Principles for Good Governance and Ethical Practice

A Guide for Charities and Foundations

REFERENCE EDITION




Panel on the Nonprofit Sector

Convened by Independent Sector

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Panel on the Nonprofit Sector

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We are delighted to share with you these principles for good governance and ethical practice, which are designed to guide board members and staff leaders of every charitable organization as they work to improve their own operations. The Panel on the Nonprofit Sector has been dedicated to finding ways to strengthen governance, transparency, and ethical standards within the charitable community since its creation in October 2004 at the encouragement of the U.S. Senate Finance Committee. Over the last three years, we have brought together thousands of people involved with charities and foundations to develop and refine recommendations to Congress, the Internal Revenue Service, and our own community that would achieve those goals.

The Panel issued its first report to Congress and the nonprofit sector in June 2005, and a supplement to that report in April 2006. Together, those reports offered over 150 recommendations for actions that Congress and the Internal Revenue Service should take to improve the laws, as well as education and enforcement efforts to prevent unscrupulous individuals from abusing charitable resources for personal gain. It also outlined actions that we in the charitable community needed to take to improve our own practices. Many of those recommendations have been enacted into law through the Pension Protection Act of 2006, and we continue to work with Congress and the IRS to make improvements in the regulatory framework under which charitable organizations operate.

We know that government action cannot—and should not—replace strong, effective governance of individual organizations and constant vigilance by our own community. The Panel has spent the past eighteen months working with an outstanding advisory committee led by Rebecca Rimel, President, Pew Charitable Trusts, and Joel Fleishman, Director, Philanthropic Foundations Research Program, Terry Sanford Institute of Public Policy, Duke University, to examine how we might advance the state of governance and self-regulation throughout our community. It further invited public comment from the charitable community. The result is the 33 principles presented here.

We encourage the board and staff leaders of every charitable organization to examine these principles carefully and determine how best they should be applied to their own operations. Many organizations will find that they already follow—or go beyond—these principles. Others may wish to make changes in their current practices over time, and some may conclude that certain practices do not apply to their operations. We hope these principles will help our organizations as we continue to reach for the highest standards of governance and ethical practice that the communities we serve expect and deserve.

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Preamble

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 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.[1] 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.[2] Individual 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. The public has high expectations for both the ethical standards and the impact of the country's 1.4 million charitable organizations, but often has trouble distinguishing one nonprofit from another. Unethical or improper conduct by an individual organization, 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 rules for the organizations and activities that are exempt from taxes and eligible to receive tax-deductible contributions: for example, government has determined that such contributions may not be used for partisan political activities or the private benefit of the donor. At the same time, government has wisely avoided intruding on how organizations pursue their missions, manage their programs and structure their operations.

> Nonprofit organizations have long embraced the need for standards of ethical practice that preserve and strengthen the public's confidence.

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 none have applied 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.

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 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.

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 since its inception in 2004. Its work 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.

DEVELOPING SECTOR-WIDE PRINCIPLES TO SUPPORT SELF REGULATION

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.

USING AND ADAPTING THE PRINCIPLES FOR YOUR ORGANIZATION

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.[3] 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 certain 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 standards that nonprofits subscribe to on a purely voluntary basis, without any external verification, because they want to strengthen their governance practices and ethical conduct.

> Self-regulation begins with good governance.

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.

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.

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 under four main categories:

1. **Legal Compliance and Public Disclosure** (principles 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** (principles 8-20)—policies and procedures a board of directors should implement to fulfill its oversight and governance responsibilities effectively.
3. **Strong Financial Oversight** (principles 21-26)—policies and procedures an organization should follow to ensure wise stewardship of charitable resources.
4. **Responsible Fundraising** (principles 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 Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations is available in an abridged format to share with board and staff members, donors, and others interested in the work of the nonprofit community. This reference edition provides additional information, including legal background on each principle, a glossary of terms, the two studies on self-regulation systems commissioned by the Panel to inform this work, and the more than 50 existing self-regulation systems and standards that the Panel's Advisory Committee on Self-Regulation studied during its work.

Independent Sector, which convened and supported the Panel, also offers information on its website, www.independentsector.org, to assist organizations in finding tools and other resources for applying these principles.

A PROCESS OF CONTINUING VIGILANCE 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**.

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

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

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

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. 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 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 confronted by small and mid-sized tax exempt organizations. Some state attorneys general and other state charity , as well as many national, state and regional associations of nonprofit organization, 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.

LEGAL BACKGROUND

A charitable organization is generally organized as a corporation or a trust under the laws of the state in which it was created. Some organizations choose to operate as unincorporated associations, although that legal form leaves directors and members exposed to a higher degree of liability for financial and other legal responsibilities of the organization. Unincorporated associations are still subject to legal requirements for charitable organizations.

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[1]) must apply for and be recognized by the IRS as tax-exempt under section 501(c)(3) of the tax code. To receive this classification, an organization must file a formal application (Form 1023) with the IRS that describes its current or planned financial and programmatic activities, organizational documents, and governance structure. 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.

Private foundations derive their primary financial support from the contributions of a limited group of sources, such as an individual, family, or corporation. Foundations are subject to substantially more restrictive rules governing their operations, and their donors receive less favorable tax treatment for donations. For example, private foundations are prohibited from engaging in most direct or indirect financial transactions with their donors, directors, and businesses and family members of those donors and directors, except for compensation or reimbursement of expenses related to personal services that are reasonable and necessary to fulfilling the foundation's charitable purposes. A private foundation is required to make charitable distributions every year equal to at least 5 percent of the value of its noncharitable assets and must pay an annual excise tax generally equivalent to

[1] Houses of worship, specific related organizations, organizations (other than private foundations) whose annual gross receipts do not normally exceed $5,000, and organizations (other than private foundations) subordinate to another tax-exempt organization that are covered by a group exemption letter, are not required to seek formal recognition of 501(c)(3) status.

2 percent of its net investment income.[2] Private foundations are prohibited from engaging in lobbying activities (subject to certain exceptions) and are subject to specific rules regarding its holdings in for-profit business enterprises and the types of investments it is allowed to make. Private foundations and their managers may be subject to severe excise taxes and other penalties for violations of these prohibitions.

Public charities generally derive a substantial portion of their funding from the general public or from a governmental unit. 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. Public charities are prohibited from engaging in "excess benefit transactions," that is, transactions with insiders (persons in a position to exercise substantial influence over the organization) that provide economic benefits in excess of fair market value. There are specific rules for the operation of certain public charities established as medical research organizations, charities that operate as credit counseling organizations, and certain supporting organizations, as well as for specific types of funds held by a public charity known as "donor-advised funds."[3]

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."[4] Public charities (but not private foundations) may also lobby directly or conduct grassroots advocacy efforts to influence the outcome of other legislation so long as such efforts constitute an "insubstantial part" of the organization's 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.[5]

Organizations that solicit charitable contributions must be knowledgeable of and abide by charitable solicitation regulations and reporting requirements of the states and local jurisdictions in which they operate or raise funds. Thirty-eight states and the District of Columbia currently require certain charitable organizations to register before soliciting residents or conducting fundraising activities within their state. Organizations that hire third parties to raise funds on their behalf must also take steps to ensure that those third parties comply with state and local registration and reporting requirements.

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 also abide by other 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.

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[2] IRC § 4940(a), Reg. §53.4940-1(a).

[3] IRC §4966(d)(2) defines a donor-advised fund as a fund or account that is owned and controlled by a sponsoring organization, separately identified by reference to contributions of a donor or donors, and to which the donor or a designated advisor has or reasonably expects to have advisory privileges with respect to the distribution or investment of the assets in the fund. The definition specifically excludes a fund or account that makes distributions only to a single identified organization or governmental entity or that makes grants for travel, study or similar purposes provided that certain conditions are met.

[4] Treas. Reg. § 53.4945-2(d)(2)(ii).

[5] IRC §501(h).

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 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.

LEGAL BACKGROUND

There is no legal requirement to have a code of ethics.

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 should 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 particularly fostered 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.

LEGAL BACKGROUND

While there is no federal requirement that an organization have a conflict of interest policy, board members and organization managers are subject to penalties if they are found to have approved transactions that result in an excessive financial benefit to anyone in a position to exercise substantial influence over the organization's affairs. (For a more complete discussion of excess benefit transactions, see the Legal Background to principle #13.)

The Internal Revenue Service requires public charities to disclose on their annual information returns (Forms 990) if any officers, directors, trustees, key employees, highest compensated employees, or highest compensated profession or other independent contractors are related through family or business relationships[6] and whether the organization has a conflict of interest policy.[7] The IRS Form 1023, which an organization must file to obtain a determination of federal tax-exemption under section 501(c)(3) of the Internal Revenue Code, asks the organization to indicate whether it has adopted a conflict of interest policy and, if not, how it will handle conflicts of interest.

All states mandate that directors and officers owe a duty of loyalty to the organization, and improperly benefiting from a transaction involving a conflict of interest, if improper, more than likely violates that duty. Some state statutes specifically penalize participation in transactions involving conflicts of interests unless the organization follows certain prescribed procedures.

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[6] IRS 2006 Form 990, Part V-A, line 75b. Family relationships include "an individual's spouse, ancestors, children, grandchildren, great-grandchildren, siblings (whether by whole or half blood), and the spouses of children, grandchildren, great-grandchildren, and siblings. Business relationships are defined as "employment and contractual relationships, and common ownership of a business where any officers, directors, or trustees, individually or together, possess more than a 35% ownership interest in common."

[7] 2006 Form 990, Part IV-A, line 75d.

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 to civil and criminal sanctions.

Policies that protect people who report wrongdoing—sometimes known as a "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 to either a board member or an external entity specified by the organization. Some large organizations have set up computerized systems that allow 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.

LEGAL BACKGROUND

Some states have enacted laws that provide protections for employees who report misconduct under specific conditions. Federal law prohibits employment-related retaliation by all entities—including charitable organizations—against whistleblowers who provide information on certain financial crimes delineated under federal law.[8] Whistleblowers who report suspected tax fraud to the IRS are also protected from retaliation.[9]

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[8] The Sarbanes-Oxley Act of 2002) Pub. L. No. 107-204, 18 U.S.C. 1513(e).

[9] Tax Relief and Health Care Act of 2006, § 406, P.L. 109-432

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.

LEGAL BACKGROUND

Federal, state and local laws and regulations require both for-profit and nonprofit organizations to retain certain business records—such as applications for employment and payroll records, tax forms and contracts—for specified lengths of time. Failure to maintain such records may subject the organization and/or individuals to penalties and fines and may compromise the organization's position in litigation.

The Sarbanes-Oxley Act provides that it is a federal crime, punishable by a fine and up to twenty years in prison, for any corporate agent, whether of a for-profit or nonprofit corporation, knowingly to alter, destroy, mutilate, conceal, cover up, falsify, or make a false entry in any record with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of a federal department or agency or any bankruptcy case.[10] The same penalty applies to anyone who alters, destroys, mutilates, or conceals a record, or attempts to do so, with the intent to impair the object's integrity or availability for use in an official proceeding, regardless of whether such proceeding is pending or about to be instituted at the time of the offense.[11]

Other federal laws, such as the Privacy Act of 1974 and the Health Insurance Portability and Accountability Act of 1996 (which affects health care providers), establish rules for all types of organizations for the collection, maintenance, use and dissemination of personal information to protect the privacy of individuals. State laws vary considerably from state to state and may supersede federal laws where the state law is more restrictive.

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[10] Id., § 802 and United States Code Title 18, § 1519.

[11] Id., § 1102 and United States Code Title 18, § 1512.

6 A charitable organization's board of directors 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 governance, financial oversight, and 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 protect its assets in such an event. The board of directors should consider the appropriateness of 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 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 in place for backing up and preserving electronic and print copies of documents and other information vital to its 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 paid and volunteer staff.

LEGAL BACKGROUND

The federal Volunteer Protection Act and most state volunteer liability laws do not protect board members, regardless of whether they are compensated, and other volunteers from liability for "willful or criminal misconduct, gross negligence, reckless misconduct, or a conscious, flagrant indifference to the rights or safety of the individual harmed by the volunteer action."[12] The federal Act and most state laws do not prevent individuals from filing lawsuits against board members and other volunteers, nor do they provide the charitable organizations immunity from legal actions, although some states place a dollar limit on the organization's liability.

The governing documents of a charitable organization may include "indemnification provisions" that allow the organization to pay the costs of defending or paying settlements or judgments board members might incur for actions related to their board service. Federal or state laws prohibit the organization from indemnifying a board member who acted in bad faith and for other specific types of offenses.

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. Those returns serve as a 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 communication 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.

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.

[12] The Volunteer Protection Act of 1997, Pub. L. 105-19.

LEGAL BACKGROUND

Federal law requires many public charities, including all supporting organizations,[13] 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 its finances and programs. The IRS may impose penalties on any organization that fails to file timely and accurate returns, and failure to file for three consecutive years will result in revocation of tax-exempt status. Charitable organizations are required to make these forms,[14] as well as their initial application for recognition of tax exemption, correspondence with the IRS in connection with that application, available for free inspection during regular business hours at its principal, regional, and district offices.[15] 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.

