

Policy for a system of controls over philanthropic grants: Fondazione Cariplo's Model

by Luigi Maruzzi ⁽¹⁾

ABSTRACT ⁽²⁾

Given their legal status and mission, Banking Foundations can be taken as a paradigm of well-structured philanthropic organizations with a good track record of grant programs in the arts & culture, environmental, social & human services and scientific research areas.

Being technically neutral in their grant control activities is rather tricky for Banking Foundations as the relationship they have with the nonprofit organizations to which they make their grants is built on common values so deeply shared that at times the boundaries between these two sets of players are hardly distinguishable.

Stepwise introduction of advanced control procedures is indispensable for both these and all other grantmakers and their grantees. If Banking Foundations were to opt for a system that does not feature more structured controls this would ultimately result in their misalignment with other funders that strongly pursue medium/long-term grant accountability. Being a potential hurdle to co-funding said misalignment would have to be corrected.

However, absent any legislation mandating controls, the solutions adopted by these grantmakers markedly differ and are largely driven by concerns about their reputation as philanthropic entities.

For the choices it has made since 2007 and its policy hinged on moral suasion mechanisms Fondazione Cariplo stands out among its peers as an entity capable of striking the right balance between philanthropic constraints and levels of control.

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¹ Fondazione Cariplo Director of Grants Administration.

² Adapted English version of the original Italian article published in "*Enti Non profit*" (Issue No.1 of 2013).

1. Project planning and grant payment process

Nonprofit organizations that seek a grant from a Banking Foundation are aware that if their application is successful, the grant they get will be paid in accordance with set procedures ⁽³⁾.

Typically, the grant is paid in installments in accordance with work progress and not outright in its entire amount after the grant is approved or the project gets started.

This means the grant is paid over the grant life cycle which is reasonably long and seen by Fondazione Cariplo as the ideal timeframe for the performance of its controls.

As you will understand from the details given in the following pages, the procedures put in place are there not to satisfy some bureaucratic requirements, but to get project data and information on which the foundation builds its grant payment decisions. Said data and information provide evidence that the grant is used for its intended purposes as approved originally (or in its later amended version) and warn of any discrepancies, anomalies or other vulnerabilities.

Before discussing the types of control the foundation can carry out, it is helpful to explain the factors that contribute to have the grant payment process span such an extended period of time.

Understanding these factors is important because it shows the length of the grant payment process is not related to the introduction of controls into the process, but to other reasons.

To this end, it is essential to elucidate the close link between project planning by the grantseekers and the foundation's choices for adequate planning and development of the grant payment process, which is influenced by numerous aspects both in terms of efficiency and dynamics ⁽⁴⁾.

It is fundamental that when seeking a grant, nonprofit organizations:

- prepare a time-schedule for individual actions and the entire project through completion;
- show that project activities are viable. Ideally this is done via a technical-operational feasibility study (for the actions the project intends to put in place) and a management plan (in relation to future use of the facilities created under the project);
- show that financial resources needed have already been secured or are being gathered. This is what is technically termed "financial coverage". If the nonprofit organization intends to get a loan from a bank, it must also prove to be 'bankable'.

For extraordinary projects (not for ordinary work) carried out by nonprofit organizations that are social enterprises, the requirements above can be satisfied by the submission of a business plan.

For the foundation it is fundamental to:

- have an information system that can manage all information and data relating to the project;

³ In questa sede si parlerà di "erogazione" come versamento effettivo delle somme promesse, e non come assegnazione iniziale del contributo.

⁴ Key factors are: payment average, peaks and troughs, and periods in which payments tend to concentrate.

- have an operational workflow that enables all organizational units involved in the grant payment process to produce their ‘deliverables’ within set deadlines in the interest of grantees⁵ that reported on their grant;
- align grant payment scheduling (connected to the deadlines for grant reporting by the grantees) with available liquidity.

Regardless of controls in place, if the initial definition and successive governance of all elements above is not as accurate as it should be, delays may ensue.

On the other hand, if the foundation had not in place clearly defined procedures and mechanisms the ensuing indefiniteness would clearly impact grantee’s financial planning and management of its financial resources.

2. Fundamental rules

Although controls and checkpoints may vary from a foundation to another there are some fundamental rules that need to be followed.

