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**Not The Whole Loaf, But More Than Half a Loaf: A Significant Step
Forward in Self-Regulation by America's Nonprofit Sector***

by

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Background

In response to the Senate Finance Committee's "white paper" released in the late spring of 2004 and with the encouragement, in a letter of September 22, 2004, from the Senate Finance Committee chair, Senator Grassley, and the Committee's senior staff, to Diana Aviv, President and CEO of Independent Sector, that organization established, on October 12, 2004, the Panel on the Nonprofit Sector (PNS).¹ It is no exaggeration to say, as does the PNS Report released in June 2005, *Strengthening Transparency, Governance, Accountability of Charitable Organizations: a final report to Congress and the Nonprofit Sector*² that "the Panel has led to an unparalleled collaboration on how to strengthen the sector's accountability, transparency, and governance." And, also without exaggeration, the Report goes on to say that "The participants in this effort—thousands of people representing diverse organizations from every part of the country—recognize that to serve their missions effectively, they must demonstrate that they are ethical, responsible stewards

¹ See Appendix A for list of Panel members

² June 2005, p. 4

of Americans' generosity."³ Indeed, it is my strong view that, with the possible exception of The Filer Commission during the 1970s following the Tax Reform Act of 1969, America has never before experienced so widespread a coming-together of nonprofit and foundation practitioners, scholars who specialize in the study of nonprofits and foundations, lawyers who practice in, study and write about the field of nonprofits, and volunteers in a wide variety of nonprofit organizations—for the purpose of seeking consensus on ways of improving the functioning of America's nonprofits and the legal and regulatory environments in which they operate.

For about 18 months, five Work Groups—one each on Governance and Fiduciary Responsibility, Government Oversight and Self-Regulation, Legal Framework, Transparency and Financial Accountability, and Small Organizations—and 2 advisory groups—an Expert Advisory Group and a Citizens Advisory Group—composed of a wide range of nonprofit practitioners, scholars and generalists met almost continuously, always under very tight turn-around time frames, assisted by Independent Sector professional staff and outside legal counsel, to draft and redraft the recommendations generated and continually revised by the work and advisory groups, the legal advisors, and the members of the PNS. In addition, the PNS convened public hearings in which an estimated 2500 persons participated, all of them co-convened with multiple local convenors, in Atlanta, Chicago, Dallas, Denver, Des Moines, Detroit, Duluth, Helena, Minneapolis, New York, Philadelphia, San Diego, San Francisco, Seattle, and Washington, DC. In addition, the subject matter covered in the recommendations were separately considered by various professional groups that involved another 2200 persons. The Panel's final report, as requested by the Senate Finance Committee, was published in June, 2005, and its supplementary report was published in April, 2006.

³ Ibid

Among the eight principles the Panel adopted to guide its recommendation, and published in the June 2005 Report were the following two principles:

“5. A Viable System of Self-Regulation and Education is Needed for the Charitable Sector. The vast majority of charitable organizations are committed to ethical conduct and responsible governance and are willing to conform to commonly accepted standards of practice. The development and dissemination of these practices are an important component of the effort by the charitable sector to encourage all charitable organizations to embrace the highest possible standards of conduct. Whether it be peer review and feedback, coupled with transparency in practice, or more complex systems of accreditation, such initiatives, if actively embraced by the sector, are likely to bring about positive change.

“Although self-regulation is unlikely to work with those who deliberately violate standards of ethical practice and are immune to peer pressure, the charitable sector nonetheless must be actively involved in identifying and promoting best practices and strongly encouraging compliance within relevant sub-sectors. The sector must offer educational programs that reach the entire sector, especially the board members and professional leaders who may not otherwise be aware of the expectations and requirements imposed on them. Both the sector and government should provide the resources necessary to disseminate best practices and to develop and sustain ongoing education efforts to help board members to govern and CEOs to operate in a responsible, transparent, and accountable manner.”⁴

“8. Demonstration of Compliance with High Standards of Ethical Conduct Should be Commensurate with the Size, Scale, and Resources of the Organization

“All organizations should be expected to operate ethically and serve as worthy stewards of the public and private resources entrusted to them. Fraud or abuse cannot be

⁴ Ibid p. 21

condoned in any organization for any reason, since each breach of the public trust damages the reputation of the entire sector. At the same time, it may not be possible or desirable for small organizations, given their limited human, technical, and financial resources, to demonstrate their ethical and accountable operation by complying with some of the more complex legal requirements appropriate for larger charitable organizations. Lawmakers must consider the varying situations or organizations to which regulations may apply, and must refrain from adopting regulations where the costs of demonstrating compliance outweigh the benefits gained.”⁵

When the process which produced the report of June 2005 and the April 2006 supplement to the final report was completed, Diana Aviv later explained, in giving the Panel’s charge to the Advisory Committee, that “the Senate Finance Committee staff was surprised that the Supplement did not address questions about self-regulation in the sector.” She continued that “the Panel felt that this was such an important area for our field that it required a more comprehensive approach than was possible under the time frame of the Panel’s earlier work.” In other words, the Panel came to the conclusion that it would not be able to treat adequately, within the time frame it had adopted at the instance of the Senate Finance Committee, the complexity of issues that are involved in conceptualizing and implementing a self-regulation undertaking of the scope it envisioned. It decided, therefore, that it would create a supplementary Advisory Committee on Self-Regulation of the Charitable Sector, and, in the same month in which it released the supplement to the final report, announced the formation of that Advisory Committee,⁶ the first meeting of which took place on April 27, 2006.

Last Thursday, October 18, 2007, Independent Sector released the text of the Principles of Good Governance and Ethical Practice,⁷ which were adopted by the Panel on the Nonprofit Sector.⁸ Those Principles were developed over the past year and a half by

⁵ Ibid p. 22

⁶ See Appendix B for list of the members of the Advisory Committee

⁷ See Appendix C for the full text of the Preamble and the Principles

⁸ See Appendix A for a list of the members of the Panel on the Nonprofit Sector

the Panel's Advisory Committee on Self-Regulation, which was composed of some 30 members and co-chaired by Rebecca Rimel, President and CEO of the Pew Charitable Trusts, and by me.⁹ Several Independent Sector staff members, especially President and CEO Diana Aviv and Pat Read, Senior Vice President for Public Policy and Government Relations, as well as the latter's associates, were of critical help to the Advisory Committee in drafting, editing, substantively shaping, and recommending the Principles to the Panel for its consideration and adoption. And of course Diana Aviv's roles not only as the leader of Independent Sector but also as the Director of the Panel on the Nonprofit Sector were certainly decisive both throughout the period of the Advisory Committee's existence but also in the shaping of the final decisions which were reserved to the Panel.

On many occasions heretofore, I have both written and spoken of the extraordinary job Diana Aviv did in conceiving the very idea of the Panel on the Nonprofit Sector as a potentially powerful way by which the U.S. nonprofit sector could respond to the challenge issued to it in mid-2004 by Senator Grassley, the Chairman of the Senate Finance Committee, and the Committee staff. Not since the Filer Commission in the mid-1970s has there been such a feat of organization in the nonprofit sector. That was well before John Gardner conceived of America's need for an umbrella organization of the nonprofits sector and created The Independent Sector. Similarly, America's nonprofit sector came together over four years in Independent Sector's Panel on the Nonprofit Sector to try to speak with one voice to both the governmental powers that be and the nonprofit sector itself on the many broad issues involved in the laws and regulations which define and constrain the ways in which nonprofits and foundations go about the important work they do. To speak to the interested government powers that be, which invited the sector to offer its views on those issues, the Panel was able to crystallize and advocate the sector's views on specific legislative proposals. According to Senator Grassley and his staff, the Panel's recommendations were very helpful in shaping their interim views about legislative proposals. Some of those recommendations have already been embodied in the Pension Protection Act of 2006.

⁹ See Appendix B for a list of the members of the Panel's Advisory Committee on Self-Regulation

Diana Aviv's creation of the Panel was brilliantly conceived and artfully executed. One cannot help but admire—and praise—the clear vision, seemingly inexhaustible energy, entrepreneurial skill and shrewd diplomacy with which she laid out and implemented the plan for the creation and execution of the Panel on the Nonprofit Sector. It was a tour de force from beginning to end, and it could not have been brought off as well, perhaps at all, by anyone else I know.

The Advisory Committee Process and the Panel on the Nonprofit Sector's Decision

As was the case with all of the Panel's activities, everyone involved in the Advisory Committee understood that its role would be limited to proposing recommendations to the Panel, and that the Panel would dispose of those recommendations in its total discretion. There is absolute clarity about that. The Panel had an unquestioned right, under the constitutive principles which it adopted for itself, to accept, modify, or reject any of the recommendations of the Advisory Committee. In all of its deliberations over the recommendations of the Work Groups and earlier Advisory Committees, the Panel did pick and choose among the recommendations made to it, and adopted those that it thought best to adopt. So far as I know, individuals involved in the Work Groups and Advisory Committees did not challenge or criticize decisions of the Panel with which they disagreed.

Why, then, have I chosen to depart from their course and taken the step of criticizing the Panel's decision? The question that I have been forced to consider in writing this paper is whether the Principles promulgated by the Panel, standing alone, are an adequate response to the challenge issued to America's nonprofit sector by the Senate Finance Committee. I believe that they are not. I am convinced that the Principles do constitute a significant step forward for the organized nonprofit sector, but I believe that the Panel's unwillingness to couple with the Principles a recommendation that the sector also establish an entity charged with encouraging, monitoring and publicizing compliance

means that the progress of compliance will be much slower than it should be, or than it would be if such an entity were to be created.

Because I served as co-chair of the Advisory Committee and was so named in the release announcing the publication of the Principles, I do not feel comfortable remaining silent in the wake of what I regard as an inadequate final action by the Panel. If I were to remain silent, those who read about the Panel's action, as being based on the recommendations of an Advisory Committee of which I was co-chair, might well think that I concur in the Panel's decision, and regard it as an adequate step at this point in time.

It is with great reluctance that I express my disappointment in the Panel's unwillingness to go the extra mile in taking leadership by putting its weight behind at least some minimal efforts to achieve compliance with the Principles it has promulgated. I respect and admire the members of the Panel, all of whom are distinguished leaders of America's nonprofit sector, and many of whom are close friends of mine over many years. Just as I have frequently praised Diana Aviv for creating and energizing the Panel, I have also praised the Panel for the great good which I believe it has done, as well as for the members' time and energy which they have poured into it. Having heretofore repeatedly praised them for doing so well, I feel obligated to criticize them when I think, as I do at this point in time, that they have not adequately fulfilled their leadership role in this particular circumstance.

I understand, as does everyone who observes nonprofit organizations, that the nonprofit sector is not united on the need for such a compliance-inducing mechanism. I cannot judge whether those who disagree with the need for such a mechanism speak for any significant proportion, much less most, of the organizations that make up America's nonprofit sector. I imagine, however, that a recommendation by the Panel to create such a mechanism would likely have triggered some criticism of the Panel for going too far. But lead, I think, is what a group of distinguished leaders such as those who make up the Panel are supposed to do. They are supposed to give as much weight to their obligation to lead

the opinion of those they represent, as they give to their duty to reflect the present views of those whom they represent. I believe that, in failing to recommend any compliance mechanism, the Panel members have taken the easy and comfortable, rather than courageous and leaderly, way out and have struck a balance that gives too much weight to the reservations expressed by those organizations in the sector that resist the idea of more energetic sector efforts to achieve compliance with ethical norms.

Without question, the Panel very impressively did the first part of its work—that directed at bringing about satisfactory and supportive changes in the law affecting nonprofits by government, as well as that directed at fending off undesirable government changes in the law. It is my considered view that it did less well in satisfying the challenge given it by Senator Grassley at the end of the first part of its work, in which he said to nonprofits something like the following: “You have told us that you oppose a number of initiatives we have been considering to strengthen the regulation of the nonprofit sector, and we listened to you. You have said that you can better handle yourselves the challenge of improving the compliance of nonprofits to legal requirements and to ethical standards. Well, the ball is now in your court to deliver on that challenge and to regulate yourselves more satisfactorily than we, the government can.”

In other words, I think that the Panel succeeded in representing the nonprofit sector to the government in this instance, but failed adequately to represent the government to the nonprofit sector by its unwillingness to exercise courage in leading and persuading the nonprofit sector to take meaningful steps in regulating itself. The proclamation of principles of ethical behavior is unquestionably an important first step in self-regulation, but, without any mechanisms for compliance encouragement, monitoring and reporting, the Principles alone hardly constitute any convincing definition of “self-regulation.” By comparison with several of the already-existing certification, accreditation, or educational systems of self-regulation by subsector organizations, the principles alone are a pale shadow of meaningful self-regulation. Indeed, while they are a considerable

advance in specificity over Independent Sector's 1991 and 2002 *Obedience to the Unenforceable*,¹⁰ they are not advances beyond declaration and exhortation.

Many other observers of the U.S. nonprofit scene will surely be disappointed that those Principles were not accompanied by the establishment, or the recommendation for the establishment, of an entity charged with some measure of continuing responsibility for conducting an educational campaign to gain compliance with those Principles, for monitoring changes in such compliance, and for publicizing non-compliance with them.

I would have preferred to write this paper in a different form. Indeed, thinking that it would be permissible for me to do so because the advisory process would be completed when the Panel acted on the Advisory Committee's recommendations one way or the other and announced its decision, I did write the first version of this paper as a chronological unfolding of the Advisory Committee's 18-month long decision-making saga from beginning to end. I learned only two weeks ago, however, that, as interpreted by the Panel and Diana Aviv, no account could be publicly given of the internal deliberations of the Advisory Committee, whether during the Panel's decision-making process or after it had concluded.¹¹

I understand fully and respected completely that non-disclosure policy during the Advisory Committee's and the Panel's deliberations, because the process had to be indeed interactive and fluid. I do not understand, however, the need for non-disclosure after the Panel had concluded its decisions on the Advisory Committee's recommendations, and find the rationale for such non-disclosure at this point to be utterly unconvincing. The rationale is all the more unconvincing in view of the extent to which the exercise or non-exercise of nonprofit self-regulation is inherently related to the need for additional government regulation of nonprofits, and that nexus is unquestionably a matter of substantial public policy. The only possible explanation for continuing non-disclosure, at

¹⁰ Independent Sector, *Obedience to the Unenforceable: Ethics and the Nation's Voluntary and Philanthropic Community*, 1991 and 2002. Available on the Independent Sector web site, www.independentsector.org

¹¹ See Appendix E for "Policies for Work Group and Committee Participation"

this point after the Panel has acted, of what the Advisory Committee recommended to the Panel is to protect the Panel from criticism for failing to adopt the Advisory Committee's recommendation to establish an entity to spearhead educational efforts designed to encourage compliance with the Principles and to monitor and report publicly on such compliance. I do not believe that the public interest is well-served by shielding the Panel from such criticism.