A tax-exempt organization may meet the public inspection requirement by posting those 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. In either case, the internet site must clearly inform visitors that the documents are available and provide instructions for downloading them. Any individual with access to the internet must be able to download, view, and print the document without having to pay a fee or acquire special computer hardware or software, other than software that is readily available free of charge.

Beginning in 2008, each public charity that is not otherwise required to file 990 or 990-EZ[16] will be required to file an annual notice electronically with the IRS that indicates its legal name; mailing address; web site address; taxpayer identification number; name and address of a principal officer; evidence of the continuing basis for the organization's exemption from filing Form 990; and, upon termination, notice of that termination. There are no monetary penalties for failure to file the notice, but failure to file the annual notice for three consecutive years will result in revocation of tax-exempt status.

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[13] Religious congregations and specific related institutions, specified governmental instrumentalities, and other organizations relieved of this requirement by authority of the IRS, are excluded from this requirement. Public charities (other than supporting organizations) with annual gross receipts of $25,000 or less are relieved of this requirement until 2008.

[14] Each annual information return must be made available for a period of three years beginning on the date the return is required to be filed or is actually filed, whichever is later. For tax years beginning after August 17, 2006, the requirement that charitable organizations make their annual IRS returns available for public inspection also includes the requirement to disclose the Form 990-T (report of unrelated business income).

[15] IRC § 6104. Organizations that received tax exemption prior to 1987 are not required to make their initial application for tax-exemption available if they do not have a copy of the application.

[16] Other than houses of worship and specific related institutions, specified governmental instrumentalities, and other organizations relieved of this requirement by authority of the IRS.

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, unstaffed 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.

LEGAL BACKGROUND

Federal, state and local laws governing charitable corporations and trusts require that each organization have a governing body that is entrusted with the power to act on behalf of the beneficiaries of the organization.

The duties and requirements for directors of charitable organizations are generally determined by the laws of the state in which the organization was founded or incorporated. Some states also have established requirements for the board of directors of any organization that conducts activities, particularly fundraising, within its borders.

The Revised Model Nonprofit Corporation Act, adopted in 1987 by the American Bar Association's Subcommittee on the Model Nonprofit Corporation Law of the Business Law Section, sets forth parameters for the structure and composition of boards. It also sets forth duties of loyalty and due care by requiring that: "a director shall discharge his or her duties as a director, including his or her duties as a member of a committee (1) in good faith; (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) in a manner the director reasonably believes to be in the best interests of the corporation."[17]

The Revised Act has been adopted in whole or in modified form by 23 states[18] for regulation of nonprofit entities, including charitable organizations. The original Model Act (developed in 1952) has been adopted in whole or in modified form by six other states and the District of Columbia.[19]

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[17] Revised Model Nonprofit Corporation Act § 8.30

[18] The Act has been adopted in whole or with modifications in Alaska, Arkansas, California, Colorado, Georgia, Hawaii, Idaho, Indiana, Maine, Minnesota, Mississippi, Missouri, Montana, Nebraska, North Carolina, Oregon, South Carolina, Tennessee, Utah, Vermont, Washington, West Virginia, and Wyoming.

[19] Alabama, New Jersey, North Dakota, Texas, Virginia, and Wisconsin have adopted the original Model Nonprofit Corporation Act as promulgated or modified.

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. 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 with strong committee structures, including organizations with widely dispersed board membership, hold only one or two meetings of the full board each year. Foundations that make grants only once during the year may find that one annual meeting is sufficient.

LEGAL BACKGROUND

The Revised Model Nonprofit Corporation Act and many state laws stipulate that the rules regarding meetings of the board, including their frequency, should be established in the bylaws of the organization. Most state laws allow a charitable organization to stipulate meeting quorum requirements, that is, the number of board members who must be present before the meeting begins, in its governing documents. In the absence of such stipulations in the governing documents, state laws generally require that organizations hold at least one annual meeting with a majority of board members present.

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 organizational matters. Except for very small organizations, this generally means that the board should have a minimum of 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.

LEGAL BACKGROUND

Federal law currently permits organizations to qualify for tax-exempt status with a single director or trustee. The Panel on the Nonprofit Sector has recommended that Congress amend the federal tax code to require that each organization, with certain exclusions,[20] have a minimum of three members on its governing board to be recognized as tax-exempt under section 501(c)(3) of the code.

State laws in this area vary depending on whether the organization is established as a corporation or a trust. The Revised Model Nonprofit Corporation Act stipulates that a board of directors must have a minimum of three members. It sets no maximum number and allows an organization to set and change the number of directors in its bylaws, so long as there are always at least three directors in place. In practice, some states require only one director for nonprofit corporations, and some also permit the formation of a corporation sole.[21] One state, New Hampshire, requires public charities to have a minimum of five directors who are not related family members.[22] Charitable organizations established by trusts are governed by one or more trustees as specified in the trust instrument.

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 the organization's 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. For example, in order to be recognized as a Community Housing Development Organi-

[20] Excluded would be houses of worship and specific related institutions, specified governmental instrumentalities, and other organizations relieved of this requirement by the IRS.

[21] Generally corporation sole pertains to houses of worship and is a form of religious organization consisting of one person only, and his or her successors in some particular station, such as the bishop or rector of a church. As a corporation sole, certain legal capacities and rights are granted in perpetuity to the individual by right of the particular station he or she holds

[22] New Hampshire requires that boards of directors of public charities (certain religious organizations excepted) have at least five voting members "who are not of the same immediate family or related by blood or marriage." N.H. Rev. Stat. § 292:6-a.

zation, one-third of the board members must be representatives of the low-income community the organization serves.[23]

Some donors to private foundations wish to involve family members on the boards of their foundations to ensure that the donor's philanthropic tradition will continue through future generations. If family members do not have the expertise and experience necessary to provide appropriate governance and oversight, 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.

LEGAL BACKGROUND

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;[24] 2) organizations that qualify as publicly-supported charities based on a "facts and circumstances" test may need to have a governing board that is representative of the community;[25] 3) supporting organizations that must show a close relationship with the organizations they support through specific board positions; and 4) credit counseling organizations which must meet specific rules for board composition.[26]

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; or (4) be related to (as a spouse, sibling, parent or child), or reside with any individual described above.[27]

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.

[23] Community Housing Development Organizations (CHDOs) must maintain at least one-third of the governing board's membership for residents of low-income neighborhoods, other low-income community residents, or elected representatives of low-income neighborhood organizations. 24 CFR Part 92.

[24] Internal Revenue Service *Audit Guidelines for Hospitals*, 1992. See Fremont-Smith, Marion R., *Governing Nonprofit Organizations: Federal and State Law and Regulations*, The Belknap Press of Harvard University Press (2004), page 244.

[25] Treas. Reg. §1.170A-9(e)(3).

[26] IRC § 501, 513; Pension Protection Act § 1220.

[27] This principle does not apply to private foundations; medical research institutions recognized under IRC § 170(b)(1)(A)(iii); supporting organizations or subsidiaries that are required by law or by their articles of incorporation to include representatives of the supported or sponsoring charities on their board of directors; public charities that are incorporated under the auspices of a religious organization and are required under their articles of incorporation to include clergy and others who are compensated by the parent religious organization; and public charities that are established as charitable trusts where the trust instrument specifies that trustees shall be institutions or professional advisors that are expected to provide services beyond general governance, including substantial asset and investment management activities.

This principle does not apply to private foundations and certain medical research institutes that operate under specific legal restrictions regarding self-dealing transactions, and other charitable organizations whose articles of incorporation or trust instruments include specific 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.

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.

LEGAL BACKGROUND

Five states have legislative mandates for the independence of nonprofit boards of directors. North Dakota,[28] Maine,[29] California,[30] and Vermont[31] require that no more than 49% of the board may be "interested" or "financially interested" persons. While the definitions vary slightly in each state, "financially interested" persons are generally those who have received or are entitled to receive compensation for personal services rendered to the organization (other than compensation for board service), and/or those who are related family members of compensated persons.[32] New Hampshire requires that at least five voting members of the board of a charitable corporation "are not of the same immediate family or related by blood or marriage."[33] The New Hampshire provision does not apply to private foundations, and certain religious organizations including churches and integrated auxiliaries of churches.

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. One of the most important responsibilities of the board, then, 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.

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28 ND Cent. Code § 10-33-27.

29 Maine Nonprofit Corporation Act, Title 13-B, § 713-A (2).

30 Cal. Corp. Code § 5227 (a).

31 11B VT Stats § 8.

32 Maine and Vermont define related parties as "spouse, brother, sister, parent or child," while California also includes ancestor, descendant, brother-in-law, sister-in-law, son-in-law, daughter-in-law, mother-in-law, or father-in-law.

33 N.H. Rev. Stat. § 292:6-a.

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.

Governing boards are responsible for hiring and establishing the compensation of the CEO and for approving the compensation range of other persons in a position to exercise substantial control of the organization's resources. It is the responsibility of the CEO to hire and set the compensation of other staff, consistent with reasonable compensation guidelines set by the board. If 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, the board should review the compensation to ascertain that it does not provide an excess benefit.

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.

LEGAL BACKGROUND

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.[34] Charitable organizations are prohibited from providing excessive compensation or economic benefit to executives and other individuals who have substantial influence over the organization's affairs, and to family members of such individuals.[35] Private foundations are generally prohibited from engaging in any financial transactions, other than payment of reasonable compensation for services deemed necessary to the foundation's exempt purposes, with such individuals.[36]

Federal law specifically encourages public charities to have executive compensation approved in advance by members of an "authorized body" of the organization (such as the board or a board-appointed committee), none of whom has a conflict of interest with respect to the transaction.[37] 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.[38] Although the IRS may not draw any negative inferences simply because an organization chooses not to follow these procedures,[39] penalties on those who receive, and on charity managers who approve, compensation that is later found to be excessive, may be avoided if procedures are followed.

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[34] Treas. Reg. § 53.4958-4(b)(1)(ii).

[35] IRC § 4941 and § 4946; § 4958(f).

[36] IRC § 4941.

[37] Treas. Reg. § 53.4958-6(a)(1).

[38] Treas. Reg. § 53.4958-6.

[39] Treas. Reg. § 53.4958-6(e).

Federal tax regulations define comparable data needed to determine the reasonableness of compensation or other transactions with disqualified persons as including (1) compensation paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions; (2) the availability of similar services in the geographic area; (3) current compensation surveys compiled by independent firms; (4) actual written offers from similar organizations competing for the disqualified person; and, if the transaction involves the transfer of property, (5) independent appraisals of that property and (6) offers received as part of an open and competitive bidding process. Public charities with gross receipts (including contributions) of less than $1 million may rely on the compensation paid by three comparable organizations in the same or similar communities for similar services when approving compensation arrangements.[40]

Board members and other managers of charitable organizations who approve a transaction knowing it provides an excess benefit are generally jointly and severally liable for a tax on the transaction amount for private foundations or the excess benefit for public charities, unless their participation is not willful and due to reasonable cause.[41] For private foundations, an exception to the general rule provides that if the transaction involves compensation, the penalties are based on a percentage of the excess compensation (not the *total* compensation).[42]

To impose penalties on public charity or private foundation managers, the IRS must prove that the organization manager's actions in accepting or approving an excess benefit or self-dealing transaction were conscious, voluntary, and intentional, and that the manager had actual knowledge of sufficient facts to determine that the transaction would be an excess benefit or self-dealing transaction, was aware that such a transaction would violate federal excess benefit or self-dealing transaction laws, and negligently failed to make reasonable attempts to determine whether the transaction was an excess benefit or self-dealing transaction.[43] 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)[44] is generally not held responsible for knowing that the transaction was improper.[45] 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.[46]

Federal laws do not subject managers of public charities to the excess benefit rules when they are setting the compensation for a new chief executive officer, chief financial officer, or a chief operating officer so long as the new employee was not a board member, key manager, or substantial contributor to the organization in the preceding five years, there is a written agreement governing the terms of compensation before the new executive takes office and the compensation is based on a fixed amount or formula over single or multiple years.[47]

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[40] Treas. Reg. § 53.4958-6(c)(2).

[41] IRC § 4941; IRC 4958.

[42] IRC §4941(e)(2).

[43] Treas. Reg. §§ 53.4941(a)-1(b)(3), 53.4958-1(d)(4)(i).

[44] Public charity managers may also rely on the professional advice of certified public accountants or accounting firms with relevant tax law expertise, and independent appraisers or compensation consultants who perform such valuation services on a regular basis, are qualified to make valuations of the particular type of property or services involved, and provide certifications regarding those qualifications. Treas. Reg. § 4958-1(d)(4)(iii).

[45] Treas. Reg. § 53.4958-3(a)(1).

[46] Treas. Reg. § 53.4958-1(d)(4)(iv).

[47] Treas. Reg. §§ 53.4941(a)-1(b)(3), 53.4958-1(d)(4)(i).

