Fiscal Sponsorship Is Maturing as a Field

M. Melanie Beene

Cautious, longtime grantmakers may recall the stir created in 1989 by John Edie, the Council on Foundation's attorney, when he wrote *Use of Fiscal Agents: A Trap for the Unwary*. This report, unfortunately, cast a shadow over the concept of fiscal sponsorship that still lingers in some quarters. Since that time, however, and across the past twenty years, the practice of fiscal sponsorship has continued to grow, organize itself, and become increasingly sophisticated. With the publication this spring of guidelines for the best practices of fiscal sponsorship by the National Network of Fiscal Sponsors (NNFS), the field of fiscal sponsorship has arguably come of age. (To link to these guidelines, go to tidescenter.org/fileadmin/tc_pdfs/nnfs/NNFS-Guidelines-for-Comprehensive-Fiscal-Sponsorship.pdf.)

Edie's report led to a period of debate within the nonprofit sector over what was then called fiscal agency. Now, those in the know never use the term "fiscal agent" as it implies that the fiscal sponsor is the agent of the fiscally sponsored project (FSP), when in fact it works the other way around. The FSP is the agent of the fiscal sponsor who takes legal responsibility for the project activity that is sponsored. A true fiscal agent would be exactly the situation the IRS prohibits.

In response to the confusion created by this controversy, Gregory L. Colvin published the definitive book on the subject, *Fiscal Sponsorship: 6 Ways to Do It Right* (Study Center Press, 1993. Revised edition, 2005). It remains the only available text on the subject.

In 2003, thanks to a grant from the Kellogg Foundation to strengthen the field of fiscal sponsorship, Tides Center conducted a benchmarking study that led to the first gathering of fiscal sponsors to discuss the issues and challenges of using fiscal sponsorship as a mechanism to support innovation in the nonprofit sector. By early 2004, the leaders of these organizations decided to meet regularly to collaboratively define and build the relatively unknown, and greatly misunderstood, field of fiscal sponsorship within the nonprofit sector. This group—Community Initiatives (then called CIF of the San Francisco Foundation), Community Partners (Los Angeles), the Colorado Nonprofit Development Center (Denver), Earth Island Institute (Berkeley), Public Health Foundation Enterprises (City of Industry, California), Third Sector New England (Boston), and Tides Center (San Francisco)—became known as the National Network of Fiscal Sponsors.

The group worked together and created a field scan survey of the current practice of fiscal sponsorship around the country. Out of that collaboration came a series of national and regional convenings across the next six years in Los Angeles, Philadelphia, Oakland, Denver, and Washington, D.C., attended by more than 140 practicing fiscal sponsors. These new guidelines on best practices are a product and culmination of those discussions.

The National Network of Fiscal Sponsors hopes that funders will read the guidelines and help raise awareness of best practices in the field. To aid in this regard, I include here a list of questions for grantmakers to use in talking with their fiscally sponsored grantees.

Eight Questions Funders Should Ask Their Grantees Who Use Fiscal Sponsors

1. Do you have a written agreement with your fiscal sponsor?

Without a written sponsorship agreement or memorandum of understanding, the fiscally sponsored project (FSP) has no recourse especially since the sponsor must retain sole authority over the funds. It is recommended that the funder request a copy of the agreement with the other documents requested at the time of application.

2. Do you understand the implications of the model of fiscal sponsorship your project is using?

While Gregory Colvin's *Fiscal Sponsorship: 6 Ways to Do It Right* outlines six ways to structure the fiscal sponsorship relationship, in practice, the vast majority of projects are either Comprehensive Fiscal Sponsorship (or Model A. Direct Project in Colvin's terminology) or Preapproved Grant Relationship (Model C). These different models involve different legal relationships, different liabilities for both sponsor and FSP, different ownership of the project results, and different tax filing responsibilities. They also have different models of best practices as indicated in the National Network of Fiscal Sponsors (NNFS) guidelines.