When I informed Diana Aviv of my decision to include that fact in this paper, she responded that she was convinced that the strongly favorable vote margin within the Advisory Committee in support of the establishment of such an entity had been eroded somewhat by individual members who had expressed to her in confidence some wavering between the time the Advisory Committee meeting on January 25 took place and when the Panel received my report of the Advisory Committee's recommendation and acted upon it on February 5. As she held such communications confidential, and didn't share that fact either with the Advisory Committee or its co-chairs, I have no idea of the extent to which any wavering or defections from the Advisory Committee majority, which, when votes were taken in three successive meetings, were overwhelmingly in favor of the decision, did or did not erode the majority's position. Moreover, I confess that I, for one, find keeping such information confidential from the Committee and/or the co-chairs a very strange way of proceeding under such circumstances. Indeed I was surprised to learn that that circumstance was communicated to the Panel without giving the Advisory Committee, which had struggled mightily for eighteen months, and with considerable success, to harmonize contrasting views among its members, the opportunity to try to work out some compromise among its own members on the issues in contention.

While I cannot possibly know, therefore, what the Advisory Committee would have voted after those wavering had gone one way or the other, I do know that, on every occasion on which the Committee did vote, the vote was decisively in favor of recommending the creation of an entity charged with compliance education, monitoring and reporting.

Reflections on the Year-Long Course of the Committee's and the Panel's Deliberations

The Principles

The Preamble and 33 Principles represent a watershed for the self-regulation of the nonprofit sector in the United States.¹² They represent a major step forward from Independent Sector's 1991 and 2003 publication, *Obedience to the Unenforceable*,¹³ which embodied general statements about nonprofits' obligations to conduct themselves in accordance with ethical norms. The 2007 Principles constitute the first consensus code of principles of both minimal and aspirational standards of good governance and ethical practice ever advanced by a wide cross-section of nonprofit leaders, practitioners and scholars. They cover four major categories of nonprofit practice:

1. **Facilitating Legal Compliance and Public Disclosure (1-7)** — responsibilities and practices, such as implementing conflict of interest and whistleblower policies, that will assist charitable organizations in complying with their legal obligations and providing information to the public.
2. **Effective Governance (8-20)** — policies and procedures a board of directors should implement to fulfill its oversight and governance responsibilities effectively.
3. **Strong Financial Oversight (21-26)** — policies and procedures an organization should follow to ensure wise stewardship of charitable resources.
4. **Responsible Fundraising (27-33)** — policies and procedures organizations that solicit funds from the public should follow to build donor support and confidence.

None of these suggested principles were arbitrarily-chosen in any sense, nor are they radical departures from any existing standards. They were all generated

¹² See Appendix C for the full text of the Preamble and the Principles of Good Governance and Ethical Practice

¹³ See footnote 10 above for citation

by a careful study of both existing federal and state law regulating nonprofit organizations, and also the codes of ethical practices and good governance which now apply to most nonprofits that are subject to relevant standards promulgated by accrediting, licensing, or supervising bodies of like-missioned nonprofit organizations. The Advisory Committee, the Independent Sector staff and the Panel on the Nonprofit Sector embodied in these Principles a broad synthesis of existing legal requirements and existing ethical and governance standards, and, where it seemed to them appropriate to do so, raised the bar a bit. If a wide swath of American nonprofits gradually achieves full compliance with these Principles, as we all hope they will, that will constitute a significant improvement over the present and will signify both the willingness and ability of America's nonprofits to grasp the nettle of self-regulation. By doing so, the nonprofit sector will also diminish the likelihood of further governmental regulation.

The Lack of a Compliance Mechanism

The significance of a compliance mechanism to obtaining adherence to ethical standards of behavior in organizations had been earlier documented by an excellent Independent Sector-commissioned study performed by this National Center on Philanthropy and Law, the report of which was part of the working materials provided to the Advisory Committee. That report illustrated that many of the accreditation and licensing systems currently employed by particular subsectors of the nonprofit sector do employ either carrots—such as a seal of compliance awarded to an organization—or sticks—such as eligibility for federal funds or other benefits of some kind—or both, and virtually all of such existing systems do include oversight mechanisms charged with exerting efforts to achieve compliance.

The caveats are worth noting, however. All of such existing systems cover comparatively small numbers of organizations, and the organizations they cover are usually of like mission. Moreover, some of the ethics codes, especially those in accreditation and licensing schemes, are embedded in compliance mechanisms that are

much broader and much more burdensome than narrowly-focused ethics codes alone. That last point certainly characterizes the accreditation schemes governing institutions of higher education and hospitals, which helps explain why it was almost entirely the representatives of some of such groups on the Advisory Committee who were most skeptical about the desirability, indeed the workability, of any enforcement mechanism if it had to be layered on, or somehow integrated with, the existing accreditation systems.

Moreover, many of the existing accreditation, certification and licensing systems often cover only organizations with the same mission. Like the Independent Sector principles to be promulgated, any mechanism to enforce them would be focused not upon organizations with the same mission but upon all nonprofits of a certain asset or revenue size, irrespective of their missions. That breadth of coverage undoubtedly would have significantly complicated the successful functioning of any compliance incentives and mechanisms much more so than the promulgation of aspirational principles alone.

As I stated at the beginning of this paper, I believe that there is a good chance that large numbers of nonprofits will voluntarily, without the pressure of any compliance mechanism, undertake to comply with the promulgated Principles. I continue to believe, however, that a light-handed system of compliance incentives and an entity of some kind charged with overseeing the progress of compliance and the conduct of an initiative to educate the nonprofit sector about the desirability of compliance with the principles could significantly increase both the level of compliance and the speed with which compliance could be attained. Consequently, I also continue to be disappointed by the reluctance of the Panel on the Nonprofit Sector to embrace such a system, and find myself puzzled as to the reason for its unwillingness to do so.

One need not dig deeply to discern the stark contrast between principles 5 and 8 of the Panel's June 2005 Report, quoted above, and the Panel's decision in February 2007 not to accept the Advisory Committee's recommendation that a compliance-furthering

entity be established as a complement to the Principles to be promulgated. What was it that caused the Panel to change its mind on that point over about 18 months?

It is hard to believe that the opponents of any compliance mechanism within the Advisory Committee did not orchestrate a campaign both within the Panel and, later in the press, by activating a surrogate—the Foundation Roundtable—to try to forestall the adoption by the Advisory Committee or the Panel of any compliance-inducing mechanism. The fact that the Foundation Roundtable chose to release its open letter to the press the day before the January 25th meeting of the Advisory Committee suggests so.¹⁴ From the very first meeting of the Advisory Committee, a few members made clear their aversion to any kind of overlay of additional principles of conduct upon what their respective accreditation systems required. Every time the issue came up in the Advisory Committee, they argued passionately against any additional compliance mechanism, and every time the Advisory Committee voted the overwhelming majority favored the creation of such a mechanism.

One can sympathize with the self-interest of the opponents in not adding to the requirements by which the behavior of their institutions is assessed. But the Advisory Committee made clear, on every occasion on which enforcement mechanisms were discussed, that it never intended to add an additional layer of supervision to such well-developed accreditation schemes. Rather it repeatedly stated that, at most, existing organizations would be able to “opt out” of any IS-sponsored additional enforcement mechanism if their substantive principles of conduct were aligned with the IS Principles to be promulgated. If such alignment was required and actually brought about, their organizations would not have been subject to any IS-sponsored enforcement mechanism that was created. If their pre-existing substantive principles were not aligned with the new IS-sponsored principles, the IS enforcement mechanism would recommend to their organizations that their standards be raised in order to achieve alignment. The Advisory Committee never contemplated the creation of a unified enforcement mechanism that

¹⁴ See Appendix D

would embrace existing subsector accreditation or enforcement systems. Any new IS-sponsored system of enforcement would have been limited to organizations not now covered by any existing subsector standard-setting and -compliance systems. If existing systems remained out of compliance, the IS would have had to deal with it.

Conclusion

It would be all too easy to dismiss the achievements of Independent Sector's Panel on Nonprofits' Advisory Committee on Self-Regulation as "all bark and no bite," but that knee-jerk reaction to its accomplishments to date would be unfair as well as inaccurate. "Bite" can be achieved in many ways in addition to moving jaws, and, for better and worse, the Panel on the Nonprofit Sector preferred to use suasion rather than even mild coercion as its means for achieving compliance with the Principles. While it is true that most members of the Advisory Committee would have preferred to accompany those Principles, which it struggled very hard to develop, polish, agree to and perfect, with both some system of education and compliance monitoring, even if only mildly coercive, and some entity, even if light-handed, to drive a campaign to achieve compliance, it is also true that both the co-chairs and most, perhaps even all, of the members believe that, because the Principles are persuasive, logical, timely and fair-minded in their own right, and because America's nonprofit sector seems eager to do, and be seen as doing, the right thing, they are likely over time to attract compliance by an ever-broadening swath of America's nonprofit organizations. Still, the Panel's failure to accept the Advisory Committee's recommendation that a compliance-inducing entity, which would be phased in gradually, be coupled with the promulgation of the Principles cannot help but be viewed as unwillingness to put its money where its mouth is.

It is remarkable that the Advisory Committee was able to come together with unanimity on the substantive content of the Principles themselves. Why, one wonders, was the Panel unwilling to follow the Committee's recommendation concerning a compliance-inducing mechanism? Perhaps the Panel members were persuaded by the intensity with

which a few members of the Advisory Committee, as well as others outside the Committee, opposed any enforcement or compliance mechanism, and by the worry among members of the Panel that, if such a mechanism were appended to the Principles, members of that minority, all of them representing large and long-established, wealthy important subsectors of the nonprofit sector, would withdraw from the entire effort. If they had done so, the possibility of gaining widespread approval of the Principles themselves might have been seriously compromised. Perhaps it was those circumstances that led the Panel to choose to give up entirely on an enforcement mechanism, that it had itself contemplated in its own public report in 2005, in order to save the possibility of agreement on the substance of the principles. That, I think, was the trade-off the Panel members made, and it is, as I wrote at the beginning of this paper, a judgment call which was not unreasonable, even if I disagree with it. Perhaps the Panel's decision was facilitated by the change-over from the Republican to the Democratic leadership in the Senate, which shifted the chair of the Senate Finance Committee from Republican Senator Charles Grassley to Democratic Senator Baucus. There is now an impression, widespread in the nonprofit community, that that shift of chair took the heat off the nonprofit sector to continue to respond forcefully to the challenge with which Senator Grassley and his staff jolted the sector.

But I can also say that, in all honesty, I do respect the judgment call made by the members of the Panel, and the Panel's resulting unanimous position that it would be both less contentious and more productive of the Panel's aim throughout the nonprofit sector if the Principles make their own way by force of their persuasiveness than if some mechanism of actual force were created to speed and monitor compliance. The reader must judge whether I have succeeded in balancing fairly my own preferred outcome with the Panel's reasoning for its decision. I will say that there has already developed a steady flow of anecdotal information suggesting that the interim principles previously published by the Panel for public comment have become, at least for some organizations, including such large and prominent ones as the American Red Cross, a model by which to raise the ethics and governance requirements in their own organizations.

I sincerely hope that such voluntary adoption of the Principles will spread quickly. Like most other members of the Advisory Committee, I share the hope of the Panel that the now-promulgated Principles will indeed make their own way by uncoerced and unincentivized emulation, which, as an ideal, is always preferable to coercion, even if only mild. I believe, however, that progress toward that end will be slower than it should be if it is to enable the nonprofit sector to be proud of the way it governs itself, as well as if it is to forestall unnecessary additional regulation by various levels of government.

Appendix A

Panel on the Nonprofit Sector

Co-Convenors

Paul Brest, President
William and Flora Hewlett Foundation
Menlo Park, CA
[succeeded in 2006 by Lorie Slutsky, President
New York Community Trust
New York, NY]

M. Cass Wheeler, Chief Executive Officer
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Panel Members

Susan V. Berresford, President
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**Marsha Johnson Evans, President and CEO
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***Jonathan F. Fanton, President and CEO
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Brian Gallagher, President and CEO
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**Kenneth L. Gladish, National Executive Director
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Raul Yzaguirre, Immediate Past President and CEO
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Executive Director

Diana Aviv, President and CEO
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**These members concluded their service on the Panel in December, 2005.

***These members were appointed to the Panel in February 2006.

Appendix B.—Advisory Committee on Self-Regulation of the Charitable Sector

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Appendix C

THE FOLLOWING DOCUMENT EMBARGOED UNTIL 5:30 PM, MONDAY,
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P R E A M B L E

NONPROFIT ORGANIZATIONS in the United States — educational, charitable, civic, and religious institutions of every size and mission — represent the most widespread organized expression of Americans' dedication to the common good. The creation of these voluntary, often grassroots organizations to accomplish some public purpose is a distinguishing feature of our national life. Since at least the 1835 publication of Alexis de Tocqueville's *Democracy in America*, they have been recognized internationally as a source of social cohesion, a laboratory of innovation, and a continually adaptable means of responding to emerging ideas, needs, and communal opportunity. Individuals have continued to use their First Amendment freedoms of speech and association to create and energize organizations that define common needs, rally popular support, and pursue innovative approaches to public problems. These nonprofits have been a source of national achievement on many fronts.