Charitable organizations, with some exceptions,[48] are required to report on their Form 990 or 990-PF the name, title, and average hours per week of every board member, officer, and key employee. In addition, the organizations must report the compensation, contributions to employee benefit plans and deferred compensation, expense account, and other allowances paid during the year covered by the report to any current or former board member, officer, and key employee. The instructions to the forms specify that all types of compensation must be reported, including both taxable and nontaxable fringe benefits except for de minimis fringe benefits (for example, property or services provided to the individual of such a small value as to make accounting for it impractical).[49]

14 The board of a charitable organization that has paid staff should ensure that the positions of chief executive officer, board chair, and board 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/executive director 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.

LEGAL BACKGROUND

State laws generally require that a charitable corporation have a secretary, and may also require that the corporation have a president, a treasurer, and other officers as appointed by the board. Some permit the same individual to hold simultaneously more than one office in the corporation, while others have restrictions that specify that the offices of president and the treasurer cannot be held by the same individual.

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[48] Excluded from this requirement are organizations, other than private foundations and supporting organizations, with annual gross receipts of $25,000 or less, houses of worship and specific related institutions, specified governmental instrumentalities, and other organizations relieved of this requirement by authority of the IRS. IRC § 6033(a)(2)

[49] IRC § 132(e).

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 needed and if funds permit, should provide 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.

LEGAL BACKGROUND

There are no specific federal or state legal requirements regarding orientation and ongoing training of board members. Because the law requires board members to exercise reasonable care in making decisions on behalf of the organization, however, they must make an effort to obtain adequate information to inform their decisions.

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.

LEGAL BACKGROUND

There are no federal or state laws or regulations requiring governing boards of nonprofit organizations to evaluate the performance of the board as a group or as individuals.

The Revised Model Nonprofit Corporation Act stipulates that directors may be removed through judicial proceedings or by a vote of the board if "a director has engaged in fraudulent or dishonest conduct, or gross abuse of authority or discretion, with respect to the corporation…and removal is in the best interest of the corporation."[50] In judicial proceedings, a court may also stipulate that the director who is removed may be barred from serving on the board for a proscribed period of time.

17 The board should establish clear policies and procedures addressing 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.

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[50] Revised Model Nonprofit Corporation Act § 8.05

LEGAL BACKGROUND

There are no federal or state laws or regulations limiting the length of time an individual may serve on the board of a charitable corporation. Some state laws establish the length of a term of board service if such terms are not specified in the organization's articles of incorporation or bylaws, but they do not limit the number of terms an individual may serve. Trust laws in all states permit trustees to serve as appointed without any limitation on the term.

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.

LEGAL BACKGROUND

Each organization's articles of incorporation and governing instruments set forth the requirements for its conduct and that of its board of directors. Charitable organizations are required to submit these articles and instruments to the Internal Revenue Service when applying for recognition as a 501(c)(3) exempt organization. If an organization amends its governing instruments, it must provide the revised documents to the appropriate Exempt Organization office or attach them to the next annual information return (Form 990, 990-EZ, or 990-PF) it files with the IRS.[51]

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 com-

[51] IRS Publication 557, Tax-Exempt Status for Your Organization, page 16.

mon 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.

LEGAL BACKGROUND

Some legal scholars argue that a board member's duty of loyalty to the beneficiaries of a charitable organization requires that he or she ensures that the organization's purposes are carried out effectively.[52] 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. Changes in the articles of incorporation or other governing instruments must also be reported to the Internal Revenue Service.

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

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[52] Marion Fremont-Smith, *Governing Nonprofit Organizations: Federal and State Law and Regulations*, The Belknap Press of Harvard University Press (2004), pp. 225-226.

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.

LEGAL BACKGROUND

Charities and foundations are permitted under current law to pay reasonable compensation for services provided by board members. 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.[53] Federal tax laws prohibit excessive compensation and transactions that provide excessive economic benefit to board members and other disqualified persons.[54] The rules and penalties regarding excessive compensation of board members are the same as those applied to the compensation of the chief executive officer or other disqualified persons (see Principle #13).

Charitable organizations, with some exceptions,[55] are required to report on their Form 990 or 990-PF the name, title, and average hours of service per week of every board member, officer, and key employee. In addition, the organizations must report the compensation, contributions to employee benefit plans and deferred compensation, expense account, and other allowances paid to any board member by the organization and its affiliated entities. Public charities must also provide this information for former employees and board members who received any compensation or benefit during the reporting year. The instructions to the Forms specify that all types of compensation must be reported, including both taxable and nontaxable fringe benefits except for de minimis fringe benefits (for example, property or services provided to the individual of such a small value as to make accounting for it impractical). [56]

[53] Treas. Reg. § 53.4958-4(b)(1)(ii).

[54] IRC §§ 4941, 4958.

[55] Excluded from this requirement are organizations, other than private foundations and supporting organizations, with annual gross receipts of $25,000 or less, houses of worship and specific related institutions, specified governmental instrumentalities and other organizations relieved of this requirement by authority of the IRS. IRC § 6033(a)(2).

[56] IRC § 132(e).

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.

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.

Legal Background

Federal law requires many public charities and all private foundations to file an annual information return (Form 990, 990-EZ, or 990-PF) with the Internal Revenue Service with accurate information on the organization's finances and programs. IRS regulations permit any authorized officer of the organization[57] to sign Form 990 returns certifying, under penalty of perjury, that the return and accompanying schedules and statements are true, correct, and complete. The Internal Revenue Code provides for penalties if an organization fails to file a required return or to include required information on Form 990 series returns.

For tax years beginning after August 17, 2006, each public charity with annual revenues of $25,000 or less[58] is required to file an annual notice electronically with the IRS that indicates its legal name; mailing address; web site address; taxpayer identification number; name and address of a principal officer; evidence of the continuing basis for the organization's exemption from filing Form 990; and, upon termination, notice of that termination. There are no monetary penalties for failure to file the notice, but failure to file the annual notice for three consecutive years will result in revocation of tax-exempt status.

The Revised Model Nonprofit Corporation Act requires that a nonprofit corporation with members (other than religious corporations) must furnish on request from a member its latest annual financial statements with a balance sheet and state-

[57] For a corporation or association, this officer may be the president, vice president, treasurer, assistant treasurer, chief accounting officer or other corporate or association officer, such as a tax officer. For a trust, the authorized trustee must sign.

[58] Other than houses of worship and specific related institutions, specified governmental instrumentalities, and other organizations relieved of this requirement by authority of the IRS.

ment of operations. If the statements are prepared by a public accountant, they must include the accountant's report. Otherwise, the statements must include a statement from the organization's president or the individual responsible for the corporation's financial records stating whether the statements were prepared on the basis of generally accepted accounting principles or, if not, the basis of preparation. 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.

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). 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. California requires charitable organizations, other than educational organizations and hospitals, to file audited financial statements if their gross annual revenues are $2 million or more,[59] whereas Maryland requires organizations soliciting contributions in its state to file audited financial statements if annual total contributions to the organization equal or exceed $200,000.[60]

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. It is also a key tool for ensuring that the organization lives within its means. 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 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 to govern how the funds will be invested and what portion of the returns, if any, can be used for immediate operational or programs. The boards of organizations

[59] CA Govt. Code § 12585.

[60] Maryland Solicitations Act § 6-402.

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.

LEGAL BACKGROUND

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."[61]

Under all state laws, directors 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 when 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),[62] which has been adopted in some form by 47 states and the District of Columbia. This Act requires board members to exercise ordinary business care and prudence under the facts and circumstances prevailing at the time of an investment decision. 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.[63] Some states also apply UPIA to charitable corporations or specific types of funds within charitable corporations.

In July 2006, the National Conference of Commissioners on Uniform State Laws (NCCUSL) approved the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which is expected to supersede UMIFA in many states.[64] UPMIFA applies to both charitable corporations and charitable trusts and provides more guidance for boards and others responsible for managing the investments of charitable organizations. It defines the following principles of prudence for those who manage and invest funds of charitable organizations:

1. Give primary consideration to donor intent as expressed in a trust instrument;
2. Act in good faith, with the care an ordinarily prudent person would exercise;
3. Incur only reasonable costs in investing and managing charitable funds;
4. Make a reasonable effort to verify relevant facts;
5. Make decisions about each asset in the context of the portfolio of investments, as part of an overall investment strategy;
6. Diversify investments unless, due to special circumstances, the purposes of the fund are better served without diversification;
7. Dispose of unsuitable assets; and
8. In general, develop an investment strategy appropriate for the fund and the charity.[65]

Under UPMIFA, a charity also has the flexibility to spend or accumulate as much of an endowment fund as it deems prudent.

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[61] IRC § 4944.

[62] UMIFA was promulgated by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in 1972. It liberalized prior rules that limited the ability of a charity to expend from its endowment funds anything other than the fund's income

[63] UPIA was promulgated by NCCUSL in 1994 and is based on the General Standard of Prudent Investment set forth in the Restatement (Third) of Trusts, which was released in 1992. The Restatement reflects modern portfolio theory which has become universally accepted. The Uniform Trust Code promulgated by NCCUSL in 2000, and amended in 2001, 2003 and 2005, incorporates UPIA wholesale as the standard applicable to the investment of trust assets.

[64] As of March 2007, UPMIFA had been adopted by 16 states and was being considered by 14 additional states.

[65] Uniform Prudent Management of Institutional Funds Act (as approved by the National Conference of Commissioners on Uniform State Laws, July 2006), Prefatory Note, page 2.

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 offices of the charitable organization—the terms of such loans should be clearly understood and approved by the board. Such loans must then be reported on the organization's annual information returns (Form 990 and 990-PF).

LEGAL BACKGROUND

Federal laws prohibit private foundations, supporting organizations, and donor-advised funds from making loans to disqualified persons.[66] The Revised Model Nonprofit Corporation Act states that a nonprofit corporation "may not lend money to or guaranty the obligation of a director or officer of the corporation,"[67] and most states allow such only in very limited circumstances

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 public charities permitted to make such loans, the IRS generally scrutinizes the transactions 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.[68]

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[66] IRC §4941(d)(2)(B), § 4958(f)(1)(D), and § 4958(c)(2).

[67] The Revised Model Nonprofit Corporation Act § 8.32.

[68] IRS Instructions to 2006 Form 990, page 15.

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 carrying out 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 expenditures. The board should review the budget and financial reports to determine whether the organization is allocating its funds appropriately.

LEGAL BACKGROUND

Both private foundations and public charities are permitted to incur reasonable and necessary "administrative expenses" to further their charitable missions. Congress has never placed a general limitation on the amount of administrative expenses public charities can incur.

Public charities that are required to file Form 990 must disclose their total expenditures for administration or what the instructions to the form calls "management and general" expenses. The IRS defines management and general expenses as the organization's expenses for overall function and management, rather than for its direct conduct of fundraising activities or program services. Overall management usually includes the salaries and expenses of the chief officer of the organization and that officer's staff. If part of a manager's time is spent directly supervising program services and fundraising activities, the appropriate portion of his or her salary and expenses should be allocated to those functions.[69]

[69] IRS 2006 Form 990 Instructions, page 28.

Rental income expenses and program-related income expenses are not included in management and general expenses. Administrative expenses are further distinguished from "indirect expenses" such as rent, reception services, etc. which can be allocated to various program cost centers and to management and general.

There is no comparable definition of administrative expenses for private foundations in the instructions to the Form 990-PF. Private foundations are permitted to count all "reasonable and necessary" administrative expenses against their five percent payout requirement.[70] Federal law does not permit expenses for ongoing investment management, such as investment consultant fees, custodial fees, attending investment conferences, etc., to be counted as qualifying distributions.

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.

LEGAL BACKGROUND

Public charities and private foundations, like taxable organizations, are permitted to pay for or reimburse ordinary and necessary expenses incurred in carrying out the organization's activities, including the costs of travel. Under federal tax regulations, expenses for transportation, lodging, and meals must be documented to establish that they were incurred in connection with the work of the organization and not the personal activities of the individual. Federal tax regulations also require that these expenses not be "lavish or extravagant under the circumstances," though "lavish" and "extravagant" remain undefined in the tax code or in regulations.[71]

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.[72] Travel expenses also have specific documentation requirements; for example, proper receipts and an

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[70] IRC § 4942(g)(1)(A).

[71] IRC § 162(a)(2); Treas. Reg. §§ 1.162-2, 1.162-17.

[72] Treas. Reg. §§ 1.162-2, 1.132-5.

indication of the business purpose of the travel or expenditure must be provided.[73] Taxable organizations also have limitations on deductions for meals, entertainment expenses, and some travel expenses.[74]

Travel expenses that are paid or reimbursed but are not properly documented or are "lavish or extravagant" must be treated as additional taxable compensation to the individual benefiting from them. The law requires public charities intending to treat an expenditure as compensation to provide contemporaneous written substantiation by reporting the amounts on a Form W-2, a Form 1099, or a Form 990, or otherwise documenting such compensation in writing; otherwise, the compensation will be treated automatically as an "excess benefit."[75] Board members and executives of charitable organizations who approve or receive excessive travel benefits are subject to penalties under existing law.[76]

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 in question 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.