Arts activities, in our experience, generally always use the Preapproved Grant Relationship model (Model C), but they can also use other models. In Model C, foundation grants and donations may be the only funds going through the sponsor (and therefore given oversight). Earned revenues from the same project activity will not necessarily show up on the project budget the fiscal sponsor produces. These revenues are not required to go through the fiscal sponsor in a Model C relationship (although in many cases they do, especially when the FSP wants all its activity represented in one place). One reason some arts FSPs prefer Model C fiscal sponsorships is to avoid a fee on their earned income.

The Preapproved Grant Relationship model of fiscal sponsorship is widely misunderstood and easily abused as a "conduit" when the fiscal sponsor fails to exercise the requisite "discretion and control." The key element to avoid in fiscal sponsorship relationships is the creation of a "pass-through" or "conduit" arrangement. The fiscal sponsor must exercise "variance power" or independent "discretion and control" over the fiscally sponsored project for the relationship to pass IRS muster.

3. What other services beyond use of the sponsor's tax-exempt status do you receive?

Fiscal sponsors typically provide a variety of ancillary services beyond tax-exempt status, which will vary among sponsors (e.g., accounting, grants management, HR, payroll and benefits administration, insurance, space, group purchasing, professional development workshops and consultations, and opportunities for outreach, marketing, and publicity). With the Preapproved Grant model, however, there can be no employees and the sponsor generally does not insure the project. If "use of the tax-exempt status" is the only service provided and there is insufficient oversight, you should be forewarned that the IRS may deem this a disallowed pass-through transaction for which there is a penalty to the donor.

Generally, unless the fiscal sponsor is taking financial responsibility for the funds, there is no mechanism for the sponsor to provide the needed programmatic and financial oversight.

4. What fee are you being charged? When is it taken? Is it refunded on unexpended funds when you transfer fiscal sponsors or terminate the relationship?

The fee structure should be spelled out in the fiscal sponsorship agreement or policies. Fees can range from token to 25 percent, but an average fee is around 10 percent. Some fiscal sponsors take it from the revenues as they are received; others take the fee from the expenses as they are incurred. (See fiscalsponsordirectory.org for a national list of fiscal sponsors. This directory, maintained by the San Francisco Study Center, includes information on each fiscal sponsor, including fees.)

An issue that comes up when a fiscally sponsored project wishes to change sponsors is whether the fee on the unexpended funds will be returned. There is no uniform agreement on this question in the field, but it would be useful for the FSP to know its sponsor's practice on the front end because failure to return the unused portion of the fee can make it administratively difficult to switch sponsors. In any event, how the relationship between the FSP and the fiscal sponsor is terminated should be spelled out in the agreement.

5. Do you get regular, timely, accurate financial accounting of your sponsored funds?

Without such an accounting, your grantee does not have a reliable fiscal sponsor.

6. Does your fiscal sponsor provide programmatic and financial oversight of your project?

This is another way of inquiring whether the fiscal sponsor is exercising appropriate "discretion and control" of the donated funds. Typically, the sponsor will not be involved with artistic decisions but will verify that the project is being carried out according to the plans laid out in your grant proposal and the FSP's contract with the sponsor.

7. Does your fiscal sponsor file your grant reports with your grantors?

The fiscal sponsor is the grantee of record and should be tracking, submitting (or assuring submission), and maintaining copies of any required reports. As a funder, your legal relationship is with the sponsor, not the fiscally sponsored project (FSP), so it serves you to know how the fiscal sponsor operates.

8. Does your fiscal sponsor follow the National Network of Fiscal Sponsors' guidelines for best practices?

While the NNFS only issued its best practices guidelines this spring (2010), they are the culmination of years of work and discussion among fiscal sponsors from around the country—sponsors of all sizes, representing a variety of disciplines. The best way for these guidelines to become widely disseminated, and more important, widely followed, is for the philanthropic community to ask its grantees to adhere to them.

Part of the impetus in the fiscal sponsorship field to codify these "best practices" was to help funders understand the fiscal sponsorship relationship and to weed out those sponsors (and they are still out there) who give the field a bad name by merely "passing through" or laundering the funder's grant money.

For the final seal of approval, John Edie, that early harbinger of caution, now says, "The [NNFS] guidelines look excellent—if only more organizations followed them!"

M. Melanie Beene is president and CEO of Community Initiatives, a fiscal sponsor based in San Francisco, California.