The variety of purposes, forms, and motivating beliefs that make up the charitable community in the United States is one reason why it has consistently earned widespread support from large numbers of Americans. In recent decades, the percentage of survey respondents expressing confidence in the ethics and honesty of U.S. charities and voluntary organizations overall has hovered around two-thirds.¹⁵ For individual charitable organizations, responses are even more favorable, some reaching above 70 percent. In 2006, 20 percent of all Americans — more than 61 million of them — volunteered in some capacity in an assortment of different kinds of nonprofit activity.¹⁶ Individual

¹⁵ Independent Sector, *Keeping the Trust :Confidence in Charitable Organizations in an Age of Scrutiny*, August 2002, p. 2.

¹⁶ Bureau of Labor Statistics, *Volunteering in the United States, 2006*, Washington, DC: U.S. Department of Labor, 2007.

donations totaled more than \$207 billion, which came on top of the \$41 billion given by corporations and foundations created from private money.

Preserving this diversity, adaptability, and capacity for innovation depends in large part on maintaining the public's trust. Because the country's 1.4 million charitable organizations are connected by the common mission of improving lives, a taint on one organization's reputation can easily harm the image of all of them. Unethical or improper conduct by individual nonprofits, though rare, can thus jeopardize the human and financial support on which countless other activities rely. Yet government attempts to prevent such abuses, if not carefully pursued, can themselves diminish the unique value that nonprofits bring to American life. Too heavy a regulatory hand, or too uniform and inflexible a set of legal restraints, could stifle the very creativity and variety that makes nonprofit activity worth protecting and encouraging. Government appropriately sets broad rules for the use of tax-exempt funds by charitable organizations, but for the sake of the benefits that flow from these organizations, government has wisely avoided intruding on how organizations, as they pursue their missions, manage their programs and structure their operations.

Just as important, nonprofit organizations have long embraced the need for standards of ethical practice that preserve and strengthen the public's confidence. Many such systems in fact already exist, though few, if any, apply to the entire range of American charitable organizations. The pages that follow therefore set forth a comprehensive set of principles to inform the field. Their purpose is to reinforce a common understanding of transparency, accountability, and good governance for the sector as a whole — not only to ensure ethical and trustworthy behavior, but equally important, to spotlight strong practices that contribute to the effectiveness, durability, and broad popular support for charitable organizations of all kinds.

Mandates and Guidelines:

Toward a balanced system of law and self-governance

Any approach to preserving the soundness and integrity of the nonprofit community must strike a careful balance between the two essential forms of regulation — that is, between prudent legal mandates to ensure that organizations do not abuse the privilege of their exempt status, and, for all other aspects of sound operations, well-informed self-governance and mutual awareness among nonprofit organizations. Such a balance is crucial for ensuring that structures of accountability and transparency are core strengths of our nonprofit community, affording organizations the support they need to pursue their various callings and the flexibility they need to adapt to the changing needs of their communities, their fields of endeavor, and the times.

The Panel on the Nonprofit Sector has worked over the past three years to help find that balance. Created in 2004 at the encouragement of the leaders of the Senate Finance Committee, the Panel had addressed concerns shared by nonprofit organizations, members of the public, Congress, and federal and state oversight agencies about reports of illegal or unethical practices by some charitable organizations and their donors. The Panel's Final and Supplemental Reports, issued in 2005 and 2006 respectively, offered more than 100 recommendations for improving government oversight, including new rules to prevent unscrupulous individuals from abusing charitable organizations for personal gain. The Pension Protection Act of 2006 enacted many of these recommendations into law, and the Panel is continuing to work with members of Congress and the executive branch on ways of implementing the remaining ones.

The Panel has been equally committed to formulating effective, broadly applicable methods of self-regulation. This track of its work likewise dates back to the invitation from the Senate Finance Committee's leaders in 2004. The ensuing effort has proceeded from a belief — among lawmakers and their staffs no less than among charitable organizations — that the best bulwark against misconduct will always be a well-informed vigilance by members of the nonprofit community themselves, including a set of principles

they could adopt, promote sector-wide, and improve over time. These principles should be clear enough to be practical and readily implemented in a wide variety of organizations, but flexible enough to allow each organization's governing board and management to adapt them to the dictates of that organization's scope and mission. Widespread use of such principles would enable organizations to improve their operations by learning from each other. Critically, it would also provide a common yardstick by which members of the public can evaluate how to direct their support.

Expanding Self-Regulation:

Drawing sector-wide principles from an array of current systems

Though given fresh impetus by current members of Congress and by the creation of the Panel on the Nonprofit Sector, the idea of self-regulation is far from a recent preoccupation among charitable organizations. Among the earliest such efforts dates back to 1918, when a coalition of nonprofits established the National Charities Information Bureau to help the public learn about the ethical practices and stewardship of organizations that raise money from donations. Many excellent systems of self-regulation have long been in use in various subsets of the sector, each tailored to the goals, resources, and challenges of its particular field and membership. In searching for generally applicable standards for the whole sector, the Panel's first step was therefore to commission two studies to review, analyze, and find patterns among these existing systems.

The Panel then called together 34 leaders from charities, foundations, academia, and oversight agencies to form a special Advisory Committee on Self-Regulation. Armed with the two studies of self-regulation regimens already in use, the Committee began its work in 2006 with a detailed review of principles and standards drawn from more than 50 such systems, including selections from both the nonprofit and for-profit sectors. After extensive deliberation, the members developed a comprehensive set of principles drawn from current systems and incorporating the advice of experts in nonprofit law and governance.

This first set of draft principles was circulated for public comment in early 2007. After considering the resulting feedback, the committee and the Panel made revisions and released a second draft for a longer comment period. The wide-ranging reaction to both drafts demonstrated a broad interest across the nonprofit community in achieving consensus on the elements of transparent, accountable, and ethical conduct. The resulting guidance and encouragement further strengthened the Panel's final set of principles.

Structure of Accountability:

Adaptable standards for a diverse field

In the following pages, the Panel sets forth 33 principles of sound practice that should be considered by every charitable organization as a guide for strengthening its effectiveness and accountability. Six of these principles describe actions that all charitable organizations *must* take because they are required by law.¹⁷ The other 27 describe actions that charitable organizations *should* strongly consider following, based on their legal and operational structure and their particular charitable purposes.

This distinction — between firm rules based on law and more flexible principles that must be interpreted and applied differently in different cases — is essential to understanding and using this document. In following this approach, the Panel on the Nonprofit Sector examined a broad continuum of different models, reflecting greater and lesser degrees of uniformity and means of enforcement. At one end of this spectrum are systems of accreditation, such as those for hospitals and institutions of higher education, that carry the force of law and sanctions for violations. Further along on the continuum are standards that members of an association or network of similar organizations, such as associations of land trusts or evangelical religious institutions, agree to follow. While failure to meet these standards may not force an organization to close its doors, the advantages to being a member in good standing of the umbrella network is usually sufficient to encourage careful adherence to its rules and norms. Finally, there are

¹⁷ Principles 1, 3, 21, 25, 26 and 27 describe actions that are required by law of all charitable organizations.

standards that nonprofits subscribe to on a purely voluntary basis, without any external verification, because they want to strengthen their operations.

The first two approaches tend to be effective primarily with organizations that are closely affiliated with one another or belong to a relatively homogeneous group — where practices and professional expectations are highly standardized or where social sanctions have a strong impact. For a group as broad and diverse as the whole community of nonprofits, the third approach is clearly more appropriate: standards of practice that organizations are encouraged, but not required, to meet. Many national and state associations of charitable organizations with voluntary memberships have found this approach benefits their member nonprofits. The Panel has followed the practice, common to many such voluntary associations, of describing the reasoning behind each principle and offering guidance on how to adapt and apply it.

To be sure, a significant number of nonprofit organizations already function under one of the more prescriptive regimens as a result of their participation in some subset of the sector. Yet few of these systems offer a comprehensive approach to good governance and ethical practice. Even organizations that subscribe to the more comprehensive systems may well find ideas and practices in this document that will improve their self-governance further.

Still, given the wide, necessary diversity of organizations, missions, and forms of activity that make up the nonprofit community, it would be unwise, and in many cases impossible, to create a set of universal standards to be applied uniformly to every member. Instead, the Panel commends the following set of principles to every charitable organization as guideposts for adopting specific practices that best fit its particular size and charitable purpose. Organizations can use these principles to evaluate their current standards.

Self-regulation begins with good governance. Every charitable organization, by federal and state law, must have a board of directors or, if it is established as a charitable trust, one or

more trustees. The board sets the organization's broad policies and oversees its operations, including its financial policies. The board also has a responsibility to create an environment in which there is open and robust deliberation of the issues on which it takes action. Whether or not the organization has paid staff, the board bears the primary responsibility for ensuring that the organization lives up to its legal and ethical obligations to its donors, consumers, and the public. For organizations that do have staff, the chief staff officer, in partnership with the board, has responsibility for overseeing or carrying out many of the activities implied by these principles. It is therefore to the boards and chief executives of nonprofit organizations that this document is particularly, though not exclusively, addressed.

The 33 principles that follow are organized into four main categories:

1. **Facilitating Legal Compliance and Public Disclosure (1-7)** — responsibilities and practices, such as implementing conflict of interest and whistleblower policies, that will assist charitable organizations in complying with their legal obligations and providing information to the public.
2. **Effective Governance (8-20)** — policies and procedures a board of directors should implement to fulfill its oversight and governance responsibilities effectively.
3. **Strong Financial Oversight (21-26)** — policies and procedures an organization should follow to ensure wise stewardship of charitable resources.
4. **Responsible Fundraising (27-33)** — policies and procedures organizations that solicit funds from the public should follow to build donor support and confidence.

It is advisable that an organization's board conduct a thorough discussion of the complete set of principles, and determine how the organization should apply each to its operations. It is possible that after this review, a board may conclude that certain principles do not apply to its organization. Developing a transparent process for communicating how the organization has addressed the principles, including the reasons that any of the principles

are not relevant, is likely to foster a greater appreciation of the diverse nature of the sector and a deeper respect for the board's good stewardship.

The Longer Term:

A process of continuing vigilance, review, and adaptation

Strengthening ethics and accountability is an organic process that requires an ongoing commitment by boards and staff of individual organizations and by the entire nonprofit community. Over time, discussion within organizations and across the community may well result in refinement of the principles presented here. Such discussions would provide a further demonstration of the value to the whole sector of coming together to improve its work.

For organizations whose practices do not currently meet the standards recommended by the Panel, and for existing systems of self-regulation that fall short as well, reaching those levels may take some time. Yet even the process of striving toward these standards will strengthen the organization and its ability to serve its community. The key is to begin that process today.

THE FOLLOWING DOCUMENT EMBARGOED UNTIL 5:30 PM, MONDAY,
OCTOBER 22, 2007

PRINCIPLES OF GOOD GOVERNANCE
AND ETHICAL PRACTICE

FACILITATING LEGAL COMPLIANCE AND PUBLIC DISCLOSURE

1. A charitable organization must comply with all applicable federal laws and regulations, as well as applicable laws and regulations of the states and the local jurisdictions in which it is based or operates. If the organization conducts programs outside the United States, it must also abide by applicable international laws, regulations and conventions that are legally binding on the United States.

Charitable organizations are subject to a range of federal, state, and local laws, which are described in the reference version of this report available at www.nonprofitpanel.org. An organization's governing board is ultimately responsible for overseeing and ensuring that the organization complies with all its legal obligations and for detecting and remedying wrongdoing by management. While board members are not required to have specialized legal knowledge, they should be familiar with the basic rules and requirements with which their organization must comply and should secure the necessary legal advice and assistance to structure appropriate monitoring and oversight mechanisms.

There are many resources to help charitable organizations and their boards understand the law. The Internal Revenue Service provides a free online workshop at www.stayexempt.org, which covers tax compliance issues relevant to small and mid-sized tax-exempt organizations. Some state attorneys general and other state charity officials, as well as many national, state and regional associations of nonprofit organizations, provide online tools and resources that offer legal guidance.

Organizations may also find it helpful to consult with state and local chapters of bar associations for referrals to low-cost or pro bono legal assistance. The American Bar Association operates an online website, www.findlegalhelp.org, that can also be useful for locating legal advisors.

- 2. A charitable organization should have a formally adopted, written code of ethics with which all of its directors or trustees, staff and volunteers are familiar and to which they adhere.**

Adherence to the law provides a minimum standard for an organization's behavior. Each organization should also have a code of ethics that outlines the practices and behaviors that its staff, board, and volunteers agree to follow. The adoption of such a code, though not required by law, helps demonstrate the organization's commitment to carry out its responsibilities ethically and effectively. The code should be built on the values that the organization embraces, and should highlight expectations of how those who work with the organization will conduct themselves in a number of areas, such as the confidentiality and respect that should be accorded to clients, consumers, donors, and fellow volunteers and board and staff members.

The process by which a code of ethics is adopted and implemented can be just as important as the code itself. The board and staff should be engaged in developing, drafting, adopting, and implementing a code that fits the organization's characteristics. It should then be complemented by policies and procedures that describe how the principles in the code will be put into practice. Organizations should include a discussion of the code of ethics in orientation sessions for new board and staff members and volunteers, and should regularly address adherence to the code in their ongoing work.

3. A charitable organization should adopt and implement policies and procedures to ensure that all conflicts of interest, or the appearance thereof, within the organization and the board are appropriately managed through disclosure, recusal, or other means.

A conflict of interest arises when a board member or staff person's duty of loyalty to the charitable organization comes into conflict with a competing financial or personal interest that he or she (or a relative) may have in a proposed transaction. Some such transactions are illegal, some are unethical, but others may be in the best interest of the organization as long as certain clear procedures are followed.

Establishing and enforcing a conflict-of-interest policy is an important part of protecting charitable organizations from unethical or illegal practices. The policy need not be complex, but it must be consistent with the laws of the state in which the nonprofit is organized and should be tailored to specific organizational needs and characteristics. The policy should require full disclosure of all potential conflicts of interest within the organization. It should apply to every person who has the ability to influence decisions of the organization, including board and staff members and parties related to them. Some organizations may extend the policy to substantial contributors as well.

Board members and staff should be encouraged to disclose any interest they have in a transaction or matter that is before the organization where that interest could be reasonably viewed by others as affecting the objectivity or independence of the decision maker, even if the interest is not the result of the staff or board member having a formal affiliation with some other party. The practice of full disclosure should be fostered particularly at board meetings, and the fact of any conflict and the action taken in response, including abstention, should be recorded in the minutes.