LEGAL BACKGROUND

Federal law generally requires that payments of travel expenditures for spouses, family members, and others accompanying an individual traveling on behalf of the organization must be treated as taxable income to the individual they are accompanying.[77] As with other travel expenses, the law requires public charities intending to treat such expenditures as compensation to provide contemporaneous written substantiation by reporting the amounts on a Form W-2, a Form 1099, or a Form 990, or otherwise documenting such compensation in writing; otherwise, the compensation will be treated automatically as an "excess benefit."[78] Board members and executives of charitable organizations who approve or receive excessive travel benefits are subject to penalties under existing law.[79]

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[73] IRC § 274(d); Treas. Reg. §§ 1.274-5, 1.274-5T.

[74] IRC § 274 and the regulations thereunder.

[75] IRC § 4958(c)(1)(A); Treas. Reg. § 53.4958-4(c)(1).

[76] IRC §§ 4941

[77] Treas. Reg. §§ 1.162-2, 1.132-5

[78] IRC § 4958(c)(1)(A); Treas. Reg. § 53.4958-4(c)(1).

[79] IRC §§ 4941, 4958.

Responsible Fundraising

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 reputation and history of service to the community from one that may claim a similar name or purpose, but whose fundraising appeal is deceptive or 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.

LEGAL BACKGROUND

Overlapping federal, state, and local laws regulate charitable solicitations. States play the leading role, with 38 states and the District of Columbia currently regulating such practices. Most states can also prosecute fraudulent or misleading charitable solicitations under their anti-fraud and consumer protection statutes. Many cities and counties have enacted their own solicitation ordinances. The Federal Trade Commission has jurisdiction over fraudulent solicitations in interstate commerce by for-profit organizations, including those who solicit on behalf of charitable nonprofits, while the Postal Service can prosecute fraudulent or misleading solicitations conveyed via the U.S. mail.

Over the years, state and local governments have attempted to prevent fraudulent fundraising, as well as curb what they perceive to be a waste of charitable assets, by limiting the amount that could be paid for fundraising (including amounts paid to professional fundraisers) or by requiring point-of-solicitation disclosures about the proportion of the funds that the charity would receive. The U.S. Supreme Court struck down three of these efforts on the grounds that they infringed on charities' First Amendment free speech rights.[80] While the Court expressed sympathy for state regulators' desire to protect their citizens from deceptive practices, it noted that existing anti-fraud statutes were adequate and that there were much less restrictive tools for combating fraudulent solicitations than percentage caps and point-of-solicitation disclosures, which it found to be excessive burdens on or unlawful compulsion of speech and thus unconstitutional. However, when the Court affirmed these precedents in 2003, it also upheld the Illinois Attorney General's right to pursue an action for fraud against a professional fundraiser that made representations to donors that a "significant amount" of each dollar donated would be going to the charity, when only 15 percent actually did.[81]

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[80] See *Village of Schaumburg v. Citizens for a Better Environment*, 444 U.S. 620 (1980); *Secretary of State of Maryland v. Munson*, 467 U.S. 947 (1984); and *Riley v. National Federation of the Blind of North Carolina, Inc.*, 487 U.S. 781 (1988).

[81] *Illinois ex rel. Lisa Madigan v. Telemarketing Associates, Inc.*, 538 US 600 (2003).

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 they expect their 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 the 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.

LEGAL BACKGROUND

If a donor provides a clear, written directive about how funds are to be used at the time a charitable gift is made, the board of the recipient organization has a fiduciary obligation to comply with the donor's directive 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. This type of instruction would include a contract or grant agreement between a private or public funder and a charitable organization. An organization's communications while it is soliciting contributions may also create a legally binding restriction that can be enforced under state and federal fraudulent solicitation prohibitions.

When carrying out a donor's clear, written directive on how to use a contribution becomes impossible, impracticable, or illegal, 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 directions provided by the donor.[82]

[82] See Comment to § 413 of The Uniform Trust Code, promulgated by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in 2000, and amended in 2001, 2003 and 2005, which provides in part: "if a particular charitable purpose becomes unlawful, impracticable, impossible to achieve, or wasteful ... the court may apply cy-pres to modify or terminate the trust ... in a manner consistent with the settlor's charitable purposes." UPMIFA, as adopted July 2006, Comment to Section 6, similarly allows a release of restrictions with donor permission, and permits deviations to modify or release a restriction, through court order or upon notification to the State Attorney General (or other applicable charity official). Modifications from the original intent of the donor must be "in accordance with the donor's probable intention" for deviation, and "in a manner consistent with the charitable purposes expressed in the gift instrument" for cy pres.

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, the 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.

LEGAL BACKGROUND

Federal law requires charitable organizations to provide a written disclosure statement to donors who contribute more than $75 if the organization has provided the donor with goods or services in exchange for the contribution.[83] The disclosure statement must inform the donor that the amount of the contribution that is deductible for Federal income tax purposes is limited to the excess of the amount of any money (and the value of property other than money) contributed by the donor over the value of the goods or services provided to the donor by the charity, and must provide a good faith estimate of the value of the goods or services received by the donor. The IRS indicates on its website that no disclosure statement is required if "the goods or services given to a donor have insubstantial value."[84]

A taxpayer who itemizes deductions on his or her annual income tax return is required to have a contemporaneous written acknowledgement from the charitable organization to substantiate deductions for contributions of $250 or more.[85] The written acknowledgement must include the amount of cash and a description (but not the value) of any property other than cash contributed; whether the charity provided any goods or services in consideration, in whole or in part, for the contribution; and a description and good faith estimate of the value of any goods or services received by the donor.[86] For tax years beginning after August 17, 2006, taxpayers are required to have bank records or a written communication from the organization (indicating its name and the

[83] IRC §§ 6115, 6714.

[84] See IRS Publication 1771; www.irs.gov/pub/irs-pdf/p1771.pdf

[85] IRC § 170(f)(8)(A); Treas. Reg. § 1.170A-13(f).

[86] IRC § 170(f)(8)(B)(i), (ii) and (iii).

date and amount of the contribution) to substantiate a deduction for a charitable contribution of any amount.[87]

For non-cash contributions, the taxpayer is generally allowed to deduct the fair market value of property donated to a public charity or to a federal, state, or local governmental entity. The amount that taxpayers may deduct varies depending on the type of property contributed, the type of organization to which the property was contributed, and the taxpayer's income. In the case of tangible personal property (e.g., artwork), the taxpayer is entitled to a fair market value deduction only if the property is given to a public charity that uses the property in its exempt purposes. If the taxpayer is claiming a deduction of more than $500 for any single item other than publicly-traded stock, the taxpayer must submit Form 8283 (Noncash Charitable Contributions) with his or her tax return. If the deduction claimed for any single item (other than publicly traded stock) exceeds $5,000, the taxpayer must have the item appraised by a qualified appraiser, then attach to the tax return a copy of the appraisal, a signed declaration of the appraiser, and a signed acknowledgement from the charitable organization that received the donation. If the charity sells contributed property valued at $5,000 or more within three years of the property's receipt, the charity must file Form 8282 (Donee Information Return), which reports that sale to the IRS.[88] For tax years beginning after August, 2006, taxpayers can only claim deductions for clothing and household items donated to charity if the items are in good used condition or better.[89]

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.

LEGAL BACKGROUND

Federal law designates certain transactions as prohibited tax-shelter transactions and imposes excise taxes and disclosure rules on certain tax-exempt entities that are party to such transactions, regardless of whether the transaction was initiated

[87] IRC § 170(f)(17).

[88] IRC § 170(e)(7).

[89] IRC § 170(f).

by a charitable contribution.[90] Recent guidance provided by the Internal Revenue Service outlines the circumstances in which excise taxes may be imposed pursuant to Internal Revenue Code Section 4965 on charity managers and organizations on income received after August 15, 2006, resulting from a transaction in which the charitable organization is a party to a prohibited tax shelter transaction.[91]

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.

LEGAL BACKGROUND

Most states require charitable organizations and professional fundraisers that solicit contributions in their jurisdiction to register and provide reports on their activities. Many states require a charitable organization that has paid solicitors or professional consultants working on its behalf to have a written contract with those fundraisers that delineates the specific purpose, time, and fees to be paid under the contract; the obligations of both the organization and the paid solicitor or consultant; whether the solicitor or consultant will have custody or control of contributions at any time

[90] The Tax Increase Prevention and Reconciliation Act of 2005 P.L. 109-222.

[91] See IRS Notice 2007-18. The IRS has indicated that it will issue further guidance on charitable abusive tax-shelters in late 2007.

and how such contributions will be transmitted to the organization; and how information about donors and potential donors will be treated by the solicitor during and following completion of the contract. Some states impose fines on charitable organizations that engage professional fundraisers to solicit contributions on their behalf if those fundraisers 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 whom 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.[92] 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.

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 of 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.

LEGAL BACKGROUND

While there are no specific federal or state laws prohibiting percentage-based compensation, federal law does prohibit charitable organizations from providing excessive compensation or economic benefit to executives and other individuals who have substantial influence over the organization's affairs, and to family members of such individuals.[93] For a more complete discussion of excess compensation rules, see principle #13.

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[92] The U.S.A. Patriot Act, P.L. 107-56, 15 U.C.S. §§ 1600 et seq., brought charitable solicitations by for-profit telemarketers within the scope of the Telemarketing Sales Rule, (2003) 16 C.F.R. §§ 310 et seq.

[93] IRC § 4941 and § 4946; § 4958(f).

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 at least once a year are provided 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.

LEGAL BACKGROUND:

A charitable organization is required to report on its annual IRS information return (Forms 990) the names and addresses of those who contributed the greater of $5,000 or 2% of the total contributions received by the organization in the tax year covered by the return. Federal tax laws specifically provides that tax-exempt organizations, other than private foundations or political organizations described in section 527 of the tax code, are not required to disclose the name and address of contributors to the public.[94] However, to the extent that donor information is included in a public charity's application for tax-exemption, or correspondence with the IRS during the application process, such information may be subject to public disclosure.

Some charitable organizations affiliated with governmental entities, such as supporting organizations affiliated with a public higher education institution, may be subject to state Open Public Records or Freedom of Information laws that require disclosure of records that include donor information. As a result of court decisions upholding such requirements, the state of Iowa recently passed legislation allowing state-affiliated university foundations to preserve the confidentiality of donors' personal financial information. The Iowa law also permits the state university foundation to uphold a donor's request to remain anonymous. Eight other states[95] have enacted laws protecting donor information from disclosure.

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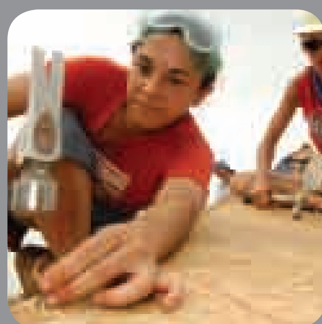
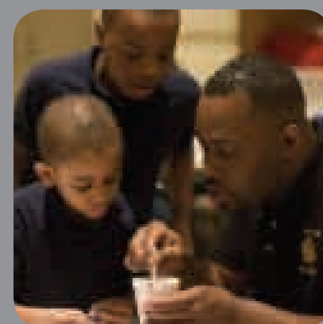
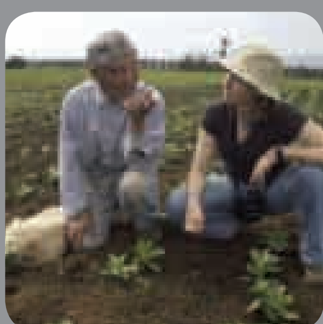
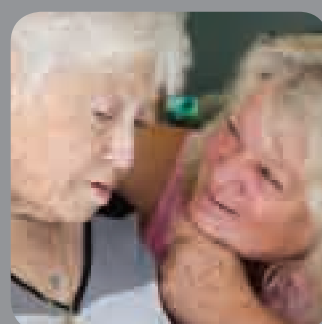
[94] IRC § 6104(d)(3)(A).

[95] Arizona, Colorado, Georgia, Florida, Louisiana, Minnesota, Nevada and New Jersey.

Appendix

Self-Regulation Systems Studied by The Panel on the Nonprofit Sector Advisory Committee on Self-Regulation

The Advisory Committee on Self-Regulation reviewed more than 50 standards or principles that address the conduct of charitable organizations or of individuals who provide services to the nonprofit community, as well as systems that apply to for-profit industries and professions. The systems are listed below, divided into three categories: those developed by accreditation bodies and professional associations in the United States; those developed by regulatory bodies outside the United States; and those that apply to for-profit organizations.

The descriptions are drawn from materials produced by the organization.

CHARITABLE REGULATORY SYSTEMS AND STANDARDS

American Association of Homes and Services for the Aging. *Quality First Covenant.* www.aahsaa.org

The American Association of Homes and Services for the Aging's 5,700 member organizations offer a continuum of aging services: adult day services, home health care, community services, senior housing, assisted living residences, continuing care retirement communities, and nursing homes. Its Quality First program was launched in 2002 in partnership with the Alliance for Quality Nursing Home Care and the American Health Care Association.