When deciding to put in place a system of controls, the grantmaker must properly weigh the risk of not having the controls and the benefits of having them so as to put in place a control system that is properly calibrated to the grantmaker’s organization.

The control framework must be consistent with all other components of the philanthropic activity.

For this to happen it is indispensable to understand the connections between philanthropic goals, efficiency objectives and the characteristics of the control system the grantmaker intends to put in place. In other words, the grantmaker must always take into account their correlations (interdependence).

A scheme like the one set out below may help understand the range of options for each variable:

VARIABLE	RANGE OF OPTIONS	
Grantmaker constraints	Tight	Loose
Risk assessment	Little relevant	Relevant
Control system	Absent	Well-structured
Organizational structure	Basic	Adequate
Grant payment process	Bureaucratic	Efficient
Grant reporting rules	Formal	Comprehensive

To give you an idea of the space within the options range, consider that, for example, grantmaker constraints are:

- “loose” when the foundation does not intend to interfere in any way with grantee processes (including by making recommendations or giving advice) and gives grantees maximum leeway;

⁵ “Grantee” means the nonprofit organization that received the grant.

- “tight” when, taking the same approach to all categories of grantees, the foundation strives to maximize transparency and promotes adoption of good accountability practices.

3. Making the right choices

Different grantmakers can make different choices regarding the types of controls they apply consistently with their philanthropic activities. The two examples below may be helpful to explain the importance of best balancing the variables above so as to put in place a control system that is effective.

3.1. Example A

The grantmaker is willing to pay grants fast, so it may put in place few rules and handle the process with a ‘small’ team. Yet, with few rules the grantmaker does not get enough information and the decisions it makes are not built on a sound base of data. Additionally, any attempts to fill ‘data gaps’ risk to make the grantee feel treated differently from other grant recipients and, if repeated, as the victim of some sort of bureaucracy attack.

3.2. Example B

The grantmaker believes the trust-based relationship it has with the grantee is in itself a guarantee of proper grant use. The grantmaker makes just a few formal checks but has no control in place (either in the implementation stage or upon closeout).

Negatives are:

- the grantmaker does not get a real picture of how its grant is used;
- in case of inspections carried out by the competent governmental authority it is hard for the grantmaker to prove it adopted adequate measures to prevent anomalies;
- the goal of the grantmaker as a philanthropic entity to maintain a good relationship with grantees may be compromised in the event of reputational damage caused by just one grantee.

3.3. Striking the right balance

Well-meant choices are not enough to attain good results. So, the grantmaker may be prompted to put in place a balanced control system as follows.

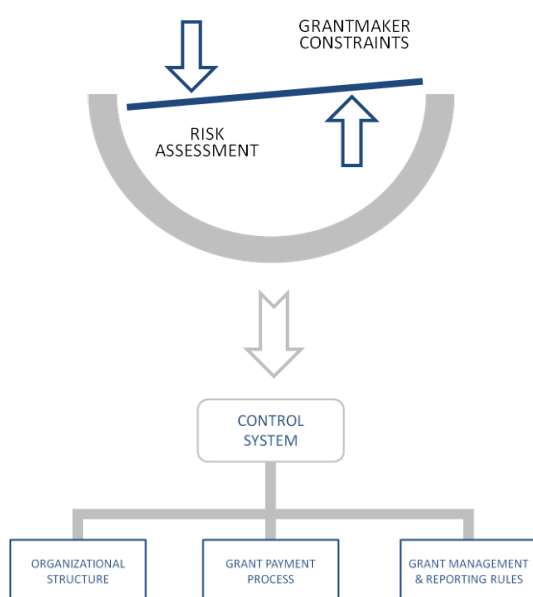
The grantmaker

- realizes lack of controls (or of effective controls) is too high a risk to be overlooked ⁽⁶⁾;
- believes improving grantees accountability (by promoting the adoption of good practices) may help them increase their ability to respond to the needs of the constituency/ community/society;

⁶ The analysis of the grantmaking landscape confirms potential risks in connection with developments such as a) collaborations and partnerships of organizations from different geographical areas and sectors becoming more commonplace; b) proliferation of entities that although formally legally separate maintain strong ties with the organizations from which they originated; c) local presence of organizations authorized to operate beyond the borders of the country where they are domiciled.