Conflict-of-interest policies should distinguish between situations that give the *appearance* of a conflict and those that involve a *material* conflict where a board or

staff member has a direct or indirect financial interest in transactions with the organization. It is important that there be in place a transparent process, in which board members engage, to understand the nature of the conflict and whether it can be appropriately managed. For example, some foundations and grantmaking public charities prohibit grants to organizations for which one of the funder's board or staff members serves as an uncompensated director or trustee. Others require disclosure of this relationship and recusal from the decision-making process. Still others encourage board or staff members to be engaged actively with other charitable organizations, including the charities they may fund, as a way of learning about those organizations and the fields in which they work.

Once a conflict-of-interest policy is developed, all board and senior staff members should be required to sign it and to disclose any material conflicts of interest, both at the time they join the organization and at the beginning of each new board year. Many organizations use an annual questionnaire or disclosure statement for this purpose and commonly provide information about board members' conflicts to auditors or others reviewing the organization's financial transactions. When senior employees, board members or their family members have a material conflict of interest in a matter being considered by the board or the staff, they should refrain from attempting to influence other decision-makers regarding the matter. Board members with a material conflict of interest are required by law to recuse themselves from board discussions and votes regarding those matters, other than to respond to information requests.

4. A charitable organization should establish and implement policies and procedures that enable individuals to come forward with information on illegal practices or violations of organizational policies. This “whistleblower” policy should specify that the organization will not retaliate against, and will protect the confidentiality of, individuals who make good-faith reports.

Every charitable organization, regardless of size, should have clear policies and procedures that allow staff, volunteers, or clients of the organization to report suspected wrongdoing within the organization without fear of retribution. Information on these policies should be widely distributed to staff, volunteers and clients, and should be incorporated both in new employee orientations and ongoing training programs for employees and volunteers. Such policies can help boards and senior managers become aware of and address problems before serious harm is done to the organization. The policies can also assist in complying with legal provisions that protect individuals working in charitable organizations from retaliation for engaging in certain whistle-blowing activities. Violation of such provisions may subject organizations and the individuals responsible for violations to civil and criminal sanctions.

Policies that protect people who report wrongdoing — sometimes known as “Whistleblower Protection Policies” or “Policies on Reporting of Malfeasance or Misconduct” — generally cover suspected incidents of theft; financial reporting that is intentionally misleading; improper or undocumented financial transactions; improper destruction of records; improper use of assets; violations of the organization’s conflict-of-interest policy; and any other improper occurrences regarding cash, financial procedures, or reporting.

The policy should be tailored to the nonprofit’s size, structure, and capacity, and it must reflect the laws of the state in which the nonprofit is organized or operates. All policies should specify the individuals within the organization (both board and staff) or

outside parties to whom such information can be reported. Small organizations with few or no paid staff may wish to designate an external advisor to whom concerns can be reported without any threat of retaliation. This is a particular concern for family foundations whose board members and staff may not feel comfortable sharing concerns about suspected illegal or unethical practices directly with another family member or close associate of the family. Larger organizations should encourage employees and volunteers to share their concerns with a supervisor, the president or executive director, and/or the chief financial officer of the organization, but should also provide a method of reporting anonymously and confidentially to either a board member or an external entity specified by the organization. Some large organizations have set up a computerized system that allows for anonymous reports, and a number of private companies offer anonymous reporting services via a toll-free telephone number, email address, or intranet site.

It is equally important that the organization have clear procedures to investigate all reports and take appropriate action. The policy should stipulate that there will be no retaliation against any individual who reports a suspected violation, except in those instances where the organization determines that a false report was made with intent to harm the organization or an individual within the organization.

- 5. A charitable organization should establish and implement policies and procedures to protect and preserve the organization's important documents and business records.**

A written document-retention policy, consistently monitored over time, is essential for protecting the organization's records of its governance and administration, as well as business records that are required to demonstrate legal compliance. Such a policy also helps to protect against allegations of wrongdoing by the organization or its directors and managers. Board members, staff and volunteers should be made thoroughly familiar with the policy and informed of their responsibilities in carrying it out.

The policy should address the length of time specific types of documents must be retained, as well as when it is permissible or required to destroy specific types of documents. The policy should provide guidance to staff and volunteers for paper and electronic documents, files and e-mail messages. Specific procedures should also ensure that any document destruction is immediately halted if an official investigation of the organization is under way or anticipated.

Charitable organizations are required to maintain permanently their organizational documents, board minutes and policies, and materials related to their state and federal tax-exempt status. Other documents related to the governance, administration, fundraising, and programs of the organization must be kept in paper or electronic form for specific periods, depending on applicable laws and reporting requirements. Federal and some state laws prohibit the destruction, alteration, mutilation, or concealment of records related to an official legal proceeding.

- 6. A charitable organization's board should ensure that the organization has adequate plans to protect its assets — its property, financial and human resources, programmatic content and material, and its integrity and reputation — against damage or loss. The board should review regularly the organization's need for general liability and directors' and officers' liability insurance, as well as take other actions necessary to mitigate risks.**

The board of a charitable organization is responsible for understanding the major risks to which the organization is exposed, reviewing those risks on a periodic basis, and ensuring that systems have been established to manage them. The level of risk to which the organization is exposed and the extent of the review and risk management process will vary considerably based on the size, programmatic focus, geographic location, and complexity of the organization's operations.

Risk management generally includes a review of potential risks to the organization's significant assets, such as its property, its good will, and its key programs and activities, and decisions about the most appropriate ways to protect those assets from loss. All organizations should consider carefully all of the principles in this report — for effective governance, strong financial oversight, and responsible fundraising practices — as they develop appropriate policies and procedures to protect their assets.

Board members may have personal liability for fines and other penalties as a result of certain legal violations, such as failure to pay required payroll and other taxes or approval of excess benefit or self-dealing transactions. Federal and some state volunteer liability laws provide some safeguards for board members who are not compensated, other than receiving reimbursement of expenses, and who act in good faith. Nonetheless, while it is rare for a charitable organization and its board to be the target of a lawsuit, each organization should still take steps to ensure that its board members and its assets are protected. The board of directors should consider including indemnification provisions in the organization's governing documents, based on a review of the laws of the states in which it is based or operates. The board should also assess periodically the organization's need for insurance coverage based on its program activities and financial capacity. Insurance is only one risk management strategy, however. Other financial strategies should also be considered to protect an organization's assets, such as establishing reserve funds to absorb minor losses, borrowing from lenders, and negotiating with third parties to assume certain losses. The organization should also have policies and procedures designed to reduce the risk of various occurrences, or limit the exposure of the organization to certain identified risks.

Even the smallest organizations should have procedures for backing up and preserving electronic and print copies of documents and other information vital to their governance, financial, and programmatic operations. Larger organizations may require more extensive risk management programs, including emergency preparedness and

disaster response plans in case of natural or man-made disasters or other crises that may disrupt significantly its programs and operations.

Organizations that employ staff should have written personnel policies that conform to federal and state laws. They should develop appropriate procedures to protect the health and safety of both employees and volunteers while they are at work.

Organizations providing services to vulnerable individuals should ensure that appropriate screening, training and supervision procedures are in place to minimize safety risks to consumers and clients, as well as to paid and volunteer staff.

- 7. A charitable organization should make information about its operations, including its governance, finances, programs and activities, widely available to the public.**

Charitable organizations also should consider making information available on the methods they use to evaluate the outcomes of their work and sharing the results of those evaluations.

For private foundations and most public charities, filing an accurate and complete annual information return with the IRS is a legal requirement. It serves as the primary source of information about their finances, governance, operations and programs for federal regulators, the public and many state charity officials. Beyond this basic requirement, charitable organizations can demonstrate their commitment to accountability and transparency by offering additional information about what they do and how they operate.

A good first step is to provide an annual report that lists the organization's board and staff members, describes its mission, shares information on program activities, and details financial information including, at a minimum, its total income, expenses and ending net assets. Such reports need not be elaborate, can be produced in paper or electronic form, and can direct the reader to other readily available documents (such as the Form 990 return or audited financial statements) for further information. If an

organization chooses to produce such reports on a less frequent basis, such as every two or three years, it should ensure that any intervening changes in its board and staff or programs and its current financial statements are provided as an attachment or are otherwise made known to readers of the report.

Another source of transparency and accountability and a key method for communicating about the organization's work is a website, which can be maintained independently or through another organization. A website should feature the same information recommended for annual reports, with links directly to or instructions on how to request the organization's most recent IRS Form 990 return and other financial statements. Useful websites often provide such essential information as the organization's vision and mission statements; lists of board and staff members; statement of values and code of ethics; and policies on conflicts of interest, whistleblower protection and travel policy.

Information on an organization's results and how they are measured can be an especially valuable means of explaining its work and accounting to donors and the public. Such information, and the ability to provide it, will vary considerably from one organization to another. To the extent evaluation or information on outcomes is available, some version of it should be included in annual reports, websites and other forms of communication. More information about program evaluation is provided in principle #19.

EFFECTIVE GOVERNANCE

- 8. A charitable organization must have a governing body that is responsible for reviewing and approving the organization's mission and strategic direction, annual budget and key financial transactions, compensation practices and policies, and fiscal and governance policies.**

The board of directors bears the primary responsibility for ensuring that a charitable organization fulfills its obligations to the law, its donors, its staff and volunteers, its clients, and the public at large. The board must protect the assets of the organization and provide oversight to ensure that its financial, human and material resources are used appropriately to further the organization's mission. The board also sets the vision and mission for the organization and establishes the broad policies and strategic direction that enable the organization to fulfill its charitable purpose.

When the board determines that the organization is ready to add paid staff, the board is responsible for selecting, overseeing, and, if necessary, terminating the chief staff officer. In smaller, un-staffed organizations, the board may have a more direct role in overseeing and sometimes delivering the organization's programs and services. In larger organizations, the board generally works as a strategic partner to the staff leadership in ensuring that the organization meets its goals and commitments.

- 9. The board of a charitable organization should meet regularly enough to conduct its business and fulfill its duties.**

Regular meetings provide the chief venue for board members to review the organization's financial situation and program activities, establish and monitor compliance with key organizational policies and procedures, and address issues that affect the organization's ability to fulfill its charitable mission.

Charitable organizations should ensure that their governing documents satisfy legal requirements in establishing rules for board activities, such as quorum requirements and methods for notifying board members about meetings. The board should establish and implement an attendance policy that requires board members to attend meetings regularly. Given the time and expense involved in traveling to meetings, some boards may choose to conduct their business through conference calls or forms of online communication that permit members to hear and be heard by all other participants. In such cases, the organization's governing documents should specify that such alternative methods of holding meetings are permitted.

Boards often form committees and authorize them to handle some work between full board meetings. (Some states require that only board members serve on committees that have power to act on the board's behalf.) The organization's governing documents should specify whether the board may create one or more such committees. In most states, the law prohibits boards from delegating certain responsibilities to committees, such as dissolving the organization's assets; electing or removing directors; and altering the organization's governing documents. However, committees may investigate and make recommendations on any of these issues, subject to the full board's consideration and decision.

While many charitable organizations find it prudent to meet at least three times a year to fulfill basic governance and oversight responsibilities, some, including organizations with widely dispersed board membership, with strong committee structures hold only one or two meetings of the full board each year. Foundations that make grants only once a year may find that one annual meeting is sufficient.

10. The board of a charitable organization should establish its own size and structure and review these periodically. The board should have enough members to allow for full deliberation and diversity of thinking on governance and other organizational matters. Except for very small organizations, this generally means that the board should have at least five members.

The ideal size of a board depends on many factors, such as the age of the organization, the nature and geographic scope of its mission and activities, and its funding needs. Although a larger board may ensure a wide range of perspectives and expertise, a very large board may become unwieldy and end up delegating too much responsibility to an executive committee or permitting a small group of board members to exercise substantial control. Conversely, smaller boards may elicit more active participation from each member, but they should consider whether their members collectively have the full range of knowledge and experience necessary to inform their decisions, and, if not, provide opportunities for the board to confer with outside experts or advisory groups on specific matters.

11. The board of a charitable organization should include members with the diverse background (including, but not limited to ethnic, racial and gender perspectives), experience, and organizational and financial skills necessary to advance the organization's mission.

Boards of charitable organizations generally strive to include members with expertise in budget and financial management, investments, personnel, fundraising, public relations and marketing, governance, advocacy, and leadership, as well as some members who are knowledgeable about the charitable organization's area of expertise or programs, or who have a special connection to its constituency. Some organizations seek to maintain a board that respects the culture of and reflects the community served by the organization. Boards increasingly are being encouraged to be inclusive of and sensitive to diverse backgrounds when recruiting board members, in addition to

purposefully recruiting board members with expertise and professional or personal experiences that will be beneficial to the organization.

Because the board must ensure that all financial matters of the organization are conducted legally, ethically and in accordance with proper accounting rules, it should make every effort to ensure that at least one member has “financial literacy” — that is, the ability to understand financial statements, to evaluate the bids of accounting firms that may undertake an audit or review and to assist the board in making sound financial decisions. This need not entail advanced training in accounting or financial management. If the board finds itself unable to recruit members with such skills, it should contract with or seek pro bono services of a qualified financial advisor, other than its auditor, to assist the board in its financial responsibilities.

Organizations should also consider the requirements of current and prospective funding sources regarding the composition of the boards of their grantees.

Some donors to private foundations wish to involve family members on the boards of their foundations to ensure that the donors’ philanthropic tradition will continue through future generations. If family members do not have the necessary expertise and experience, the board may wish to bring in advisors. The board should also consider the advantages of diversity and the perspective offered by representatives from outside the family.

12. A substantial majority of the board of a public charity, usually meaning at least two-thirds of the members, should be independent. Independent members should not: (1) be compensated by the organization as employees or independent contractors; (2) have their compensation determined by individuals who are compensated by the organization; (3) receive, directly or indirectly, material financial benefits from the organization except as a member of the charitable class served by the organization; and (4) be related to anyone described above (as a spouse, sibling, parent or child), or reside with any person so described.