American Association of Museums. *Code of Ethics for Museums; AAM Accreditation Program.* www.aam-us.org

The American Association of Museums represents more than 15,000 individual museum professionals and volunteers, 3,000 institutions, and 300 corporate members. Its Code of Ethics for Museums lays out the ethical principles museums and museum professionals are expected to observe. AAM's Accreditation Commission, an independent body, is responsible for the administration of a separate accreditation program.

American Bar Association. *Standards: Rules of Procedures for Approval of Law Schools.* www.abanet.org

The Council of the ABA Section of Legal Education and Admissions to the Bar is the United States Department of Education's recognized accrediting agency for programs that lead to the first professional degree in law. The Council has established a process that is designed to provide a careful and comprehensive evaluation of each law school and its compliance with the Standards for Approval of Law Schools.

American Hospital Association. *Professional Standards of Conduct.* www.aha.org

The American Hospital Association represents and serves all types of hospitals, health care networks, and their patients and communities. Nearly 5,000 hospitals, health care systems, networks, other providers of care, as well as 37,000 individual members, come together to form the AHA. Its Professional Standards of Conduct are excerpted from Regulations for Certification Programs Conducted by the AHA Certification Center.

American Institute of Philanthropy. *Rating Guide and Watchdog Report.* www.charitywatch.org

The American Institute of Philanthropy is a nonprofit charity watchdog and information service. Created in 1992, AIP evaluates and assigns a grade to each of more than 500 organizations based on the percentage of its budget spent on its charitable purpose, its cost to raise $100, the years of available assets on hand, and whether it shared requested public documents.

ASAE and the Center for Association Leadership. *Standards of Conduct.* www.asaecenter.org

In 2004, the American Society of Association Executives, the Greater Washington Society of Association Executives, the ASAE Foundation, and The Center for Association Leadership joined together in two linked organizations known as ASAE & The Center for Association Leadership. ASAE (American Society of Association Executives) is a nonprofit membership organization representing more than 22,000 association CEOs, staff professionals, industry partners, and consultants. The Center, founded in 2001, provides learning and knowledge for association professionals. Their joint Standards of Conduct outline standards of association service and professional conduct which Certified Association Executives (CAEs) and their Association Chief Executive and Association Professional Staff members.

Association of Fundraising Professionals. *Code of Ethical Principles and Standards of Professional Pratice; The Accountable Nonprofit Organization; and The Donor Bill of Rights.* www.afpnet.org

The Association of Fundraising Professionals represents nearly 28,000 members in more than 190 chapters throughout the world. AFP members must agree to abide by its Code of Ethical Principles and Standards of Professional Practice and are subject to disciplinary sanctions for violations. AFP's board endorsed the statement of principles in The Accountable Nonprofit Organization developed by a think tank program of the Mandel Center for Nonprofit Organizations which was co-sponsored by the National Assembly of Voluntary Health and Social Welfare Organizations and the National Health Council. AFP created the Donor Bill of Rights with the American Association of Fund Raising Counsel (AAFRC), the Association for Healthcare Philanthropy (AHP), and the Council for Advancement and Support of Education (CASE). It has been endorsed by numerous organizations.

Association of Healthcare Philanthropy. S*tatement of Professional Standards and Conduct.* www.ahp.org

The Association for Healthcare Philanthropy is an international nonprofit professional organization representing fundraising professionals serving North America's health care systems. All members must comply with the Statement of Professional Standards and Conduct. AHP worked with the Association of Fundraising Professionals and other organizations in developing the Donor Bill of Rights.

BBB Wise Giving Alliance. *Standards for Charity Accountability.* www.give.org

The BBB Wise Giving Alliance was formed in 2001 through the merger of the National Charities Information Bureau and the Council of Better Business Bureaus' Foundation (which housed the Philanthropic Advisory Service). The Wise Giving Alliance reviews and reports on over 1700 national charities, based on its Standards for Charity Accountability.

CARF International. *Accreditation Standards.* www.carf.org

Founded in 1966 as the Commission on Accreditation of Rehabilitation Facilities, CARF International is an independent, nonprofit accreditor of providers of aging services; behavioral health; child and youth services; Durable Medical Equipment, Prosthetics, Orthotics and Supplies; employment and community services; and medical rehabilitation. The CARF family of organizations currently accredits more than 5,000 providers at nearly 18,000 locations in the United States, Canada, Western Europe, and South America.

Center for Nonprofit Excellence. *Certification program.* www.nonprofit-excellencepbc.org

The Center for Nonprofit Excellence was created by a coalition of public and private funders in Palm Beach County, Florida, to strengthen the administrative capacity of nonprofit agencies and promote best practices in nonprofit administration. Working with experts in the field, the funders created a uniform set of standards and a self-assessment program that charitable agencies must complete to receive funding from United Way, the county government, and other organizations.

Charities Review Council of Minnesota, Inc. *Standards of Accountability.* www.smartgivers.org

The Charities Review Council, established in 1946 as the Minnesota Community Research Council, is a nonprofit organization that reviews and reports on 285 nonprofit organizations based or operating in Minnesota. Its Accountability Wizard is an online tool that helps nonprofits conduct a self-assessment to determine whether they meet the Council's standards of accountability.

Charity Navigator. www.charitynavigator.org

Charity Navigator is a nonprofit charity watchdog and information service created in 2001. It evaluates over 5,000 charities based on their organizational efficiency and capacity, using financial ratios and performance categories in a number of areas, and then assigns an overall rating based on "how efficiently we believe a charity will use their support."

Combined Federal Campaign. *Requirements for participating charities.* www.opm.gov/cfc

The Combined Federal Campaign is the annual workplace giving program for federal employees, and for postal service and military personnel. Administered by the Office of Personnel Management, it includes more than 300 CFC campaigns throughout the country and internationally. Charities applying to receive funds through the CFC are required to submit to extensive review of their financial and governance practices.

Council for the Advancement and Support of Education. *Ethical Standards and Principles of Practice; and Principles of Practice for Fund-Raising Professionals at Educational Institutions.* www.case.org

The Council for Advancement and Support of Education is a nonprofit organization for advancement professionals of all levels who work in alumni relations, communications, and development. Its membership includes more than 3,300 colleges, universities, and independent elementary and secondary schools in 54 countries around the world, and more than 22,300 professional members. CASE worked with the Association of Fundraising Professionals and other organizations in developing the Donor Bill of Rights.

Council on Accreditation. *8th Edition Standards.* www.coastandards.org

COA is an international, independent, not-for-profit, child- and family-service, and behavioral healthcare accrediting organization. It was founded in 1977 by the Child Welfare League of America and Family Service America (now the Alliance for Children and Families). Originally known as an accrediting body for family and children's agencies, COA currently accredits 38 different service areas and over 60 types of programs. Its areas include substance abuse treatment, adult day care, services for the homeless, foster care, and inter-country adoption.

Council for Higher Education Accreditation. Recognition Standards. www.chea.org

The Council for Higher Education Accreditation (CHEA) is a private, nonprofit national organization that coordinates accreditation activity for higher education institutions and programs in the United States. It represents more than 3,000 degree-granting colleges and universities and recognizes 60 national, regional and specialized institutional and programmatic-accrediting organizations.

Council of American Survey Research Organizations. *Code of Standards and Ethics for Survey Research.* www.casro.org

The Council of American Survey Research Organizations represents over 300 companies and research operations in the United States and abroad. Its Code of Standards and Ethics for Survey Research sets forth agreed upon rules of ethical conduct for survey research organizations and acceptance of the code is mandatory for all members.

Council on Foundations. *Statement of Ethical Principles; National Standards for U.S. Community Foundations; Stewardship Principles and Effective*

Practices for Corporate Foundations; Stewardship Principles and Effective Practices for Family Foundations; and Stewardship Principles and Practices for Independent Foundations. www.cof.org

The Council on Foundations is a membership organization of more than 2,000 grantmaking foundations and giving programs worldwide. Its Statement of Ethical Principles defines the ethical expectations the Council has for its members and serves as the basis against which member conduct will be considered for purposes of its sanctions process. COF has also developed statements of principles and effective practices to guide the work of community, corporate, family, and independent foundations.

Donors Forum of Chicago. *Illinois Nonprofit Principles and Best Practices.* www.donorsforum.org

Established in 1972, the Donors Forum is a nonprofit membership and service organization that works to promote active relationships between grantmakers, nonprofits, and the community at large. It represents more than 200 grantmaking Members and Associate Members and 1,210 nonprofit Forum Partners.

Evangelical Council for Financial Accountability. *Seven Standards of Financial Stewardship.* www.ecfa.org

ECFA is an accreditation agency dedicated to helping Christian ministries earn the public's trust. Founded in 1979, it is comprised of over 2,000 evangelical Christian organizations that qualify for tax-exempt status and receive tax-deductible contributions. ECFA's Seven Standards of Responsible Stewardship focus on board governance, financial transparency, integrity in fundraising, and proper use of charity resources.

Giving Institute. *Standards of Membership; Standards of Practice; and Professional Code of Ethics.* www.givinginstitute.org

Giving Institute, formerly the American Association of Fundraising Counsel, is a nonprofit professional association representing 36 professional fundraising firms. It was founded in 1935 to promote the need for professional and ethical standards of practice, and to influence the creation of laws governing philanthropy. Member firms agree to abide by the Institute's Standards of Membership, Standards of Practice, and Professional Code of Ethics.

Independent Sector. *Statement of Values and Code of Ethics.* www.independentsector.org

Independent Sector is a nonprofit, nonpartisan coalition of over 600 charities, foundations, and corporate philanthropy programs, collectively representing tens of thousands of charitable groups in every state across the nation. Its Statement of Values and Code of Ethics for Nonprofit and Philanthropic Organizations is intended as a model for use by charities and foundations.

InterAction. *Private Voluntary Organization Standards.* www.interaction.org

InterAction is a membership association of U.S. voluntary organizations engaged in international humanitarian efforts. It requires its members to adhere to the principles of governance, volunteer involvement, support from the private sector, fundraising, service, and programs outlined in its PVO Standards.

Internal Revenue Service. *Good Governance Practices for 501(c)(3) Organizations.* www.irs.gov

The IRS has posted on its website a preliminary staff discussion draft of possible good governance practices for charitable organizations. The IRS says this "informal draft reflects various ideas that have been advanced by others both within and outside the exempt sector who have studied nonprofit governance. Because good governance practices may promote compliance with tax law, the IRS will continue to review recent self-regulation proposals advanced by others."

Joint Commission. J*oint Commission Requirements.* www.jointcommission.org

The Joint Commission (formerly the Joint Commission on Accreditation of Healthcare Organizations) evaluates and accredits nearly 15,000 health care organizations and programs in the United States. An independent, nonprofit organization, the Joint Commission's standards focus on improving the quality and safety of care provided by health care organizations. Its accreditation process evaluates an organization's compliance with these standards and other requirements.

Land Trust Alliance. *Land Trust Standards and Practices.* www.lta.org

The Land Trust Alliance represents more than 1,600 land trusts and is dedicated to promoting voluntary private land conservation to benefit communities and natural systems. Its Land Trust Accreditation Commission, an independent program, provides verification of land trusts' adherence to the Land Trust Standards and Practices.

Larned A. Waterman Iowa Nonprofit Resource Center and Iowa Governor's Nonprofit Task Force. *Iowa Principles and Practices for Charitable Nonprofit Excellence; Iowa Register of Accountability.* inrc.continuetolearn.uiowa.edu

The Larned A. Waterman Iowa Nonprofit Resource Center is an interdisciplinary collaboration of the University of Iowa that offers educational and service programs focused on strengthening the capacity of Iowa nonprofit organizations. The center worked with the Iowa Governor's Nonprofit Task Force and the Iowa Secretary of State to create the Iowa Principles and Practices for Charitable Nonprofit Excellence, which serves as the basis for the Iowa Register of Accountability.

Michigan Nonprofit Association. *Principles and Practices for Nonprofit Excellence in Michigan.* www.mnaonline.org

The Michigan Nonprofit Association is a statewide professional trade organization with more than 1000 members who represent every part of the state. Its Principles and Practices for Nonprofit Excellence in Michigan is designed as a support mechanism for nonprofit management and governance, providing a framework for nonprofit self-assessment and planning.

Middle States Commission on Higher Education. *Standards for Accreditation.* www.msche.org

The Middle States Commission on Higher Education is the unit of the Middle States Association of Colleges and Schools that accredits degree-granting colleges and universities in Delaware, the District of Columbia, Maryland, New Jersey, New York, Pennsylvania, Puerto Rico, the U.S. Virgin Islands, as well as in several locations internationally.

Minnesota Council of Nonprofits. *Principles and Practices for Nonprofit Excellence.* www.mncn.org

The Minnesota Council of Nonprofits (MCN) is a membership organization of more than 1,850 nonprofit organizations in the state. Its statement of accountability principles and management practices was first developed in 1994 and has been revised to reflect new management and program issues. MCN's Principles have been widely used as an educational tool for nonprofits operating in Minnesota, and many other statewide associations have used the Principles to develop appropriate guidelines for nonprofits in their states.

