about its mission, staffing and governance, programs, and funding. Although most registered nonprofits do have to provide annual program and funding reports to their supervising agencies, this information is generally treated as confidential and is not made available to the public.

In those situations, what would constitute a reasonable effort on the part of the US grantmaker to obtain equivalent information? In the case of The

Asia Foundation's program in Indonesia, for example, where we support a large number of NGOs engaged in public dialogue and debate about the role of Islam in civil society, we regularly document our project files with newspaper and magazine articles, letters to the editor, leaflets, booklets, posters, video and audio tapes, and so on—that our grantees have produced in their efforts to speak out against violence, militancy, and terrorism. Other grantmakers may have other examples of program documentation that they are able to collect to enable them to monitor their grantee's programs. Hopefully, something along these lines will be acceptable to Treasury in lieu of comprehensive annual reports or filings that simply do not exist or are not publicly available.

- Obtain contact information for members of the prospective grantee's governing body

Comment: This is do-able, provided that the organization has a formal governing body; some smaller community-based nonprofits do not.

- Identify [all] the jurisdictions in which the prospective grantee maintains a physical presence

Comment: It is usually possible to do this for locations within the specific country, but it may not be possible to obtain accurate and up-to-date information about an organization's presence and activities in other countries.

- Collect names and addresses of organizations to which the prospective grantee currently provides or proposes to provide funding, services, or material support, to the extent known

Comment: This can be done with reference to the use of funds to be provided in a prospective grant from The Asia Foundation, but is likely to be regarded as unnecessarily intrusive if we were required to map out the prospective grantee's entire universe of organizational connections beyond those directly related to our own funding support.

- Collect names and addresses of any subcontracting organizations utilized by the prospective grantee

Comment: Same as above

- The Foundation should be able to demonstrate that it conducted a reasonable search of public information, including information available via the internet, to determine whether the prospective grantee is or has been implicated in any questionable activity.

Comment: How are the following terms defined: “reasonable search,” “public information,” “implicated,” and “any questionable activity”? If “public information” refers specifically to the lists produced by the U.S. Government, the United Nations, and the European Union, those should be specifically identified and centralized in a well-publicized internet location. The reference in the Voluntary Guidelines to “any other official list available to the charity” (IV. B. 2.) is neither defined nor realistic in practice. Asian governments may draw up lists of prohibited or “questionable” local organizations for any number of immediate political purposes. Does Treasury really intend those lists to be treated as the legal equivalent of its own lists?

How often does the search have to be conducted: only once, before a grant is made, or periodically throughout the grant period? What are the Foundation’s risks and obligations if a grantee organization does not appear on a specified list when the grant is made, but is subsequently added to the list?

How can we guard against “false positives”? That is, since many people share common names, how can we ensure that the name on the list refers to the person we are actually dealing with?

If in the course of checking the lists, the Foundation finds that a prospective grantee appears on a list, and we therefore decline to make a grant, do we have any additional reporting obligations vis-à-vis Treasury or any other branch of the US Government?

- The foundation should be able to demonstrate that it verified that the prospective grantee 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.

Comment. Same as above; need to define “any list.”

- The foundation 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 country of residence, place and date of birth for key staff at the prospective grantee’s principal place of business, such as board members, etc, and for senior employees at the recipient’s other locations. The foundation should run the names through public databases and compare them to the lists noted above.

Comment. This is an extraordinarily burdensome, intrusive, and unfocused fishing expedition that would be resented by current and prospective grantees and would erode the trust that the Foundation has built up over the years. It conveys the message that the prospective grantee

is being treated as a potential supporter of terrorist activities unless proven otherwise.

- The foundation should require prospective grantees to certify that they do not employ or deal with any entities or individuals on the lists referenced above, or with any entities or individuals known to the prospective grantee to support terrorism.

Comment. What does “deal with” mean? Certification that the prospective grantee does not employ or “deal with” any entities or individuals on specific lists might be possible, but the second clause is vague and undefined. Terrorism is a politically-defined term that varies by country and context.

In Sri Lanka, the Foundation provides books and materials to schools and libraries in geographic areas controlled by the Tamil Tigers, a named terrorist organization

Also in Sri Lanka, we are negotiating a grant to the Ministry of Justice for a program of dispute resolution in areas controlled by the Tamil Tigers

In Indonesia, under our Islam in Civil Society program, we support public seminars, dialogues, and media talk shows involving moderate and hardline Islamic organizations, some of whom may “deal with” suspected terrorist groups, although none have so far shown up on US Government lists of terrorist organizations

In Mindanao, Philippines, we support efforts to provide jobs, education, and agricultural supplies to former members of hardline Islamic separatist organizations, many of whom have not formally forsworn their membership in or allegiance to those organizations. When does a “terrorist” cease being a “terrorist”?

In these and other countries, we have supported human rights and advocacy NGOs and election monitors that are regularly accused by their political opponents of supporting terrorists, radical organizations, or violent opposition groups (that is, they appear to have been “implicated in questionable activity”).

Many of these projects are funded by the United States Agency for International Development (USAID), thereby illustrating the uncoordinated policy priorities of different parts of the US Government.

Step II. Obtain annual program reports or detailed program descriptions

- To determine organizational experience, capabilities, track record
- Assess organizational reputation with the host government, in the local community and with key foundation constituencies

Comment: See earlier comment on the fact that few Asian nonprofits produce detailed annual reports or comprehensive program descriptions that are publicly available. In Asia Foundation practice, organizational competence and reputation are ascertained through direct discussion with leaders and staff of prospective grantees, review of past programs, and discussion with others who know the organization, its activities, and its reputation in the community. As suggested earlier (page 3), we also collect other documentation on our grantee's programs and related activities, which we believe should be acceptable to Treasury as evidence of grantee performance as well as our own continued due diligence.