All directors of nonprofit corporations have a “duty of loyalty” that requires them to put the interests of the organization above their personal interests and to make decisions they believe are in the best interest of the nonprofit. Individuals who have a personal financial interest in the affairs of a charitable organization may not be as likely to question the decisions of those who determine their compensation or fees or to give unbiased consideration to changes in management or program activities.

The founders of a nonprofit corporation sometimes initially turn to family members and business partners to serve on its board of directors, but interlocking financial relationships can increase the difficulty of exercising the level of independent judgment required of all board members. It is therefore important to the long-term success and accountability of the organization that a sizeable majority of the individuals on the board be free of financial conflicts of interest.

This principle does not apply to private foundations and certain medical research institutions that operate under specific legal restrictions regarding self-dealing transactions, and other charitable organizations whose articles of incorporation or trust instruments include special stipulations regarding board composition. For example, an organization established under the auspices of a religious institution may be required to include clergy or other paid representatives of that institution on its board. A supporting organization may be required to have representatives of its supported

organizations on its board. For a complete list of the types of organizations excluded from this principle, consult the reference volume of these principles at www.nonprofitpanel.org.

When a charitable organization determines that having a majority of independent board members is not appropriate, the board and staff should evaluate their procedures and meeting formats to ensure that board members are able to fulfill their responsibilities to provide independent, objective oversight of management and organizational performance.

- 13. The board should hire, oversee, and annually evaluate the performance of the chief executive officer of the organization, and should conduct such an evaluation prior to any change in that officer's compensation, unless there is a multi-year contract in force or the change consists solely of routine adjustments for inflation or cost of living.**

Boards of directors have the authority to delegate responsibility for maintaining the daily operations of the organization to a chief executive officer. For charitable organizations with paid staff, one of the most important responsibilities of the board of directors is to select, supervise, and determine a compensation package that will attract and retain a qualified chief executive. The organization's governing documents should require the full board to evaluate the performance and approve the compensation of the chief executive annually and in advance of any change in compensation. The board may choose to approve a multi-year contract with the CEO that provides for increases in compensation periodically or when the CEO meets specific performance measures, but it is important that the board institute some regular basis for reviewing whether the terms of that contract have been met. If the board designates a separate committee to review the compensation and performance of the CEO, that committee should be required to report its findings and recommendations to the full board for approval and should provide any board member with details, upon request. The board should then document the basis for its decision and be prepared to answer questions about it.

When determining the reasonableness of the compensation package paid to the chief executive, the board should ensure that the individuals involved in making the compensation recommendation do not have a conflict of interest with regard to the executive. The board or its committee should examine the compensation paid by similarly situated organizations, both taxable and non-taxable, for functionally comparable positions. Many professional associations prepare regular compensation surveys that can be useful in evaluating compensation, or the committee may turn to compensation surveys compiled by independent firms or actual written offers from similar organizations competing for the executive's services. Some organizations may find it difficult to locate salary surveys or other data to establish comparable values for executive compensation within their geographic area or field of operation, but the board should still seek objective external data to support its compensation decisions.

When governing boards use compensation consultants to help determine the appropriate salary for the chief executive, the consultant should report directly to the board or its compensation committee and should not be engaged in other business with or have any conflicts of interest with regard to the chief executive.

While governing boards are responsible for hiring and establishing the compensation of the CEO, it is the responsibility of the CEO to hire other staff. There may be cases where the CEO finds it necessary to offer compensation that equals or surpasses his or her own, in order to attract and retain certain highly qualified and experienced staff. In such cases, the compensation should be reviewed by the board of directors to ascertain that the compensation does not provide an excess benefit to the staff member.

The board or a designated compensation committee should also review the overall compensation program, including salary ranges and benefits provided for particular types of positions, to assess whether the compensation program is fair, reasonable, and sufficient to attract and retain high-quality staff. =

- 14. The board of a charitable organization that has paid staff should ensure that the positions of chief executive officer, board chair, and treasurer are held by separate individuals. Organizations without paid staff should ensure that the positions of board chair and treasurer are held by separate individuals.**

Concentrating authority for the organization's governance and management practices in one or two people removes valuable checks and balances that help ensure that conflicts of interest and other personal concerns do not take precedence over the best interests of the organization. Some state laws require that the offices of president and treasurer be held by different individuals. Both the board chair and the treasurer should be independent of the chief staff executive to provide appropriate oversight of the executive's performance and to make fair and impartial judgments about the appropriate compensation of the executive.

When the board deems it is in the best interests of the charitable organization to have the chief executive officer serve as the board chair, the board should appoint another board member (sometimes referred to as the "lead director") to handle issues that require a separation of duties, such as reviewing the responsibilities, performance or compensation of the chief executive.

- 15. The board should establish an effective, systematic process for educating and communicating with board members to ensure that they are aware of their legal and ethical responsibilities, are knowledgeable about the programs and activities of the organization, and can carry out their oversight functions effectively.**

Most people volunteer for boards because of a commitment to the mission of the organization and the value of the organization's work to society. Yet they may not have the training or information necessary to understand adequately their fiduciary responsibilities or common practices of boards of charitable organizations.

An effective board orientation process fills this need by detailing the broad oversight responsibilities of the board and the specific legal and ethical responsibilities of individual members. Members should be made aware of their personal liability for the board's actions — or for its failure to take action — and of the protections available to them. All board members should receive oral and written instruction regarding the organization's governing documents, finances, program activities, and governing policies and practices. Even members who have served on the boards of other organizations can benefit from a specific orientation to each organization for which they provide board service. Charitable organizations, if funds permit, should provide if needed opportunities for board members to obtain special training or advice on legal and financial issues and responsibilities. It is also advisable for an attorney or insurance agent who is knowledgeable about board liability to explain the legal protections available to board members, as well as the options for insurance.

The ongoing process of board education includes ensuring that members have received and reviewed sufficient information on the issues to be addressed at each board meeting. Agendas and background materials should be distributed far enough in advance of all board meetings so that all members can be expected to read and consider the issues prior to attending the meeting.

- 16. Board members should evaluate their performance as a group and as individuals no less frequently than every three years, and should have clear procedures for removing board members who are unable to fulfill their responsibilities.**

A regular process of evaluating the board's performance can help to identify strengths and weaknesses of its processes and procedures and to provide insights for strengthening orientation and educational programs, the conduct of board and committee meetings, and interactions with board and staff leadership. Many boards will find it helpful to conduct such a self-assessment annually; others may prefer a schedule that coincides with the terms of board service or regular long-range planning

cycles. A number of print and online tools, ranging from sample self-assessment questionnaires to more complex evaluation procedures, can help an organization design a board evaluation or self-assessment process that best meets its needs.

The board should establish clear guidelines for the duties and responsibilities of each member, including meeting attendance, preparation and participation; committee assignments; and the kinds of expertise board members are expected to have or develop in order to provide effective governance. Many boards assign responsibility for oversight of the board evaluation and development function to their executive committees or to a separate board-development committee. Board members with this responsibility should be empowered to discuss problems of attendance or other aspects of board performance with individual members to ascertain whether the problem can be corrected or the individual needs to resign or be removed from the board. Removing a non-performing board member generally requires the action of the full board or, if the organization has members, the action of the membership.

17. The board should establish clear policies and procedures setting the length of terms and the number of consecutive terms a board member may serve.

Every charitable organization should determine whether its best interests are served by limiting the length of time an individual may serve on its board. Some organizations have found that such limits help in bringing fresh energy, ideas and expertise to the board through new members. Others have concluded that term limits may deprive the organization of valuable experience, continuity and, in some cases, needed support provided by board members. They believe organizations should rely solely on rigorous board procedures for evaluating board members and removing those who are not able to fulfill their governance responsibilities effectively. Some family foundations may decide not to limit board terms if their donors expressed a wish that family members continue serving as long as they are willing and able.

Organizations that do limit the terms of board service should consider establishing a staggered term process that provides a continual flow of new participants while retaining a cadre of more experienced members. Many organizations find it useful to establish policies making board members eligible for re-election after taking a year or more off. It is always valuable to find ways in which members who have completed their service can continue to be engaged in the organization's programs and services.

Organizations that choose not to limit the terms of board service should consider establishing a regular process whereby the board reaffirms its commitment to this approach and members actively indicate their desire to continue serving on the board. Some organizations create an alumni council or honorary board to provide an easy option for board members who feel it is time to leave active service but still wish to be involved in the organization. Others specify the age at which a member must retire from the board.

Whether or not the organization establishes board term limits, it is always helpful to have a process for involving prospective board members on committees or task forces until there is an appropriate opening on the board.

18. The board should review organizational and governing instruments no less frequently than every five years.

Regular reviews of the organization's articles of incorporation, bylaws and other governing instruments help boards ensure that the organization is abiding by the rules it has set for itself and determine whether changes need to be made to those instruments. The board may choose to delegate some of this deliberation to a committee, but the full board should consider and act upon the committee's recommendations.

Most state laws permit the state attorney general to file suit asking the court to hold a board accountable for failure to abide by the requirements set forth in these basic documents. If it becomes impractical or no longer feasible to carry out the purposes of the organization as outlined in its articles of incorporation, the board should take appropriate action to amend the articles and to file the amended articles with state officials, as required. In some instances, a charitable organization may need court approval to amend its organizing documents.

- 19. The board should establish and review regularly the organization's mission and goals and should evaluate, no less frequently than every five years, the organization's programs, goals and activities to be sure they advance its mission and make prudent use of its resources.**

As stewards of the public's trust and the resources invested in the organization, board members have an obligation to ensure that the organization uses its resources as effectively as possible to advance its charitable mission. Every board should therefore set strategic goals and review them annually, generally as part of the annual budget review process. This review should address current needs and anticipated changes in the community or program area in which the organization operates that may affect future operations. It should also consider the financial and human resources that are needed to accomplish the organization's goals. Such periodic performance reviews and assessments are a common feature of many self-regulation, accreditation and funding programs in which nonprofit organizations participate.

Although discussions of individual program activities and accomplishments are typical of most board meetings, these are not a substitute for a more rigorous periodic evaluation of the organization's overall impact and effectiveness in light of goals and objectives that the board has approved.

Because organizations and their purposes differ, it is incumbent on each organization to develop its own process for evaluating effectiveness. Most organizations should have at least an informal review of their progress on goals and objectives annually, but, because of the time and cost involved, may choose to conduct a more rigorous evaluation less frequently. Even for organizations whose work is not properly measured in one-year increments, such as scientific research or youth-development programs, interim benchmarks can be identified to assess whether the work is moving in the right direction.

20. Board members are generally expected to serve without compensation, other than reimbursement for expenses incurred to fulfill their board duties. A charitable organization that provides compensation to its board members should use appropriate comparability data to determine the amount to be paid, document the decision and provide full disclosure to anyone, upon request, of the amount and rationale for the compensation.

Although some charitable organizations reimburse expenses related to board work, the vast majority of board members serve without compensation. In fact, board members of public charities often donate both time and funds to the organization, a practice that supports the sector's spirit of giving and volunteering.

When organizations find it appropriate to compensate board members due to the nature, time or professional competencies involved in the work, they must be prepared to provide detailed documentation of the amount of and reasons for such compensation, including the responsibilities of board members and the services they provide. Any compensation provided to board members must be reasonable and necessary to support the performance of the organization in its exempt function. Compensation paid to board members for services in the capacity of staff of the organization should be clearly differentiated from any compensation paid for board service.

Board members of charitable organizations are responsible for ascertaining that any compensation they receive does not exceed to a significant degree the compensation provided for positions in comparable organizations with similar responsibilities and qualifications. Some organizations hire compensation consultants to identify comparable compensation levels, some rely on data available through national and regional associations or for-profit firms, and some conduct their own surveys of compensation paid by similar organizations. When they establish their own compensation, board members generally cannot be considered independent authorizing bodies and therefore generally cannot avail themselves of the legal protections accorded to such bodies.

STRONG FINANCIAL OVERSIGHT

21. A charitable organization must keep complete, current, and accurate financial records.

Its board should receive and review timely reports of the organization's financial activities and should have a qualified, independent financial expert audit or review these statements annually in a manner appropriate to the organization's size and scale of operations.

Complete and accurate financial statements are essential for a charitable organization to fulfill its legal responsibilities and for its board of directors to exercise appropriate oversight of the organization's financial resources. A board that does not have members with financial expertise should retain a qualified paid or volunteer accounting professional to establish whether financial systems and reports are organized and implemented appropriately.

Having financial statements prepared and audited in accordance with generally accepted accounting principles and auditing standards improves the quality of the information. Each organization must ensure that it has its annual financial statements

audited or reviewed as required by law in the states in which it operates or raises funds or as required by government or private funders. When an audit is not legally required, a financial review offers a less expensive option that still provides the board, regulators and the public with some assurance of the accuracy of the organization's financial records. Many smaller organizations that have opted to work with an independent accountant have noted that the accountant provided invaluable guidance.

Every charitable organization that has its financial statements independently audited, whether or not it is legally required to do so, should consider establishing an audit committee composed of independent board members with appropriate financial expertise. By reducing possible conflicts of interest between outside auditors and the organization's paid staff, an audit committee can provide the board greater assurance that the audit has been conducted appropriately. If state law permits, the board may appoint non-voting, non-staff advisors rather than board members to the audit committee.

Organizations with small boards of directors or limited organizational structures may not choose to delegate the audit responsibility to a separate committee. Audit committees may also be inappropriate for charitable organizations that are organized as trusts rather than as corporations.

- 22. The board of a charitable organization must institute policies and procedures to ensure that the organization (and, if applicable, its subsidiaries) manages and invests its funds responsibly, in accordance with all legal requirements. The full board should review and approve the organization's annual budget and should monitor actual performance against the budget.**

Sound financial management is among the most important responsibilities of the board of directors. The board should establish clear policies to protect the organization's financial assets and ensure that no one person bears the sole responsibility for

receiving, depositing, and spending its funds. Day-to-day accounting and financial management should be the task of staff or, in the case of organizations with no or one staff member, designated volunteers who have the necessary time and skills. The board is responsible for reviewing practices and reports to ensure that those staff or volunteers are adhering to the board-approved policies.