National Association of Independent Schools. *Principles of Good Practice.* www.nais.org

The National Association of Independent Schools is a nonprofit membership organization representing approximately 1,300 independent schools and associations in the United States, and affiliates with independent schools abroad as well. NAIS has adopted its Principles of Good Practice for its own operations and encourages independent schools to adopt them as guiding principles.

National Catholic Development Conference. *Code of Stewardship and Ethics; Guide to Preparing a Statement of Accountability.* www.ncdc.org

The National Catholic Development Conference is the largest association of religious philanthropies in the United States and "affirms the mission of each of its members by working for and with them as fundraisers." NCDC members commit to the Code of Stewardship and Ethics each year.

National Center for Family Philanthropy. *Values and Guiding Principles.* www.ncfp.org

The National Center for Family Philanthropy is a nonprofit membership organization that works to promote philanthropic values, vision, and excellence across generations of donors and donor families.

National Health Council. *Standards of Excellence: Good Operating Practices for Voluntary Health Agencies.* www.nationalhealthcouncil.org

The National Health Council's 115 member organizations include voluntary health agencies, professional and membership associations, nonprofit organizations with an interest in health, and health care businesses. Its voluntary health agency members must comply with all of the Standards to remain in good standing.

New England Association of Schools and Colleges. *Standards for Accreditation.* www.neasc.org

Founded in 1885, the New England Association of Schools and Colleges, Inc. establishes and maintains standards for education from pre-K to the doctoral level. NEASC serves more than 2,000 public and independent schools, colleges and universities in the states of Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont, and American/international schools in more than seventy nations.

North Central Association Commission on Accreditation and School Improvement. *AdvencEd Accreditation Standards for Quality Schools.* www.ncacasi.org

Founded in 1895, the North Central Association Commission on Accreditation and School Improvement is a non-governmental, voluntary organization that accredits 8,500 public and private schools and districts. One of six regional accrediting organizations in the United States, NCA CASI accredits schools and districts in 19 states, the Navajo Nation, and the Department of Defense Dependents' Schools worldwide. In 2006, NCA CASI, Southern Association of Colleges and Schools Council on Accreditation and School Improvement (SACS CASI), and National Study of School Evaluation (NSSE) formed one unified organization, known as AdvancED, dedicated to advancing excellence in education through accreditation, research, and professional services. AdvancED represents 23,000 public and private schools and districts in 30 states and 65 countries and serving close to 15 million students.

Standards for Excellence Institute. *Standards for Excellence: An Ethics and Accountability Code for the Nonprofit Sector.* www.standardsforexcellenceinstitute.org

The Standards for Excellence Institute is an operating division of Maryland Association of Nonprofit Organizations. Its Standards for Excellence program is "a comprehensive system of nonprofit sector self-regulation [designed] to strengthen the ability of nonprofit organizations to act ethically and accountably in their management and governance, while enhancing the public's trust in the nonprofit sector." The Institute currently has a national replication partner, the National Leadership Roundtable on Church Management; local replication partners in Colorado, Idaho, Louisiana, Maryland, Ohio, Oklahoma, Pennsylvania, and West Virginia; and licensed consultants in 13 jurisdictions.

United Way of America. *United Way Standards of Excellence.* unitedway.org

The United Way of America first introduced its standards of excellence in 1973, and issued a substantially revised edition in 2005. The standards are designed as "aspirational benchmarks [to] enhance the effectiveness of the 1,350 United Way affiliates."

Western Association of Schools and Colleges. *WASC Criteria.* www.acswasc.org

The Western Association of Schools and Colleges is one of six regional accrediting associations in the United States. It provides assistance to schools located in California, Hawaii, Guam, the Commonwealth of the Northern Marianas, American Samoa, the Federated States of Micronesia, the Republic of the Marshall Islands, Fiji, and East Asia. Its board of directors is composed of representatives from the Accrediting Commission for Senior Colleges and Universities; the Accrediting Commission for Community and Junior Colleges; and the Accrediting Commission for Schools.

YMCA of the USA. *National Committee on Membership Standards: Policies and Procedures Manual.* www.ymcaexchange.org

The membership standards outline the specific qualifications that the 2,663 YMCA organizations must meet to be recognized by the board of the YMCA of the USA. The standards are set and administered through the National Committee on Membership Standards whose charge is to "support, inspire and hold YMCAs responsible and accountable for achieving the highest standards of quality in fulfilling the YMCA mission, the YMCA National Constitution, and not-for-profit performance."

INTERNATIONAL CHARITABLE REGULATORY BODIES AND STANDARDS

Australian Council for International Development. *Code of Conduct.* www.acfid.asn.au

The Australian Council for International Development is an independent national association of Australian non-government organizations working in the field of international aid and development. The ACFID Code of Conduct is a voluntary, self-regulatory industry Code, but NGOs wishing to attain Australian Agency for International Development (AusAID) accreditation are required to formally adopt and become a signatory to, as well as demonstrate compliance with, the ACFID Code of Conduct.

Imagine Canada. *Ethical Fundraising and Financial Accountability Code.* www.imaginecanada.ca

Imagine Canada was formed through a union of the Canadian Centre for Philanthropy (CCP), and the Coalition of National Voluntary Organizations (NVO). It is a national registered charity that "looks into and out for Canada's charities and nonprofits." Agencies that adhere to its Ethical Code are entitled to use Imagine Canada's trustmark indicating their compliance with its fundraising and financial accountability standards.

European Foundation Center. *Principles of Good Practice.* www.efc.be

The European Foundation Centre is an international association of over 200 foundations and corporate funders "dedicated to creating an enabling legal and fiscal environment for foundations, documenting the foundation landscape, strengthening the infrastructure of the sector, and promoting collaboration, both among foundations and between foundations and other actors, to advance the public good in Europe and beyond." EFC members must subscribe to the EFC Principles of Good Practice

International Committee on Fundraising Organizations. *ICFO International Standards.* www.icfo.de

The International Committee on Fundraising Organizations is an association of national bodies that accredit charitable organizations and fundraising activities. Its International Standards apply to international private, nonprofit organizations that directly, or indirectly through subsidiary bodies, raise funds from the public for charitable or public benefit purposes.

International Non-Governmental Organisations Accountability Charter. www.ingoaccountabilitycharter.org

The International Non-Governmental Organisations Accountability Charter was developed as a result of conversations at a 2003 International Advocacy Non-Governmental Organisations Workshop. The Accountability Charter is owned by its founding signatories, a group of 11 international NGOs.

United Kingdom Charity Commission. www.charity-commission.gov.uk

The Charity Commission, created by the Charities Act 2006, is the independent regulator of charities in England and Wales. The Commission is charged with registering, regulating, and educating charitable organizations to improve their effectiveness and increase public confidence in their work.

BUSINESS STANDARDS AND REGULATORY SYSTEMS

American Board of Medical Specialties. *Certification Program and Maintenance of Certification of Medical Specialties.* www.abms.org

The American Board of Medical Specialties, a nonprofit organization, assists 24 approved medical specialty boards in the development and use of standards in the evaluation and certification of physicians.

Business Roundtable. *Principles of Corporate Governance.* www.businessroundtable.org

The Business Roundtable is an association of chief executive officers of leading U.S. companies with $4.5 trillion in annual revenues and more than 10 million employees. Its Principles of Corporate Governance, first issued in 2002 and updated in 2005, are designed "to assist corporate management and boards of directors in their individual efforts to implement best practices of corporate governance, as well as to serve as guideposts for the public dialogue on evolving governance standards."

Council of Institutional Investors. *Corporate Governance Policies.* www.cii.org

The Council of Institutional Investors is a not-for-profit association of 130 public, labor, and corporate pension funds with assets exceeding $3 trillion. Its Corporate Governance Policies set standards or recommend practices that its members believe companies and boards of directors should adopt "to promote accountability, independence, integrity, rigor and transparency."

National Association of Securities Dealers. *Rules and Regulations.* www.finra.org

The National Association of Securities Dealers merged in July 2007 with the member regulation, enforcement, and arbitration functions of the New York Stock Exchange to create a new organization, The Financial Industry Regulatory Authority (FINRA). FINRA is the largest non-governmental regulator, overseeing nearly 5,100 brokerage firms, 173,000 branch offices, and more than 669,000 registered securities representatives doing business with the United States public.

New York State Bar Association. *New York Lawyers' Code of Professional Responsibility.* www.nysba.org

The New York State Bar Association is the oldest and largest voluntary state bar association in the nation and is a separate entity from the licensing body, the New York State of Court Administration.

Public Company Accounting Oversight Board. *Standards and Related Rules.* www.pcaobus.org

The Public Company Accounting Oversight Board is a private, nonprofit corporation created by the Sarbanes-Oxley Act of 2002 to "oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports."

State Bar of California. *Rules of Professional Conduct.* www.calbar.ca.gov

The California State Bar is a public corporation within the judicial branch of government, serving as an arm of the California Supreme Court. Membership in the State Bar affords attorneys the right and privilege of practicing law in California.

Self-Regulation in the Nonprofit Sector: A Portrait of Current Issues in the Field

Conducted for the Panel on the Nonprofit Sector by the FDR Group

INTRODUCTION

The nation's charitable institutions would not flourish if they lost the trust of the public—and sound practices concerning governance and accountability play a critical role in keeping that trust. The Panel on the Nonprofit Sector is interested in fostering self-regulation by encouraging discussion; disseminating meaningful and practical information to guide best practices and principles; and creating a platform for ongoing dialogue within the charitable sector. To help in these efforts, the Panel asked the FDR Group to conduct case study research with standards-setting entities and others knowledgeable about self-regulation in the nonprofit sector.

What follows are the results of the FDR Group's research and analysis. The goals of the study are to:

- Portray the current state of self-regulation within the sector—the core issues, the debates, and the struggles;
- Provide real-life examples and anecdotes from the leading practitioners of self-regulation, gleaning their insights and lessons learned;
- Present practitioners' sense of whether self-regulation efforts are working—whether they improve the practices and behaviors of charitable organizations; and
- Capture perceptions of approaches that work, that don't work, and why.

The Issues

The study explores the pros and cons of various business models and systems of measurement, the "must-have" components of a successful standards-setting program, and the incentives that individual nonprofits have for taking part in self-regulation. The study also delves into some of the more challenging and polarizing issues facing the sector: whether to measure program outcomes and effectiveness; the degree to which current standards are duplicative or in conflict; and whether "one size fits all" in terms of establishing high standards and best practices for the sector at large as well as for specific sub-sectors.

We also include practical advice from practitioners—some do's and don'ts about launching successful self-regulation initiatives—and suggestions for improving self-regulation within the sector. Finally, we present a discussion of the unique needs of smaller organizations.

Research Approach

The study is based on 23 in-depth interviews conducted with professionals who have direct, firsthand knowledge and experience with self-regulation in the not-for-profit sector. They worked in sector-wide standards-setting groups (3 organizations), sub-sector standards-setting groups (4 organizations), small organizations that participate in either sector-wide or sub-sector self-regulation (4 organizations), one organization that administers government-affiliated accreditation, one trade association that serves a for-profit community, and one public charity that works on education issues. A detailed methodology can be found at the end of this document.

This report does not cover every self-regulating entity within the nonprofit sector, but it does include several paradigms. For example, both voluntary and mandatory accreditation approaches are discussed. Sector-wide models and sector-specific models of self-regulation are compared. A variety of systems of measurement are included—accreditation, best practices, codes of ethics, seals of approval, and ratings. Each approach has its own strengths and weaknesses. We do not judge which is best or worst, but instead offer the discussion and insights of our interviewees about the various options.

One of the benefits of the case study methodology is that it allows one to pick units of analysis that illustrate common tendencies and to pick others that are unique but instructive. We have made no effort to categorize self-regulatory organizations but instead look at each as a distinct entity with important information and lessons to offer. We have included an appendix with web site addresses and other basic information for those interested in learning more about the attributes and practices that each organization offers.

Questions for Further Discussion

This research was framed by broad, far-reaching questions, and it is thus not surprising that it raises even more questions and sometimes suggests that even more research is needed. But the study will serve its purpose if it plays the role of a conversation starter, and if it focuses attention on the issues the nonprofit field *writ large* must struggle with, engage, and debate. These include:

Needs of the Sector—Is there room for additional self-regulatory and standards-setting organizations, or is the market flooded? If there is a need, should they be broad-based and national in scope, or would it be more useful to rely on sub-sector or statewide entities?

Coverage—Are the right number of not-for-profits participating in self-regulation? Is it necessary for each and every charitable organization to be accredited, or should the sector concentrate on where most of the money goes?

Measuring Effectiveness—Can effectiveness be fairly assessed? How can outcomes that are positive yet intangible be measured? How is the effectiveness of an accreditation program affected if such things as content, programs, and outcomes are not included?