- accepts to set up a control system based on actions that have a tangible impact on grantee practices;
- drastically reduces formalities (“simplification”) in exchange for a system that ensures sound information;
- provides for review/upgrade of its internal control structure both in terms of resources and professional competences.

Figure 1 below graphically shows the process outlined above:



4. System requirements

To assure that grants are properly and effectively used certain requirements are to be satisfied by both the philanthropic grantmaker and grantees.

The philanthropic grantmaker needs to have:

- separate functions for grant payment and control and these two separate functions need to collaborate with staff responsible for the review/assessment and selection of grant applications;
- a set of rules and procedures that are simple, clear and consistent;
- training on procedures;
- an information system that facilitates submission of information, data and documents relating to the grant application/project (repository) and their use (knowledge sharing).

Grantees need to have in place a system that satisfy minimum requirements regarding:

- accounting and financial reporting⁷;

⁷ Link: http://www.fondazioneCARIPLO.it/portal/upload/ent3/1/GuidaRend_ING_web.pdf

- accounting principles and standards applied in the preparation of their annual financial statements;
- contracting to external suppliers/service providers.

5. Fondazione Cariplo's model

After satisfying the strategic, organizational, operational and regulatory requirements for putting in place its control system, the grantmaker needs to define in detail the types of control it intends to carry out and their specific contents that are to be clearly stated including in any call for proposals that is launched so that grantseekers are aware of them and take them into account in the preparation of their application.

In connection therewith, it may be useful to have a look at Fondazione Cariplo's case and its experience also in view of gathering elements for further discussion.

5.1. Grant payment

For grants awarded under a Foundation's call for proposals⁸, the requirements that Grantees are to satisfy in reporting their expenses and results to get grant payments are set out in the 'Grant Terms & Conditions'.

The Grant Terms & Conditions set forth the rules Grantees are to follow in the implementation of a project funded by a Foundation's grant and in reporting expenses and results attained upon project completion.

Grantees are required to formally accept the Grant Terms & Conditions as indicated in the 'Grant Management & Reporting Guide'⁹.

The Grant is paid in 3 steps:

- 1) payment of the grant advance, prior to incurring and reporting any expenses;
- 2) interim payment made in accordance with the ratio of incurred and reported expenses to total planned project costs. For projects that span more than one year and/or large grants there may be more than one interim payment;
- 3) final payment (balance) that is made following final grant reporting.

5.2. Grant reporting

⁸ Together with the projects it develops and manages directly, calls for proposals launched within priority programs in its four core areas (arts & culture, the environment, social & human services and scientific research) are the most structured and sophisticated form of grantmaking used by Fondazione Cariplo, both in terms of assessment/selection of grant applications and grant management and reporting procedures. Other forms of grantmaking include transfers of funds to Community Foundations, sponsorships and other funds awarded in various ways.

⁹ The accounting and financial reporting system consists of the set of rules and procedures whereby an entity records its activities in its books. The system identifies, gathers, analyzes, measures, classifies, records, summarizes and reports the organization's activities and events.

Expenses borne under the project funded with a Foundation's grant are to be reported using forms and templates, essentially:

- a) a summary report showing 'revenues', 'costs' and 'partnership members', signed by the legal representative of the grantee;
- b) a summary table of expense documents.

Grantees that do not apply self-certification are to submit documents that provide evidence of expenses (first and foremost, invoices) and of payments (essentially, wire transfer receipts).

When reporting on their grant, Grantees are also required to provide a report on results and information on publicity given to the grant awarded by the Foundation.

In addition to documents required of all Grantees, other information (at times of a technical nature) is required of them under the specific call for proposals.

The Foundation reserves the right to decide which controls to apply to make sure the activities carried out are compliant with the original grant application and expenses claimed are appropriate.

In the event of noncompliance, the Foundation is entitled to suspend grant payment and, in case of serious noncompliance, even revoke the grant.

In addition to the prerogatives of the Foundation staff in relation to grant management review (acquisition of information, data and documents that complements those already submitted by the Grantees), under the Grant Terms & Conditions the Foundation can use specific forms of control such as independent audit of expenses reported by the Grantee for the purpose of receiving grant payments.