The organization's annual budget should reflect the programs and activities the organization will undertake in the coming year and the resources it will need to raise or generate to support those activities. Careful review of regular financial reports showing both budgeted and actual expenditures and revenues will permit the board to determine whether adjustments must be made in spending to accommodate changes in revenues. Financial reports should also reflect how the organization has adhered to any restrictions placed on funds by donors or grant programs.

Prudent financial oversight requires that the board look beyond monthly or annual financial reports to consider how the organization's current financial performance compares with that of previous years and how its financial future appears. If the organization's net assets have been declining over a period of years, or if future funding seems likely to change significantly, the board may need to take steps to achieve or maintain stability.

Whenever possible, an organization should generate enough income to create cash reserves for its future. When an organization has built sufficient reserves to allow for investments, the board is responsible for establishing policies that govern how the funds will be invested and what portion of the returns, if any, can be used for immediate operations or programs. The boards of organizations with sizeable reserves or endowments generally select one or more independent investment managers to handle the organization's investments. In those cases, the board or a committee of the board should monitor the outside investment manager(s) regularly.

23. A charitable organization should not provide loans (or the equivalent, such as loan guarantees, purchasing or transferring ownership of a residence or office, or relieving a debt or lease obligation) to directors, officers, or trustees.

The practice of providing loans to board members and executives, while infrequent, has created both real and perceived problems for public charities. While there may be circumstances in which a charitable organization finds it necessary to offer loans to staff members, there is no justification for making loans to board members. Federal laws prohibit private foundations, supporting organizations and donor-advised funds from making loans to substantial contributors, board members, organization managers and related parties. Many states also forbid such loans or allow them only in very limited circumstances.

When a charitable organization deems it necessary to provide loans to an employee — for example, to enable a new employee of a charity to purchase a residence near the organization’s offices — the terms of such loans should be clearly understood and approved by the board. Such loans then must be reported on the organization’s annual information returns (Forms 990 and 990-PF).

24. A charitable organization should spend a significant percentage of its annual budget on programs that pursue its mission. The budget should also provide sufficient resources for effective administration of the organization, and, if it solicits contributions, for appropriate fundraising activities.

Charitable organizations have an obligation to devote their resources to the charitable purposes for which they were granted tax exemption, and to spend donated funds on the programs and activities for which the funds were contributed. At the same time, the successful operation of any business or organization — including the responsible pursuit of nearly any kind of charitable purpose — requires effective management and administration. Administrative activities include financial and investment management,

personnel services, recordkeeping, soliciting and managing contracts, legal services, and supporting the governing body of the organization. Not only do these elements ensure that the organization complies with all legal requirements, but they also help provide complete, accurate, and timely information to donors, the public, and government regulators.

Charitable organizations rely on other supporting services to carry out their missions. Most public charities have fundraising operations to encourage potential donors to contribute money, materials and other assets and to ensure that donors receive necessary reports about how their contributions were used. Some public charities also rely on membership development activities to solicit prospective members, collect membership dues, and ensure that members receive promised benefits. Private foundations and some public charities also have expenses associated with making grants and contributions to other organizations and individuals.

Qualified personnel are crucial for providing programs, recruiting and managing volunteers, raising funds, and ensuring proper administration. The costs of compensating personnel, including salaries and benefits, must be allocated to the particular functions they perform for the organization based on appropriate records.

Some self-regulation systems and “watchdog” organizations recommend that public charities spend at least 65 percent of their total expenses on program activities. This standard is reasonable for most organizations, but there can be extenuating circumstances that require an organization to devote more resources to administrative and fundraising activities. The board should review the budget and financial reports to determine whether the organization is allocating its funds appropriately.

25. A charitable organization should establish clear, written policies for paying or reimbursing expenses incurred by anyone conducting business or traveling on behalf of the organization, including the types of expenses that can be paid for or reimbursed and the documentation required. Such policies should require that travel on behalf of the organization is to be undertaken in a cost-effective manner.

A charitable organization's travel policies should be unambiguous and easy to follow, and should reflect the organization's principled judgment about what it considers "reasonable" expenditures for individuals who must travel to conduct business on its behalf. These policies should include procedures for properly documenting expenses incurred and their organizational purpose.

As a general practice, travel policies should ensure that the business of the organization is carried out in a cost-effective manner. Decisions on travel expenditures should be based on how best to further the organization's charitable purposes, rather than on the title or position of the person traveling. Charitable funds generally should not be used for premium or first-class travel, but boards should retain the flexibility to permit exceptions when they are in the organization's best interest. Such exceptions, if any, should be explicit, consistently applied and transparent to board members and others associated with the organization.

An organization's policies should reflect the requirements and restrictions on travel expenditures imposed under current law. The detailed guidance provided in IRS Publication 463: Travel, Entertainment, Gift and Car Expenses should serve as a guide for managers of charitable organizations in avoiding lavish, extravagant or excessive expenditures.

26. A charitable organization should neither pay for nor reimburse travel expenditures for spouses, dependents or others who are accompanying someone conducting business for the organization unless they, too, are conducting such business.

If, in certain circumstances, an organization deems it proper to cover expenses for a spouse, dependent, or other person accompanying someone on business travel, the payment generally must, by law, be treated as compensation to the individual traveling on behalf of the organization. This principle need not apply to de minimis expenses such as the cost of a meal at organization functions where participants are invited to bring a guest.

RESPONSIBLE FUNDRAISING PRACTICES

27. Solicitation materials and other communications addressed to donors and the public must clearly identify the organization and be accurate and truthful.

Charitable solicitations — whether in print, via the Internet, over the phone, or in person — are often the only contact a donor has with a charitable organization. Clear and accurate solicitation materials help potential contributors to contact the organization and obtain information necessary to distinguish an organization with a solid history of service to the community from one that may claim a similar name or purpose, but whose fundraising appeal is misleading.

A donor has the right to know the name of anyone soliciting contributions, the name and location of the organization that will receive the contribution, a clear description of its activities, the intended use of the funds to be raised, a contact for obtaining additional information, and whether the individual requesting the contribution is acting as a volunteer, employee of the organization, or hired solicitor. (A Donor Bill of Rights, endorsed by many organizations, is available at www.nonprofitpanel.org.) Descriptions of program activities and the financial condition of the organization must

be current and accurate, and any references to past activities or events should be dated appropriately.

If an organization is not eligible to receive tax-deductible contributions, it must disclose this limitation at the time of solicitation. Similarly, a charitable organization that the IRS has recognized as eligible to receive tax-deductible contributions should clearly indicate in its solicitations how donors may obtain proof of that status. The charity may post a copy of its IRS letter of determination on its website or offer to provide a copy of the letter to donors who request it. If the solicitation promises any goods or services to the donor in exchange for contributions, the materials should also clearly indicate the portion of the contribution (that is, the value of any goods or services provided) that is not tax-deductible.

28. Contributions must be used for purposes consistent with the donor's intent, whether as described in the relevant solicitation materials or as specifically directed by the donor.

When a donor responds to a charitable solicitation with a contribution, he or she has a right to expect that the funds will be used as promised. Solicitations should therefore indicate whether the funds they generate will be used to further the general programs and operations of the organization or to support specific programs or types of programs. A donor may also indicate through a letter, a written note on the solicitation, or a personal conversation with the solicitor or another official of the charitable organization how he or she expects the contribution to be used.

In some cases, an organization may not receive sufficient contributions to proceed with a given project or it may receive more donations than it needs to carry out that project. If the organization is unable or unwilling to use the contribution as stated in its appeal or in the donor's communication, it has an obligation to contact the donor and request permission to apply the gift to another purpose or offer to return the gift. Charitable

organizations should strive to make clear in materials that solicit contributions for a specific program how they will handle such circumstances,

A charitable organization should carefully review the terms of any contract or grant agreement before accepting a donation. If the organization will be unable or unwilling to comply with any of the terms requested by a donor, it should negotiate any necessary changes prior to concluding the transaction. Particularly in the case of substantial contributions, the recipient should develop an agreement that specifies any rights it may have to modify the terms of the gift if circumstances warrant. Some charitable organizations include provisions in their governing documents or board resolutions indicating that the organization retains “variance powers,” the right to modify conditions on the use of assets. Such powers should be clearly communicated to donors through a written agreement.

29. A charitable organization must provide donors with specific acknowledgments of charitable contributions, in accordance with IRS requirements, as well as information to facilitate the donors’ compliance with tax law requirements.

Acknowledging donors’ contributions is important not only because of IRS requirements, it also helps in building donors’ confidence in and support for the activities they help to fund. Organizations should establish procedures for acknowledging contributions in a timely manner and for providing appropriate receipts for cash contributions if requested. Regular updates to donors on the activities they support is another way to build trust and loyalty, as is providing ways for contributors to find more information on their own — say, through a website, print publications or visits to the organization’s office.

If the organization has provided goods or services to the donor in exchange for or recognition of the contribution, an acknowledgement must include a good-faith estimate of the fair market value of those goods or services — that is, the amount the

donor would have to pay to purchase those goods or services independently. The cost of the item to the charitable organization does not determine its fair market value, although cost may be an important factor. For example, a hotel may donate the food served at a banquet, thus imposing zero cost on the charitable organization. But the fair market value of a donor's meal at that banquet would not be zero; it would be the price he or she would have to pay for a similar meal at that hotel. The charitable organization does not have to include information on fair market value in a donor acknowledgement if that value is not more than 2 percent of the contribution or \$89, whichever is less. (These are 2007 amounts; the IRS changes them periodically.)

It is generally unwise, and may pose a conflict of interest, for a charitable organization to appraise the value of gifts of property from taxpayers seeking income tax deductions for such contributions. Organizations should, however, alert donors to IRS rules for substantiating such claims and encourage them to seek appropriate tax or legal counsel when making significant non-cash gifts.

30. A charitable organization should adopt clear policies, based on its specific exempt purpose, to determine whether accepting a gift would compromise its ethics, financial circumstances, program focus or other interests.

Some charitable contributions have the potential to create significant problems for an organization or a donor. Knowingly or not, contributors may ask a charity to disburse funds for illegal or unethical purposes, and other gifts may subject the organization to liability under environmental protection laws or other rules. Some types of corporate sponsorships or interests in corporate stock or assets may result in unrelated business income for a charitable organization. Donors may also face adverse tax consequences if a charity is unable to use a gift of property in fulfilling its mission and must instead sell or otherwise dispose of the property soon after the donation is received.

A gift-acceptance policy provides some protection for the board and staff, as well as for potential donors, by outlining the rules and procedures by which an organization will evaluate whether it can accept a contribution even before an offer is actually made. The policy should make clear that the organization generally will not accept any non-cash gifts that are counter to or outside the scope of its mission and purpose, unless the item is intended for resale or would otherwise produce needed revenue for the organization. It should list any funding sources, types of contributions, or conditions that would prevent the organization from accepting a gift. The organization should also consider establishing rules and procedures for determining whether a gift is acceptable and should identify circumstances under which a review by legal counsel or other experts would be required before accepting a gift.

- 31. A charitable organization should provide appropriate training and supervision of the people soliciting funds on its behalf to ensure that they understand their responsibilities and applicable federal, state and local laws, and do not employ techniques that are coercive, intimidating, or intended to harass potential donors.**

A charitable organization may be legally responsible when those who solicit on its behalf engage in illegal or fraudulent practices. Yet even beyond ensuring that fundraising practices are lawful and honest, a charitable organization has many reasons to provide careful training and supervision to those who solicit donations on its behalf. The most obvious reason is that they are often a potential donor's first, and sometimes only, direct contact with the organization. The organization should therefore ensure that its fundraisers are respectful of a donor's concerns and do not use coercive or abusive language or strategies to secure contributions, misuse personal information about potential donors, pursue personal relationships that are subject to misinterpretation by potential donors, or mislead potential donors in other ways. All those who solicit contributions on the organization's behalf, including volunteers, should be provided with clear materials and instructions on what information to provide to prospective donors, including the organization's name and address, how the

donor can learn more about the organization, the purposes for which donations will be used, whether all or part of the donation may be tax-deductible, and who the donor can contact for further information.

If a charitable organization decides to use an outside professional fundraising firm or consultant, it should have a clear contract — as required by law and guided by good practice — that outlines the responsibilities of the organization receiving the funds and of the firm or consultant. The fundraiser must agree to abide by any registration and reporting requirements of the jurisdictions in which fundraising will be conducted, as well as federal restrictions on telephone, email, or fax solicitations. The charitable organization should verify that the outside solicitor is registered as required in any state in which the solicitor will be seeking contributions.

In general, those soliciting funds on behalf of charities should refrain from giving specific legal, financial and tax advice to individual donors. Rather, when such questions arise, fundraisers should encourage donors to consult their own legal counsel or other professional advisors before finalizing a contribution.

32. A charitable organization should not compensate internal or external fundraisers based on a commission or a percentage of the amount raised.

Compensation for fundraising activities should reflect the skill, effort, and time expended by the individual or firm on behalf of the charitable organization. Many professional associations of fundraisers prohibit their members from accepting payment for fundraising activities based on a percentage or the amount of charitable income raised or expected to be raised. Basing compensation on a percentage of the money raised can encourage fundraisers to put their own interests ahead of those of the organization or the donor and may lead to inappropriate techniques that jeopardize the organization's values and reputation and the donor's trust in the organization. Percentage-based compensation may also lead to payments that could be regarded by

legal authorities or perceived by the public as “excessive compensation” compared to the actual work conducted. Percentage-based compensation may also be skewed by unexpected or unsolicited gifts received by the charitable organization through no effort of the fundraiser.

A similar logic applies to employees. Some charitable organizations choose to provide bonuses to employees for exceptional work in fundraising, administrative, or program activities. If so, the criteria for such bonuses should be clearly based on the quality of the work performed, rather than on a percentage of the funds raised.