Sub-sector Specific—To what extent do sub-sector regulatory organizations (both government-affiliated and not) address such things as governance, management, transparency, or other ethical considerations, the kinds of issues that are drawing media and political attention to the sector today? To what extent is there competition among accrediting agencies within a given sub-sector?

Conflicting Standards—Just how widespread is the problem of conflicting standards? Are there specific sub-sectors where it's more prevalent than others? Is it mainly a result of differences between mandatory and voluntary options? Do views differ between the regulators and the regulated?

Legally Mandated Accreditation—What are the unique challenges faced by sub-sectors that are regulated by force of law, for example, education, health care, and human services?

Acknowledgements

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What follows is a rendering of the 10 key issues that emerged from the interviews, a discussion of implications for the charitable sector, the research methodology, and descriptions of each of the standards-setting organizations that took part in the study.

ISSUE NO. 1
Self-Regulation within the Charitable Sector

The charitable sector has a long tradition of self-regulation. Research suggests that the average standards-setting organization has been doing this kind of work as early as the 1950s.[1] Although there are no conclusive statistics on the precise number of not-for-profits taking part in self-regulation, a recent study by the Johns Hopkins Center for Civil Society Studies reported that almost 2 out of 3 organizations responding to a survey took

[1] Woods Bowman, "Accountability Through Self-Regulation in the Nonprofit Sector—A Preliminary Report," December 2001 (unpublished).

part in some sort of accreditation program or followed a recognized list of best practices.[2]

Accreditation programs and standards-based initiatives in the nonprofit sector tend to stem from three sources: independent umbrella organizations that represent a particular sub-sector; government-affiliated organizations that administer accreditation or certification for a relevant government agency; and sector-wide standards-setting organizations. Others include: national membership-type organizations that set internal standards for its affiliates (for example, the YMCA); government agencies; and institutional funding sources such as United Way.

The most commonly used sources of self-regulation in the nonprofit sector are independent umbrella organizations that establish standards or offer accreditation for a particular segment of the nonprofit community. Examples in the current research include the Land Trust Alliance and the American Association of Museums; there are hundreds of others in operation. For the most part, these kinds of accrediting agencies are voluntary in nature and tend to concern themselves with standards related to program operations and outcomes.

The second type of accrediting body is government-affiliated; these are organizations that administer the accreditation process for relevant government agencies. Many sub-sectors of the nonprofit community are required by either state or federal mandate to be accredited in order to provide services to the public. Health care, human services, and education are sub-sectors that fall into this category. Colleges and other educational institutions, for instance, must be accredited by their regional accrediting commission in order to receive federal funding. Hospitals must be accredited by a sanctioned regulatory body to qualify as recipients of Medicaid or Medicare. Most human services organizations fall under this rubric as well; the Council on Accreditation, for example, is authorized by law to accredit several family and children's services, including inter-country adoption, credit counseling, and substance abuse treatment, among other things.[3]

The third type of nonprofit accrediting or standards-setting entity is sector-wide in scope; these organizations establish standards and best practices that are applicable to virtually all nonprofits regardless of the services they provide or type of work they do. For the most part they concern themselves with issues of governance and financial management rather than program and operational matters. Individual not-for-profits choose whether or not to seek this type of self-regulation; it is purely voluntary. Examples in the current research are the Better Business Bureau's Wise Giving Alliance and the Standards for Excellence.

It makes sense that a sector as diverse as the charitable one would have a wide array of types of self-regulatory agencies. One of the strengths of the sector is its vast diversity, but this also poses challenges and new questions. Is it necessary to have so many different kinds of self-regulatory organizations? Would the sector benefit from a single standards-setting body to ensure that all nonprofits reach a certain standard of quality and efficiency in agreed-upon areas? Could an existing entity fulfill this task, or is there a need for a brand new one?

Another important question that emerges from the analysis is this: To what extent do sub-sector regulatory organizations (both government-affiliated and not) address such things as governance, board and financial management, transparency, or other ethical considerations—the kinds of issues that are drawing media and political attention to the sector today? Further research is needed to learn the extent to which governance is being addressed at the sub-sector level. In the meantime, anecdotal evidence suggests that some sub-sector regulatory organizations are starting to take note of it.

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[2] The survey was based on a sample of nonprofits in five sub-sectors (children and family services, elderly housing and services, community and economic development, theaters, and museums). Because of small sample size, self-selection, and under-representation of other significant sub-sectors, these findings are not reflective of the nonprofit sector in its entirety. For full report see: Lester M. Salamon and Stephanie L. Gellar, "Nonprofit Governance and Accountability" Communique No. 4. Baltimore: The Johns Hopkins Center for Civil Society Studies, October 2005.

[3] The Council on Accreditation accredits 38 different service areas and over 60 types of programs. The ones mentioned above are legally mandated, but others are voluntary.

For example, the Commission on Accreditation of Residential Facilities (CARF), a nonprofit accrediting body that accredits thousands of nonprofit programs and organizations in the human services field, recently added a criterion on organizational oversight by governing boards to each of its accreditation areas.[4] Application of the governance criterion is voluntary, but if the individual nonprofit chooses it, the assessment of its performance will be reflected in the accreditation decision. Another example is the American Association of Homes and Services for the Aging. AAHSA has established a collaborative relationship with BoardSource whereby its members receive a 50 percent discount off BoardSource membership, thus giving them access to practical information, best practices, and training on governance issues.

ISSUE NO. 2
Consensus Areas

This research captured some compelling areas of consensus. Research participants shared their thoughts on the necessary components of a self-regulatory effort and also some practical advice for achieving success.

Necessary Components of Self-Regulation

- *Resources to help members.* Our interviewees believed that the goal of any effective standards-setting organization is not only to set the standards but also to help current and prospective members meet them. All manner of resources should be made available to help members implement standards and maintain compliance. These can include things like printed materials, self-assessments (both Web-based and not), and workshops that explain the various standards and guidelines for implementing them. None of the organizations participating in this research were in the business of "gotcha"—that is, taking joy in finding violators whose membership or accreditation can be revoked. Virtually all spoke about the importance of serving as an active resource to members.
- *Consequences for noncompliance.* Self-regulation cannot be effective without sanctions. As Prof. Harvey Dale outlined in his report to the Panel, there are two types of sanctions: 1) those with legal enforceability, imposed by the legal authority of the regulatory body or some other entity, and 2) those that are more informal and not enforced by law. These include things such as fines, loss of membership, and public censure; most organizations included in this research rely almost exclusively on informal sanctions.
- *Standard operating procedures for handling complaints about members.* To be effective, a self-regulating entity must have a formal process in place for investigating situations where standards, codes of ethics, or other requirements of membership have been violated. The rules and the process for dealing with them should be known to all members. It is through precise and consistent adherence to this process that the self-regulating entity demonstrates that violations are taken seriously and will be investigated in a fair and consistent manner.
- *Accessible, easy-to-use information.* It is in the best interest of all to write standards, codes, and other information pertinent to self-regulation in plain-speaking language and to avoid legalese. Information should be easily accessible to members both in print and via Web site. The system of measurement should be fair and consistent, and should be developed with input from those who will be measured against it.
- *Effective Web Site.* An effective web site has become an indispensable tool for disseminating information to the public at large as well as to membership. Virtually all of the organizations included in this research have capitalized on web technology; some, such as Charity Navigator and the Wise Giving Alliance, rely on their web sites for virtually all aspects of collecting and disseminating information.

Practical Advice from the Research Participants

- Don't rush the planning process. Take time to consider all of the possible approaches to self-regulation to see which fits best for your sub-sector's particular needs.

[4] 2006 Employment and Community Services Standards Manual, CARF International.

- Make a concerted effort to engage your constituency. You will need buy-in from the field in order to move forward effectively. The Land Trust Alliance's recent effort to both inform its members about the need for self-regulation and to gather information about their interest in an accrediting program offers an excellent example of an effective engagement effort.
- Be prepared for resistance from the field. Resistance can be driven by many factors—suspicion about your motives; doubt about the need for (more) oversight; concerns about the burdens of paperwork; fears that the standards are unreachable or impractical; and worries about costs, to name but a few.
- There must be a belief that the playing field is level and that the same rules apply to all. This means standards should be devised with attention to the natural tension that exists between standards that are achievable and standards that are meaningful. Any exceptions to the rules detract from the integrity of the standards.
- Requiring adherence to standards, while failing to provide ample resources for explaining them and for helping members meet them, is "a recipe for disaster," according to one research participant.
- Don't look at accreditation per se as the highest level or the ultimate to strive for—it works for some sectors better than others. It's just one of many options (e.g., licensure, best practices, seal of approval, requirement of membership, commitment to a code). One size doesn't fit all—"maturity, mission, capacity, size, needs, and aspirations of the people the organization serves—all of these things need to be taken into account," as stated by one interviewee.
- Adopt a quality improvement mentality and always make it a point to measure outcomes. In the end, several interviewees indicated, this goes hand in hand with good governance and financial accountability as well.

ISSUE NO. 3
What Individual Charitable Organizations Gain from Self-Regulation

The people we interviewed spoke about the many positive benefits that individual nonprofits get for participating in self-regulation. Having the right to display a seal of approval—some sign that illustrates in a public way that your organization is among the best or that it reaches high standards—lends reassurance, prestige, and a competitive edge in fundraising pitches and other types of development work. This is one of the more obvious benefits that self-regulation provides.

Other benefits accrue to individual charitable organizations for pursuing effective self-regulation. It's safe to say that, for most nonprofits, it takes significant effort to establish themselves as exemplary stewards of the public's trust and money, and many—especially the smaller organizations—have to do this with extremely limited resources. So having a shared goal to work towards is good for staff morale. Several of the people interviewed for this research shared anecdotes about staff rallying around a new set of standards or principles. A shared commitment to explicit standards of governance and quality services can help and energize them.

Another result of following a system of standards can be actual improvement in governance, management, and organizational practices. Going through the process of self-evaluation—an important component of many accrediting programs—forces an organization to take a concerted look at its business practices, identify problem areas, and make changes as needed.

ISSUE NO. 4
Voluntary and "Involuntary" Approaches to Self-Regulation—and the Accompanying Sanctions

A key component of self-regulation is to be able to identify and discipline those who behave inappropriately or who betray the public trust. Prof. Harvey Dale's *Study on Models of Self-Regulation in the Nonprofit Sector* defines self-regulation as "situations in which one organization (other than a government) sets standards for, oversees, accredits, or regulates other organizations." It talks about the factors that influence the effectiveness of various models of self-regulation, and points to legally enforceable sanctions as the "single most significant factor."

Legally Mandated Self-Regulation

Not-for-profits in sub-sectors that require accreditation as a result of state or federal mandate are more likely to be heavily and effectively regulated. The findings from the Center for Civil Society Studies validate this point of view. For instance, the survey found that approximately 9 out of 10 organizations dealing with children and family services or elderly housing and services were accredited, compared with just 4 out of 10 community development organizations.

As stated previously, it is mainly the sub-sectors of education, health care, and human services that fall into the force-of-law category. For these kinds of organizations, accreditation is often "involuntary"—without it, they would lose their ability to provide services or conduct their line of business. One of our research participants offered a useful illustration about the "involuntary" nature of some types of "voluntary" self-regulation: a lawyer, for example, may choose to join a state bar association or not, but without its imprimatur the lawyer cannot practice law in that state. This same principle could apply to a hospital, or a nursing home, or a college—any institution that relies on federal government money in order to function. If not adhering to a rule or standard deprives an entity of the ability to conduct business, just how voluntary is it?

Voluntary Self-Regulation

But for many types of self-regulation in the nonprofit sector, participation on the part of individual not-for-profits is purely voluntary—and thus any potential disciplinary measures or sanctions for violations are more informal. According to the research participants (and validated in Prof. Dale's study), informal methods of enforcement can be extremely effective. As one research participant described, "We don't have to enforce it…. My observation is that the press, public policy makers, and legal authorities enforce them for us. And certainly the public pressure brought by media coverage of the behavior of an organization is enormously powerful in forcing an entity to comply—take the Red Cross as an example."

Several interviewees expressed concern about the effectiveness of voluntary self-regulation. If participation is purely voluntary, their line of reasoning went, then bad actors and others who don't meet the standards for one reason or another simply won't take part. Seals of approval or certificates of excellence may be an effective way to spotlight exemplary nonprofits—and perhaps they even reflect positively on the sector as a whole. But they do nothing to weed out truly bad actors. Effective regulation, according to this line of thinking, requires mandatory participation.

Others took the view that voluntary self-regulation is appropriate and effective, because self-regulation is about commitment to high standards and continual quality improvement. As they saw it, the best nonprofits will choose to pursue standards and best practices—and not only will they benefit from doing so, but others in the sector will follow their lead, thus improving the entire sector. The American Association of Museums, for instance, purposely offers *voluntary* accreditation to its members because it believes that an organization should choose to seek "the challenge of excellence" rather than be forced to comply. Besides, according to several of the participants who held this point of view, it should be the job of the IRS, not of the sector, to seek out and punish nonprofits that willingly take part in deceptive and fraudulent behavior.