Step III. Review financial information

Current Practice

- Review current and past annual budgets showing sources and uses of revenue
- Obtain audited financial statements if they exist
- Periodically review monthly bank statements
- Review accounting methodology and sometimes provide training to grantee financial staff
- Obtain periodic reports on operations and use of foundation-granted funds
- Conduct routine internal and independent financial reviews and audits

The Treasury Guidelines add the following

- Obtain basic information on the prospective grantee's existing sources of income, such as official grants, private endowments, and commercial activities.

Comment: This information is generally not publicly available. Prospective grantees can be asked about their existing sources of income, but verification would be difficult if not impossible. Requiring US foundations to document all financial transactions of recipient organizations (that is, their funding from all sources) could require establishing new and close collaboration between US foundations and the host government entities that typically seek to monitor this information, including police, security, and intelligence agencies that generally do not cooperate with foreign foundations. While it might be possible in some

countries to establish such collaboration, the price for doing so may be high, including closer scrutiny and control by host governments over grants made by US foundations, other restrictions on the ability of US foundations to operate freely within some countries, and a likely increase in demands for corrupt and illegal payments to ensure government concurrence. US foundations have been able to contribute to open, just, and democratic societies abroad in part because they have been able to fund worthy projects directly, without the unwanted interference of corrupt or politically-motivated host governments.

Effective grantmaking requires mutual trust between donor and grantee. Developing relationships of trust can take years of concerted effort. Close cooperation with host government police and intelligence agencies, combined with an intrusive level of due diligence, will ultimately affect that mutual trust and compromise the standing of US foundations with the legitimate nonprofit clients they seek to support. Close cooperation with local police and intelligence agencies may contribute to local perception of US foundations as spies or collaborators with repressive or corrupt governments.

The problems become more salient depending on the types of nonprofit activities supported. Support to orphanages and health clinics, or provision of scholarships, generally present no problem, but support to civil society organizations, especially advocacy organizations and others working for political or societal reform, would be increasingly problematic under these Guidelines.

- Determine the identity of the financial institutions with which the prospective grantee maintains accounts

Comment: This information is currently required for all Asia Foundation grants, and it may be possible to obtain this information for grants provided by others. In addition, we require all grantees to segregate Foundation grants in separate bank accounts.

- Seek bank references to determine if (i) the financial institution is 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.

Comment: This is far beyond the competence or mandate of Foundation accounting staff. Treasury should provide and maintain lists of

acceptable—or prohibited—banks and financial institutions, against which grantee accounts could be checked.

- The foundation should require the prospective grantee to undertake reasonable steps to ensure that funds provided by the foundation are not ultimately distributed to terrorist organizations. Periodically, the grantee should apprise the foundation of the steps it has taken to meet this goal.

Comment: “Reasonable” needs to be defined. Prospective grantees need to be given specific guidelines or requirements to which they can be held accountable. The tone of the language by which this requirement will be conveyed to prospective grantees will be critically important in creating—or undermining—the sense of trust and mutual respect that is an essential ingredient in any successful philanthropic partnership.

Summary of Issues raised by Part IV of the Treasury Guidelines

- The Asia Foundation is committed to ensuring that its grant funds do not end up in the hands of terrorists or used to support any form of violent political activity. We enforce our commitment by conducting rigorous due diligence of prospective grantees, and are willing to increase our efforts to that end, if reasonable and necessary.
- As currently written, however, the Guidelines contain too many undefined terms that leave grant-makers vulnerable to risk. Those terms, cited above, need to be defined more clearly.
- The Guidelines erroneously assume that comprehensive and detailed information about prospective grantees is generally available in Asia, just as it is in the U.S. In the absence of such information, the Guidelines need to define acceptable types of alternative documentation and to specify reasonable levels of effort to obtain it.
- In most Asian countries, much of the requested information is available only to supervising government agencies and not to the public. In order to obtain this information in some countries, grant-makers may have to enter into working relationships with police, security, and intelligence agencies. Establishing relationships of that kind could compromise the ability of American grant-makers to operate freely and expose them to higher levels of control and corruption. Are there alternative sources of specific information that would be acceptable to Treasury and obtainable with reasonable effort?
- Some of the requested information, particularly about financial institutions, is beyond the capacity of most American foundations to obtain and

assess. Treasury needs to create and maintain lists of acceptable (or prohibited) financial institutions in order to provide practical guidance to grant-makers.

- Some of the Guidelines are very intrusive, going far beyond current due diligence practice. They burden American grant-makers with police and investigatory functions that can harm relationships of trust with grantees that have been developed over the years. Some of the Guidelines are likely to be met with hostility and suspicion by prospective grantees, especially in sensitive countries and particularly by nonprofit organizations that advocate for political and economic reform, engage in conflict management and reconciliation efforts, and support human rights.
- In extreme cases, American foundations may come to be viewed as intelligence agencies or instruments of American foreign policy, thereby jeopardizing their ability to operate freely in some countries and, potentially, putting their in-country staff at physical risk.
- Finally, in specific instances the Guidelines may conflict with the policy objectives of other US Government agencies, particularly the Agency for International Development and the Department of State, which fund many programs implemented by foreign NGOs. In the real world, there are circumstances in which it is unavoidable and even desirable to “deal with” organizations that may be listed as terrorist organizations or “implicated in questionable activity.” Examples drawn from The Asia Foundation’s own experience include efforts to provide humanitarian assistance and essential services to “innocent” populations living in areas controlled by named terrorist organizations, programs designed to reduce conflict and encourage dialogue among contending political forces, and efforts to support national reconciliation efforts after the cessation of violent conflict. A close reading of the Guidelines as currently written appears to prohibit support for such efforts.