- 33. A charitable organization should respect the privacy of individual donors and, except where disclosure is required by law, should not sell or otherwise make available the names and contact information of its donors without providing them an opportunity at least once a year to opt out of the use of their names.**

Preserving the trust and support of donors requires that donor information be handled with respect and confidentiality to the maximum extent permitted by law. Charitable organizations should disclose to donors whether and how their names may be used, and provide all donors, at the time a contribution is made, an easy way to indicate that they do not wish their names or contact information to be shared outside the organization. In all solicitation and other promotional materials, organizations should also provide a means, such as a check-off box or other “opt-out” procedure, for donors and others who receive such materials to request that their names be deleted from similar mailings, faxes or electronic communications in the future. The organization should immediately remove a donor’s name from any lists upon request and should ensure that all donors are contacted at least once a year with information about how they may request that their names and contact information not be shared outside the organization.

Organizations that gather personal information from donors and other visitors to their websites should have a privacy policy, easily accessible from those websites, that informs visitors to the site what information, if any, is being collected about them, how the information will be used, how to inform the organization if the visitor does not wish personal information shared outside the organization, and what security measures the charity has in place to protect personal information.

THE FOLLOWING DOCUMENT EMBARGOED UNTIL 5:30 PM, MONDAY,
OCTOBER 22, 2007

LEGAL BACKGROUND

A charitable organization is generally organized and must operate according to the laws of the state in which it was created. The organization is most often established as a corporation or a trust, each of which is subject to different sets of laws governing their creation and administration. Some organizations choose to operate as unincorporated associations despite the higher degree of liability that form may impose on directors and members.

A charitable trust is generally established by a written declaration or deed (known as the trust instrument) that transfers the title and management responsibility for property or other assets to a trustee or trustees. The trust instrument sets forth the overall purposes of the trust and may designate a specific trustee or the methods for appointing trustees. State trust laws generally set forth the broad requirements of trustees, but they often leave the court that approves and supervises the trust broad leeway in overseeing the fulfillment of the trustees' duties and the payment of any fees to trustees.

A corporation can be created only with authorization from a state, and the articles of incorporation filed with that state set forth the basic parameters for the organization's conduct and that of its board of directors. Most states outline the basic rules and requirements for charitable organizations under a state nonprofit corporation act, which is usually enforced by the state Attorney General. A charitable organization generally has bylaws that outline the rights and responsibilities of the board and members of the organization, and other aspects of how the organization will conduct its business. The bylaws should outline specific rules for board meetings, including their frequency, quorum requirements, and whether participation through electronic means is permitted. In the

absence of such stipulations in the governing documents, state laws may stipulate rules that will be applied by default.

Charitable organizations that conduct specific types of services, such as nursing homes and other types of residential facilities, providers of health care or day care for children or adults, educational facilities, etc., must abide by federal, state, and local laws and regulations that apply to any business, for-profit or nonprofit, that operates in those service areas. Charitable organizations that employ staff must abide by federal, state and local labor laws and regulations and applicable employment tax and income tax withholding requirements.

Federal Tax Exemption

In order to be exempt from paying federal income taxes and to be eligible to receive tax-deductible contributions from the public, organizations (with certain exceptions for houses of worship and for some very small organizations or subsidiaries) must apply for and be recognized by the IRS as tax-exempt under section 501(c)(3) of the tax code. Charitable organizations must submit their organizing documents — such as the articles of incorporation, trust instrument and bylaws — to the Internal Revenue Service when they apply for recognition as a tax-exempt organization. Depending on the organization's sources of support and other key factors, the IRS will determine whether it is recognized as a private foundation or a public charity. A private foundation generally derives its primary financial support from the contributions of a limited group of sources, such as an individual, family or corporation, whereas a public charity typically derives a substantial portion of its funding from the general public or from a governmental unit.

Foundations are subject to substantially more restrictive rules governing their operations, and their donors receive less favorable tax treatment for donations. There are strict limits on direct and indirect financial transactions between a private foundation and its donors, directors and businesses and family members of those donors and directors. Foundations pay an annual excise tax generally equivalent to 2 percent of their net investment income,

and must abide by specific rules regarding the amounts they must pay out annually to support charitable activities, their holdings in for-profit business enterprises, and the types of investments they are allowed to make. Foundation managers and others who violate these rules may be subject to severe excise taxes and other penalties for violations of these prohibitions.

Federal tax laws define four types of public charities: (1) public institutions, such as churches and religious congregations, schools and other educational institutions, hospitals and medical research institutions, and governmental units; (2) publicly-supported charities that receive at least one-third of their financial support from qualifying contributions and grants or from providing program services to a broad constituency; (3) supporting organizations that are organized and operated exclusively for the benefit of, or to carry out the functions of, one or more publicly-supported charities; and (4) public safety testing organizations. All public charities are prohibited from engaging in transactions that provide economic benefits in excess of fair market value to persons in a position to exercise substantial influence over the organization. Specific rules apply to certain public charities, such as medical research organizations, credit counseling organizations, supporting organizations, and charities that hold “donor advised funds.”

Lobbying and Electioneering

All charitable organizations are prohibited from supporting or opposing candidates for public office or intervening in political campaigns, but they may lobby public officials regarding legislation that might affect their existence, powers and duties, tax-exempt status, or the deductibility of contributions, often referred to as “self-defense lobbying.” Public charities (but not private foundations) may also lobby public officials directly or conduct grassroots advocacy efforts to influence the outcome of other legislation so long as such efforts constitute an “insubstantial part” of their overall activities. The tax laws permit public charities to elect to follow specific rules for the amounts they can spend on direct and grassroots lobbying activities.

Reporting Requirements

Federal law requires many public charities, including all supporting organizations and all private foundations, to file an annual information return (Form 990, 990-EZ, or 990-PF) with the Internal Revenue Service that provides accurate information about their finances, governing body, key staff, programs, and other activities. The IRS may impose penalties on any organization that fails to file timely and accurate returns. Some states also require public charities to file their IRS annual information returns with the state and may impose additional penalties for failure to meet their filing requirements.

Beginning in 2008, most small public charities that are not otherwise required to file Form 990 or 990-EZ will be required to file electronically an annual notice to the IRS with basic contact information and evidence of the continuing basis for the organization's exemption from filing Form 990. Failure to file any of the Form 990 returns for three consecutive years will result in revocation of tax-exempt status.

Charitable organizations must make these forms, as well as their initial application for recognition of tax exemption and any correspondence with the IRS in connection with that application, available for free inspection during regular business hours at their principal, regional and district offices. (Organizations that received their tax exemption prior to 1987 are not required to make their initial application available if they do not have a copy of it.) Copies of these documents must also be provided without charge, other than a reasonable fee for reproduction and postage costs, to any individual who submits such a request in person or in writing. The public inspection requirement may be met by posting the requisite documents on a widely available Internet site maintained by the organization or as part of an online database maintained by another organization that contains similar documents of tax-exempt organizations.

Board Composition

Federal laws and regulations generally do not contain requirements for the composition of a charitable organization's board of directors, with four notable exceptions: (1) health care

organizations that must have a community board to satisfy the community benefit test; (2) organizations that qualify as publicly-supported charities based on a “facts and circumstances” test, and thus may need to have a governing board that is representative of the community; (3) supporting organizations that must show a close relationship with the organizations they support through specific board positions; and (4) credit counseling organizations that must meet specific rules for board composition.

Compensation

A charitable organization is permitted under current law to pay reasonable compensation for services provided by its board members, its chief executive officer and other staff. Reasonable compensation is defined as the amount that would ordinarily be paid for like services by like enterprises (whether tax-exempt or taxable) under like circumstances. Federal tax laws prohibit charitable organizations from providing excessive compensation or engaging in transactions that provide excessive economic benefit to executives and other individuals in a position to exercise substantial influence over the organization. (People covered under such rules are generally known as “disqualified persons,” a phrase defined more fully in the reference version of this report, at www.nonprofitpanel.org.) Charitable organizations are also prohibited from providing excessive compensation or benefits to family members of or businesses controlled by those individuals. Private foundations are generally prohibited from engaging in any financial transactions with their disqualified persons, other than payment of reasonable compensation for services deemed necessary to the foundation’s exempt purposes.

Federal laws and regulations outline specific procedures a public charity may follow to determine the reasonableness of compensation it provides to disqualified persons. The compensation must be reviewed by an “authorized body” of the organization (such as the board or a board-appointed committee), no member of which has a conflict of interest with respect to the transaction. If the authorized body meets certain independence standards, approves the compensation based on appropriate data that help determine comparability or fair market value and documents the basis for its determination at the

time it makes its decision, the regulations confer a rebuttable presumption of the reasonableness of the compensation. Although the IRS may not draw any negative inferences simply because an organization chooses not to follow these procedures, following them may help in avoiding penalties on those who receive, and on charity managers who approve, compensation that is later found to be excessive.

Economic benefits other than salary (such as a bonus, housing allowance, or travel costs for a spouse or family member who is not conducting business for the organization) must be reported as compensation on a Form W-2, 1099 or 990, or the benefit must be included in a written employment contract or in the minutes of the meeting where the payment of the benefit was approved. If an organization fails to do so, and the individual fails to report the benefit as compensation on his or her income tax return, the value of the benefit will be treated automatically as an “excess benefit” that is subject to fines and penalties.

Individuals who receive excessive compensation or economic benefits, as well as the board members and other managers of charitable organizations who knowingly approve an excess benefit, are subject to severe penalties unless their participation is not willful and is due to reasonable cause. A board member or other manager who relies on the advice of legal counsel (or, in the case of public charity managers, certain other professionals) is generally not held responsible for knowing that the transaction was improper. In addition, a board member or other manager of a public charity is generally not held responsible for knowing that a transaction conferred an excess benefit if an appropriate authorized body has met the requirements of the rebuttable presumption procedures with respect to the transaction.

Financial Oversight

Under all state laws, board members must exercise their “duty of care” by providing careful oversight of the organization’s assets and financial transactions in order to protect the interests of the organization and its charitable purposes. Board members must exercise

ordinary business care and prudence in providing for the short- and long-term needs of the organization in evaluating both the overall investment portfolio and individual investment decisions.

Many states have enacted legislation regulating the investment activities of trustees and directors of charitable organizations. The state standard of care applicable to most nonprofit corporations is the Uniform Management of Institutional Funds Act (UMIFA), which has been adopted in some form by 47 states and the District of Columbia. Charitable organizations established as trusts are typically subject to the Uniform Prudent Investor Act (UPIA), which has been adopted in more than 40 states and the District of Columbia. Some states also apply UPIA to charitable corporations or specific types of funds within charitable corporations. Some states are now adopting a new model law, the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which applies to both charitable corporations and charitable trusts and provides more guidance for boards and others responsible for managing the investments of charitable organizations. Under UPMIFA, a charity would also have the flexibility to spend or accumulate as much of an endowment fund as it deems prudent.

Federal law generally does not regulate the management of investment assets by public charities. Private foundations and their managers, however, are subject to penalties under federal tax law if the board approves investments “in such a manner as to jeopardize the carrying out of any of [the organization’s] exempt purposes.”

Auditing Requirements: There is currently no federal requirement for audits of charitable organizations (except, under OMB Circular No. A-133, for organizations that expend \$500,000 or more in federal grant funds in any given year). Eighteen states require a charitable organization that solicits contributions in the state to submit a copy of an independent audit report or a certified review of financial reports annually if it meets certain financial criteria. The budget thresholds for audit requirements vary substantially.

Loans to ‘Disqualified Persons’

Charitable organizations must report any loans to current and former officers, directors, trustees, key employees and other “disqualified persons” on their annual information returns (Form 990 and 990-PF). For private foundations, such loans are considered to be self-dealing transactions that expose foundation managers and the recipients of loans to substantial penalties. For public charities that are recognized as supporting organizations or that maintain donor-advised funds, such loans may be considered to be excess benefit transactions that result in substantial penalties. For other public charities, the IRS generally scrutinizes such loans to determine whether they qualify as a true loan or some other type of payment. In making its determination, the IRS examines information reported on the Form 990, including the maturity date of the loan, repayment terms, the interest rate charged, any security or collateral provided by the borrower, and the purpose of the loan. The IRS also expects that the organization maintain and be able to provide written documentation of the loan. The financial benefit of a loan that is provided at below-market interest rates must be added to the borrower’s other compensation to determine if the total qualifies as an excess benefit transaction. Any payment that is not determined to be a loan may automatically be treated as an excess benefit transaction.

Rules on Expense Reimbursement

Under federal tax regulations, expenses for transportation, lodging and meals paid for or reimbursed by the organization must be documented to establish that they were incurred in connection with its work and not the personal activities of the individual. Federal tax regulations require that these expenses not be “lavish or extravagant under the circumstances,” though these terms remain undefined in the tax code or in regulations. Special rules apply to many types of travel-related expenses and reimbursement methods, including per diem payments, car allowances, employer-provided vehicles, security expenses, and travel expenses of spouses or other family members.

Travel expenses that are not properly documented or are “lavish or extravagant” must be treated as additional taxable compensation to the individual benefiting from them. If a public charity intends to treat an expenditure as compensation, it must report those amounts on a Form W-2, a Form 1099, or a Form 990, or otherwise document such compensation in writing; otherwise, the compensation will be treated automatically as an “excess benefit.” Board members and executives of charitable organizations who approve or receive excessive travel benefits are subject to penalties under existing law.

Fundraising Regulations

Thirty-eight states and the District of Columbia currently require certain charitable organizations and for-profit firms working on their behalf to register before soliciting residents or conducting fundraising activities within their state and to provide reports on their activities. Some states also have established requirements for the board of directors of any organization that conducts activities, particularly fundraising, within its borders.

Many states require a charitable organization to have a written contract with paid solicitors or professional consultants working on its behalf, specifying various aspects of the arrangement. Some states impose fines on charitable organizations if professional fundraisers they engage to solicit contributions fail to register or provide reports as required.

Federal law requires for-profit firms soliciting for charitable nonprofits via telephone to follow specific rules that include (1) disclosing the purpose of the call and the name of the organization for which the call is made promptly and “in a clear and conspicuous manner,” and (2) honoring requests by the recipient of the call not to call again. The law also prohibits professional solicitors from misrepresenting, directly or by implication, the nature or purpose of the charitable organization, the purpose for which the contribution will be used, the percentage of the contribution that will go to that purpose, and the organization’s or the solicitor’s affiliation with or sponsorship by a specific organization, business, individual or government entity.