5.3. First level and second level audits

First level audit of expenses is required of individual Grantees when self-certified expenses (employees and operating expenses) amount to €250,000 or more, irrespective of the size of the grant; for projects carried out by partnerships the amount of self-certified expenses that triggers the audit requirement is different and is calculated using a specific formula.

The audit is to be conducted by a professional independent auditor that certifies the expenses and issues an "Independent Auditor's Report". The requirements for said independent audit are intended to assure independent expert review of compliance of expenses claimed (eligibility and consistency of expenses) at the Grantee's premises with direct examination of original documents.

Second level audit is an audit conducted by an independent external auditor engaged directly by the Foundation that can be performed within three years after the final grant payment.

This audit is intended to "test" the reliability of the control framework. It is done on a sample basis on projects that received a Foundation's grant and were already audited by an independent auditor engaged by the Grantee.

The Foundation is also entitled to conduct its own audit at the Grantee's premises to satisfy itself of compliance with its requirements for projects that are not certified/audited by third-parties.

Other specific controls are applied when the entity commissioning the first level audit is the Foundation itself (Foundation's own projects).

All types of audit and control outlined herein show the oversight power of the Foundation that it can exercise also in other ways through its staff, e.g.:

- meetings with grantee representatives,
- visits at the Grantee's premises,
- inspections at the project site.

The Foundation is also entitled to request an audit of the Grantee's financial statements as well as of technical or scientific aspects of the project.

6. Control system

Fondazione Cariplo carries out numerous controls to satisfy itself that the requirements set forth in the Grant Terms & Conditions are met.

There are controls that verify figures tick and tie¹⁰; plus other checks that verify the intrinsic consistency of numbers (and that they add up).

Additionally there are controls that are typical of project management and match information relating to project duration, actions, sites, budget, grantees/entities that execute the project.

These project management controls lead to other controls that contrast the original project (as officially approved) with its final version. In these controls there is a shift from merely quantitative metrics to examination of eligibility of costs that requires more technical analysis although still of financial aspects.

However, although the sophistication of the examination increases, these controls still do not constitute 'true controls', as technically the term 'control' should be used when all of the following criteria are satisfied:

- a) the examination is conducted on original documents (and not on copies although certified and stamped as such);
- b) the examination is conducted at the Grantee's premises having access to the procedures used to generate reported data;
- c) the people conducting the examination are qualified and have experience as assessors in the relevant function of the organization or are experienced certified independent auditors (when an external professional is engaged).

That said, although the more orthodox control approach is preferable, more structuring of the basic controls - essentially 'check-list' ticking which is rather neutral - by organizing them hierarchically can be a good solution for the start-up phase in view of possible stepwise upgrades at later stages.

Going back to Fondazione Cariplo's model, all audits conducted by external professionals as well as inspections made by the Foundation staff are true controls, technically speaking.

The various examinations the Foundation carries out make up a control system that assures conformity in a tiered scheme that reflects the degree of satisfaction of the criteria for technical definition of control as set out above (characteristics of documents examined, place of the examination, professional expertise), i.e.:

- 'self-certified' conformity: no verification of documents proving expenses and payments (not even of copies) which are self-certified (employee and operating expenses);

¹⁰ Financial jargon.

- “documented” conformity: examination of documents proving expenses and payments (costs borne for depreciable investments, such as facilities and buildings);
- “certified” conformity: final grant report and independent auditor’s report certifying it (all expenses).

In ascending from ‘self-certified’ conformity to ‘certified’ conformity the uncertainty about the existence of documents referred to in grant reporting or about their actual match with originals (when copies are provided) gradually reduces, although it does not entirely go away. However, when the Foundation commissions an inspection, it requires the auditor to verify also what the project has accomplished in terms of physical installations, tangible assets, services obtained thanks to the funding provided by it.

When implemented in full, the model adopted by Fondazione Cariplo is capable of satisfying various needs without going beyond philanthropic boundaries, in that it allows nonprofit Grantees to gradually adjust their practices to the new rules, stimulates the experimentation of more flexible organizational modules and helps the Foundation implement a policy hinged on moral suasion mechanisms.