If a donor provides a clear, written directive about how funds are to be used at the time a charitable gift is accepted, the board of the recipient organization has a fiduciary obligation to comply with the donor's directive, to seek the donor's permission for a different use, or to return the funds, and state attorneys general may enforce compliance. In some states, the donor (or his or her heirs) may have legal standing to ask a court to enforce those terms. If it should become impossible, impracticable, or illegal to carry out a donor's clear, written directive on how to use a contribution, a charitable organization or the state Attorney General may appeal to a court for authority to alter the original purposes of the gift or deviate from the donor's directions.

Charitable organizations must provide a contemporaneous written acknowledgement to a donor for any gift of \$250 or more. The acknowledgement must include the amount of cash donated or a description (but not the value) of any property other than cash contributed, as well as a description and good faith estimate of the value of any goods or services received by the donor. Charitable organizations are also required to provide a similar written acknowledgement for any gift of \$75 or more for which they provided goods or services whose value is more than \$86 or 2 percent of the contribution, whichever is less. Special rules apply to contributions of motor vehicles, airplanes or boats valued at \$500 or more. If a charitable organization sells any contributed property valued at \$5,000 or more within three years of the property's receipt, it must report the sale to the IRS.

Charitable organizations and their managers may be subject to excise taxes and disclosure rules if they are a party to a prohibited tax-shelter transactions, regardless of whether the transaction was initiated by a charitable contribution. A complete listing of prohibited transactions is available on the IRS website at www.irs.gov.

Charitable organizations are required to report on their annual IRS information return (Forms 990, 990-EZ or 990-PF) the names and addresses of those who contributed the

greater of \$5,000 or 2 percent of the total contributions received by the organization in the tax year covered by the return. Federal tax laws specifically provide that organizations, other than private foundations, are not required to disclose to the public the name and address of their contributors unless that information is included in its application for tax-exemption, or in correspondence with the IRS during the application process.. Some charitable organizations affiliated with governmental entities, such as supporting organizations affiliated with a public institution of higher education, may be subject to state Open Public Records or Freedom of Information laws that require disclosure of records that include donor information.

Appendix D

An Open Letter to Independent Sector on its Draft Principles of Self-Regulation

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January 24, 2007

Our colleagues at Independent Sector have issued 29 draft “principles of self-regulation” as part of the Panel on the Nonprofit Sector convened by IS at the request of Max Baucus and Charles Grassley, Chairman and Ranking Member of the Senate Finance Committee. See http://www.nonprofitpanel.org/selfreg/index_html. IS says that its draft principles would apply to all public charities with annual revenues of \$1 million or more and to all foundations with assets of at least \$25 million.

The Philanthropy Roundtable applauds Independent Sector and the Panel on the Nonprofit Sector for their tireless and well-organized work to improve nonprofit governance, board financial oversight, fundraising practices, and compliance with the law, all subjects of the draft principles. The Roundtable also appreciates IS’s spirit of openness in making its draft available and inviting comments from others.

However, The Philanthropy Roundtable has two levels of concern about the Independent Sector draft principles of self-regulation. First, we fear that some of the draft principles take a “one-size-fits-all” approach to setting rules for a very diverse sector, or would require private organizations to reveal publicly their internal decision making processes.

Second, we are concerned about how the proposed principles would be administered and enforced. Independent Sector doesn't explain what it means by "self-regulation." And there are some forms of self-regulation that would be seriously harmful to the foundation world and to charitable giving.

Concerns about the Draft Principles

Let us turn first to our concerns about specific draft principles. While most of the proposed principles are quite sensible, some apply a "one-size-fits-all" approach to charities and foundations that have diverse objectives and circumstances. For instance, Draft Principle #7 says that "The board [of a charity or foundation] should hold at least three meetings per year." Draft Principle #8 says that "The board should have a minimum of five members." And Draft Principle #17 says that "Board members are generally expected to serve without compensation, other than reimbursement for expenses incurred to fill their board duties."

These proposals unnecessarily restrict the ability of donors and trustees to use their best judgment in how to carry out their charitable objectives. There are many foundations, including most prominently the Bill and Melinda Gates Foundation, whose boards do excellent work with fewer than five members. So, too, there are many foundations and charities whose boards do not need as many as three meetings per year to perform their responsibilities effectively.

As for compensation, within the foundation world there is both a long and venerable tradition of volunteer board service and also a long and venerable tradition of compensated board service. Our experience at The Philanthropy Roundtable suggests that philanthropic excellence is common in both traditions—and so is philanthropic mediocrity—and that self-regulation should not favor one tradition over the other. Whether to compensate board members of foundations is a judgment call best left to

donors and the individuals to whom they have entrusted their charitable resources, subject of course to rules against self-dealing enforced by the Internal Revenue Service.

The Philanthropy Roundtable is concerned in addition by the violation of privacy suggested by Draft Principle #6: “A charitable organization must make information about its operations, including board members, finances, programs and activities, and methods used to evaluate outcomes of work [our emphasis], widely available to the public.” How a foundation determines its philanthropic strategy—how it makes decisions about which grants to make, and how it evaluates performance by grant recipients—is an inherently private decision by a private organization. Foundations should feel free to reveal their grant-making strategy if they wish, and many find it in their interest to do so, but it is an unnecessary breach of privacy to compel them to do so.

Foundations are private organizations that benefit from the tax exemption. Public policy has therefore set certain minimum disclosure requirements to ensure that foundations are in fact complying with the tax laws. For instance, foundations have to disclose their grant recipients, and this helps to ensure that their grants go to bona fide charitable organizations. They have to disclose their board members, compensation, and investments, in order to help guard against unreasonable compensation and self-dealing. But public policy has otherwise protected the private decisions of private organizations.

Grant-making strategy and evaluation properly falls in this zone of privacy. So long as a foundation is making grants to legitimate public charities, there is no reason tax authorities or watchdog groups need to know why it is choosing some grantees over others. Quite the contrary, maintaining privacy enables foundations to exercise their honest judgment on this most sensitive of judgment calls. Maintaining privacy also protects the grant applicants not chosen and allows foundations to provide them with confidential advice.

Caveats about Self-Regulation

The term self-regulation is ambiguous. In releasing its draft principles, it is unclear whether Independent Sector is encouraging the growth of voluntary standard-setting, self-assessment, and accreditation within the nonprofit world, or whether it is encouraging mandatory industry-wide rule-making, with the rules being made by representatives of the nonprofit industry.

The co-chairman of Independent Sector's Advisory Committee on Self-Regulation of the Charitable Sector, Joel Fleishman, calls for such a mandatory form of self-regulation in his new book, *The Foundation: A Great American Secret*. More specifically, Fleishman calls for the Internal Revenue Service to delegate much of its rule-making and enforcement authority for policing foundations to a new private industry-based regulatory agency modeled on the brokerage industry's National Association of Securities Dealers (NASD).

A variation of this proposal, suggested by the Senate Finance Committee staff in its 2004 discussion draft on the charitable sector, would be the enactment of legislation making tax-exempt status for foundations and public charities contingent on private accreditation. This would have the potential to be a much more subjective and onerous process than IRS approval of 501(c)(3) status.

If Independent Sector's purpose in drafting principles of self-regulation is simply to educate charities and foundations about best practices in the field, The Philanthropy Roundtable applauds its initiative. In addition, if IS wants to set eligibility standards for its own membership, or to give guidance to other voluntary associations that want to establish codes of conduct or self-assessment procedures for their members, the Roundtable has no problem with such an exercise. It is consistent with the principles of a free society for private membership organizations to establish governance standards, codes of conduct, and accreditation policies, so long as individual foundations are free to join or not join as members.

However, while foundations should be free to participate in voluntary accreditation or certification programs if they wish, the Roundtable is strongly opposed to any requirement that accreditation be a condition of tax-exempt status. An accreditation requirement could pose a very serious threat to independent thought in philanthropic foundations. We have seen this in the case of college accreditation, where Thomas Aquinas College of California was initially denied accreditation in the early 1990s by the regional accreditation monopoly—a private non-governmental group—because the accreditors didn't approve of the college's Great Books curriculum.

Moreover, accreditation simply isn't necessary for foundations. There is a public-interest rationale for accrediting hospitals or, perhaps, day care centers—where health and safety issues are at stake. Public charities may also find it helpful to be certified or accredited on a voluntary basis in order to win the confidence of donors. (The Evangelical Council for Financial Accountability is an excellent example of a voluntary certification process that has dramatically improved governance and financial integrity among its constituents.) Foundations, however, are not taking investments from others, nor are they entrusted with the safety of members of the public. Indeed, so long as they obey the law, foundations do not have to be and should not have to be directly accountable to anyone except their own trustees.

In addition, The Philanthropy Roundtable will strongly oppose the creation of a new private industry-wide rule-making and enforcement agency modeled on the NASD and under the supervision of the IRS. There are four reasons for our opposition:

First, the danger of over-regulation can be just as great under private as under public rule-making and enforcement bodies. For instance, the private-sector nonprofit Public Company Accounting Oversight Board (PCAOB) has been largely responsible, together with the Securities and Exchange Commission which selects the PCAOB board, for the nightmare regulations under the Sarbanes-Oxley Act that have discouraged independent

public offerings in American securities markets and led to a flight of publicly held companies overseas and into private equity. Senator Charles Schumer and Mayor Michael Bloomberg have recently warned that New York City is in danger of losing its financial pre-eminence in part because of over-regulation under Sarbanes-Oxley.

Second, creation of an NASD-like self-regulation entity would amount to double-taxation. Foundations already pay an excise tax that is supposed to provide the IRS with revenue to police the tax-exempt sector, though only a small portion of the proceeds actually go to this purpose. Foundations would have to be taxed or dunned a second time to finance the new self-regulating body. It would make more sense to apply the proceeds of the excise tax to the purpose for which it was intended, and give the IRS tax-exempt bureau the resources it needs to police the nonprofit sector. Indeed, until we have a chance to observe a fully funded IRS tax-exempt bureau in operation, there is no case for establishing a *second* regulatory agency.

Third, the culture of the IRS is dedicated to protecting the privacy of those it is investigating. This is a valuable safeguard against the introduction of politics and the abuse of power by enforcement authorities, and it could well be lost if enforcement were delegated to a separate regulatory agency.

Fourth, creation of a self-regulating body could encourage cartel-like behavior—the use of the rule-making process by politically powerful existing philanthropic leaders to exclude competition from new entrants. This is not an idle threat. Already prominent nonprofit leaders have made proposals to abolish foundations with small asset sizes, or to require family foundations to have independent directors. Creation of a new regulatory agency, especially one controlled by the industry, would provide a vehicle for enacting such rules.

There are some in the nonprofit world who favor formal industry-wide self-regulation as an alternative to misguided proposals for a dramatic expansion in federal and state oversight. The Philanthropy Roundtable does not share this view. We believe that existing

laws should be more vigorously enforced, that some narrowly tailored new laws may be necessary to correct specific abuses, and that overreaching legislative proposals can be and should be resisted on their own merits, without substituting a private self-regulatory regime that could be equally overreaching and intrusive.

Appendix E

Panel on the Nonprofit Sector

Policies for Work Group and Committee Participation

Updated May 15, 2006

Meeting Attendance Policy

We recognize that it may not be possible for members to attend or participate in all meetings, but members cannot send substitutes to attend meetings in their place. This is a policy that the Panel has adopted for itself and will be applied to all work groups and advisory groups. You may have a staff assistant join you on a conference call or at a meeting, but please provide Pat Read with the name and title of the assistant in advance of the meeting. If you are unable to attend a meeting, please share your comments in advance with Pat.

Conference Call Protocols

- Please announce yourself each time you speak. Staff will be taking notes and it is important we credit the correct individual.
- If you need to take another call or conduct a side conversation, please hang-up and call back rather than place us on hold.
- If your phone allows, please put the call on mute while not speaking.
- If at all possible, please do not call from a cell phone. Static and background noise may make it difficult for others to hear.
- We recognize how valuable your time is and will stick to the time allotted for all conference calls and meetings. Please follow up with your Staff contact if you have additional thoughts or want to share additional material with your group.

Confidentiality Agreement

To allow the Panel and the work groups the best opportunity to work through differences and reach agreement on the many difficult issues they will be addressing, all members are asked to respect the confidentiality of their Committee or Work Group deliberations.

Panel documents sent to members must not be forwarded or shared outside of the Work Group. We recognize that you may need to talk to colleagues associated with your organization who have specific expertise of relevance to the Committee discussions. If you believe that it is essential for you to share on a confidential basis the Panel materials with these colleagues to elicit input, we request that you retrieve those documents once your colleagues have reviewed them.

We also recognize that you work with a range of experts and members or coalition partners who are deeply interested in the Panel's work and who may have ideas to offer that would be helpful to the Panel and the Committee. We urge you to discuss ideas and issues with your colleagues and coalition partners without commenting specifically on Panel or Committee deliberations or distributing draft background materials. Should you find it helpful to write a précis or summary of the ideas that you want to share or get some input, we encourage you to do so as long as the Panel materials are not shared. We believe it is possible to see input from other experts and colleagues while honoring the integrity of the Panel's process.

Media Calls

Because you bring considerable expertise to these discussions and may be sought out by the press for your opinion. Naturally, you will decide how best to handle your opinion with the press and political leaders on the general areas in which you have expertise. On questions regarding the Panel's work, work group deliberations and discussions, the Panel has asked Diana Aviv to serve as the official spokesperson. We ask that you refer any calls,

emails or faxes from the media pertaining to the work of the Panel to Patricia Nash Christel, Independent Sector's Vice President for Communications and Marketing who is also helping to coordinate communications for the Panel. We urge Committee members not to speak to the media about the work of the Panel without prior discussion with Patricia so that we can ensure the highest level of accuracy and consistency.

Committee members who are interested in sending messages out to their colleagues and agency affiliates about their involvement with the Panel are encouraged to consult with Patricia and the communications team to facilitate accurate and up-to-date reports. The communications team will be available to assist with messaging or preparation for meetings and speaking engagements where a Committee Member may be asked about the Panel's work.

Information about the Panel is available through the Panel's website at www.NonprofitPanel.org.