ISSUE NO. 5
How to Measure, Whether to Judge

The Stamp of Approval

The most visible item any self-regulatory entity offers is its public symbol of approval, and organizations use different symbols to that end. The Council on Accreditation offers a certificate of accreditation, the Wise Giving Alliance and ECFA use a seal, Charity Navigator uses a star rating. Many self-regulatory entities signal their endorsement by permitting member organizations to use their logo in publications.

Some self-regulatory agencies view donors or consumers as their main constituency (e.g., Charity Navigator); others focus on the not-for-profit itself as the primary unit of concern (e.g., Standards for Excellence); and for several the focus is on a combination of both consumers/clients and organizations (e.g., Council on Accreditation).

Individual not-for-profits, for their part, often seek a seal of approval to strengthen their credibility in the public's eye and to differentiate themselves for fundraising purposes.

But many research participants acknowledged that the general public, to a large degree, has little familiarity with charity ratings and seals, where to look for them, or what it means if an organization has one or not. There was some recognition that a significant amount of work needs to be done to inform the public about the value of self-regulation. Some talked about the seal or rating as providing a useful opening with which to approach potential donors—a conversation starter, something they can use to call attention to their own commitment to excellence and the recognition they have received among their peers for a job well done.

Emphasis on Positive Reinforcement

Behind the symbols and the ratings are different approaches and assumptions, but the sector seems strongly biased toward the carrot, focusing on reward for positive behavior and shying away from overt public criticism. Even in situations when there is cause for sanction, many self-regulatory organizations handle it quietly, without a lot of fanfare. Some train the spotlight on excellent organizations, in effect saying to the sector: "Here is a role model to aspire to." The assumption, again, is that promulgating good practices and rewarding effective organizations will lead to emulation by a well-intentioned sector. After all, the government is there to handle the illegal behavior.

Charity Navigator is an exception. It will publicly and provocatively say, "Give to this charity, don't give to that one," and this partly explains its seeming unpopularity in the nonprofit community. People object to what they see as the unfair comparisons, the lack of subtlety, and the detrimental consequences of receiving a low rating. But it is perhaps no coincidence that in a polarized media environment, the most provocative self-regulating organization garners a lot of attention (which in turn triggers more objections to it).

Relying on the Honor System

Reliance on the honor system is also prevalent. Here, the self-regulating body reviews an applicant and requires the organization to sign a code of ethics or covenant that commits it to following the standards. An example is the American Association of Homes and Services for the Aging, which strongly recommends that its members sign its Quality First Covenant. Organizations that sign on commit to a set of principles and policies and then are expected to do self-assessment and self-monitoring. When asked about the gentle nature of this program—it is purely voluntary; it is self-administered—AAHSA explained that most of its member organizations already functioned within an extensive regulatory environment. Given the amount of paperwork they must deal with, it would have been an excessive and unreasonable burden to require more.

The honor system approach is also used by for-profit organizations. For instance, the Council of American Survey Research Organizations, a trade association that participated in this case study research, requires member organizations to annually sign off on its *Code of Standards and Ethics for Survey Research* and then trusts member organizations to adhere to it. CASRO itself is a not-for-profit organization, but its membership consists of for-profit companies. CASRO places a considerable amount of resources and attention to the application process; its philosophy is that it's better to identify organizations that show signs of not being capable of meeting the requirements of the code before they become members.

Measuring Program Outcomes and Effectiveness

Beyond governance standards and their ways of being measured, there is considerable thinking and struggling in the sector about how—and even whether—to measure program outcomes and effectiveness. The people we talked with would often broach this subject, and the inherent difficulties and enormous complexities were obvious. Can effectiveness be fairly assessed? How can outcomes that are positive yet intangible be measured? How can you make comparisons across sub-sectors or even within them? And then the counter-arguments: Just because we can't measure everything doesn't mean we shouldn't measure what we can. Similarly, just because something can be counted (e.g., number of clients served) doesn't mean a program has been effective (e.g., that clients got the help they needed). As one research participant said, "It's too easy just to count."

These are important questions and concerns, and it will take further research to address them sufficiently. In the meantime, the current research does offer some useful illustrations, particularly among the sub-sector accrediting bodies. Take the Council on Accreditation, for example. To be accredited by COA, a not-for-profit must be able to show that its programs are mission driven and that they are actually making a difference. While each not-for-profit should have some flexibility in determining how to best implement programs and measure outcomes, the fact that outcomes must be measurable is nonnegotiable. COA's process includes a lengthy application, peer review, site visits, accreditation, and renewal. In addition to being an accrediting body, COA also serves as a resource, providing assistance and information to its members to encourage "continuing performance improvement."

Sector-wide standards-setting bodies, such as the Wise Giving Alliance, Charity Navigator, and Standards for Excellence, do not establish specific outcomes measures for their members. Both the Wise Giving Alliance and Standards for Excellence do, however, include a standard or principle in their literature that addresses the importance of measuring whether a nonprofit is actually fulfilling its stated mission.

ISSUE NO. 6
Conflicting Standards

In the survey of nonprofit organizations conducted for the Center for Civil Society Studies, the findings showed that most organizations that participated in some type of formal self-regulation were involved in more than one program. Although the survey included only a limited number of types of nonprofits and thus is not representative of the entire sector, this finding does raise an important question. To what degree are nonprofits having a problem with duplicative or conflicting standards? Just how prevalent or troublesome is this concern?

Sector-Wide Standards, Voluntary in Nature

When it comes to broad, sector-wide standards-setting bodies, there was general consensus that currently available standards relating to governance, transparency, and accountability were mostly complementary and mutually supportive. Standards-setting organizations may differ in the number of standards or in emphasis, but, according to research participants, there was no sense of confusion or serious contradiction. As one of our interviewees said: If a group of leaders in the nonprofit sector sat around a big table in a room and closed the door, they could hammer out a list of "universal" standards—elements that the vast majority could agree upon for suitable governance and oversight of all quality nonprofits.

Concerns about conflicting standards at the sector-wide level, where they do exist, were likely to stem from differences in organizational goals. For example, Standards for Excellence certification is designed to highlight the superior operations of the most well-managed and responsibly-governed nonprofits. Its standards are set at a high level and are many in number (55, to be exact). On the other hand, the Wise Giving Alliance's standards were mainly developed to help individual donors make giving decisions and to encourage charitable giving. It's possible that a nonprofit organization could meet the governance standards of the Wise Giving Alliance and earn its seal but still not achieve certification from the Standards for Excellence Institute. This is simply a difference in emphasis as opposed to a substantive conflict in the respective standards.

One perceived problem that came up several times in the interviews revolved around conflicting benchmarks for the amount of money a nonprofit should have in the bank.[5] Here is a case

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[5] Woods Bowman and Angela Bies also address this issue in their article "Can the Charitable Sector Regulate Itself?" in T*he NonProfit Quarterly, Special Issue: Regulatory Landscape 2005*.

where exemplary practice according to one group's standards was considered poor business practice according to another's. The most-oft heard complaint was that a 4* rating from Charity Navigator, for example, would inevitably mean failure in meeting the financial requirements of other ratings organizations, for instance, ECFA. Further research is needed to determine how widespread this concern is and whether or not it actually has an impact on the financial reporting decisions of individual not-for-profits.

Sub-Sector Standards, Voluntary vs. Mandatory

The issue is more complicated, however, when it comes to those nonprofits in sub-sectors or specific fields that are required by legal statute to be accredited. For these not-for-profits, any standards or paperwork *required* by the state or other governing body would obviously take precedence over any *voluntary* standards set by another entity. Further research will be necessary to determine the extent to which this is an actual vs. a theoretical problem and the degree to which it may affect some sub-sectors more than others.

There was some anecdotal evidence from this research that potential exists for voluntary and required standards to work in tandem. The American Association of Homes and Services for the Aging was a case in point. Aware that the vast majority of its members were already subject to mandatory accreditation by a third party, AAHSA purposefully devised its standards to be voluntary and to focus on quality of care rather than regulation. Anecdotal reports from AAHSA members suggest that committing to Quality First—AAHSA's voluntary self-regulation program—not only improved the quality of care and services in their individual agencies, but it also helped them achieve (mandatory) statewide accreditation.

It is possible, though unlikely, to have a disparity between the standards of a sub-sector's national accrediting body and the standards of particular fields within that sub-sector, for example, between the American Association of Museums and the Council of American Maritime Museums. Still, not one research participant shared an anecdote to this effect.

Gap between the Regulators and the Regulated

To a large extent, this research focuses mainly on the perspectives of the standards-setting bodies themselves, with less attention paid to the individual not-for-profits that actually follow a standards program, seek a seal of approval, or are subject to mandatory accreditation. The question thus becomes: To what extent is there a gap between the regulators and those being regulated? Based on this research, many regulators don't seem to think that conflicting standards are a problem. Maryland Nonprofits, for example, reports having several current members that are standards-setting bodies within their own sub-sectors, with no reported conflict. But what do those being regulated have to say? Further research is necessary, with a special emphasis on member organizations that participate in both mandatory and voluntary regulation.

Requirements of Grant-Making Foundations

A somewhat different issue that occasionally came up in the interviews revolved around grant-making foundations and their preferred formats for receiving grant requests and status reports. Individual nonprofits may well have a legitimate gripe about the burdens of paperwork and the duplication of effort they must face to satisfy foundations. This certainly adds to the "regulatory environment" they deal with, but it should not be confused with issues revolving around self-regulation and disparate standards.

ISSUE NO. 7
Competition

Many of the organizations included in this research were keenly aware of one another's work and presence in the field. This was true especially among the three sector-wide entities—the Standards for Excellence Institute, BBB Wise Giving Alliance, and Charity Navigator—each of which is national in scope and believes that it is possible to apply standards of governance broadly across the charitable sector.[6] They did not overtly talk about each other as "the competition," but they could speak authoritatively about the details of one another's work and could readily point out the strengths of their own approach and the perceived inadequacies of others.

The extent to which there is competition among self-regulatory agencies within a given sub-sector is not covered in the current research. Further investigation should address the following questions: Are there certain sub-sectors where too many standards-setting organizations exist? Any fields where additional options would help? To what extent do the sector-wide standards-setting bodies view the industry-specific ones as competitors, and vice versa?

ISSUE NO. 8
How Will Self-Regulation Sustain Itself?

With few exceptions, the organizations considered in this research fall under the rubric of *voluntary* self-regulation—that is, individual nonprofits *choose* to pursue their given seal, or membership, or accreditation, or to follow their particular code of ethics. This leads to tension for the self-regulating entity: how to set and adhere to high standards while building and maintaining membership?

Business Models

No one has yet figured out the answer to the question of sustainability. Those lucky enough to secure a foundation grant worry about what happens when it runs out—there's no guarantee of successive funding. Those with wealthy donors worry about individual capriciousness. Other self-regulatory endeavors are subsidized by parent organizations through annual conference fees or other internal revenue streams—leaving them especially vulnerable when it's time for cost cutting or if there's a change in internal leadership.

The fee-based model—which appears to be the most common—is also not immune to problems around sustainability. Research participants whose organizations were fee-based talked about the criticism they hear from others about relying on member fees for survival—that it provides a disincentive to deny, revoke, or otherwise limit members. According to several of these research participants, this is an understandable concern. Still, they believed that a history of strict enforcement and willingness to use sanctions could effectively offset it.

The Evangelical Council for Financial Accountability provides an example. ECFA acknowledged that it faces criticism about its fee-based structure, and its response is "just watch what we do." ECFA is committed to protecting the integrity and reputation of its seal, and to that end it takes the application and compliance processes very seriously. Termination of membership is not uncommon (relatively speaking) and other sanctions or correctional steps are made use of as necessary. For example, after one investigation ECFA recommended to a member under review that it should re-file its tax returns for three years—a serious and costly repercussion for any organization. The member re-filed the taxes as requested and remained a member in good standing—a testament to both ECFA's strict adherence to its standards and to the value of ECFA's imprimatur to its members.

ECFA knows its seal works because it has increasing and continuing membership interest, and its internal surveys show that members believe the seal has credibility and is an effective fundraising tool. According to one anecdote shared by ECFA, there are some Christian radio station owners who will not air a program unless its sponsoring organization carries the ECFA seal of approval.

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[6] There are important distinctions among these standards-setting entities, and we encourage the reader to check out their respective Web sites to see what each has to offer. We also suggest taking a look at *Rating the Raters: An Assessment of Organizations and Publications That Rate/Rank Charitable Nonprofit Organizations* (2005), a publication developed by the National Council of Nonprofit Associations and the National Human Services Assembly that compares the pros and cons of several self-regulating entities.

As ECFA sees it, its shared mission and values are what set it apart from other regulatory agencies.[7] Because it consists of such a wide diversity of types of nonprofits, all of which revolve around a common value (faith), ECFA is a unique organization in the realm of nonprofit self-regulation. Can this successful approach to accreditation be duplicated in the sector at large, a diverse community where "values" are not exactly shared?

Vacuum of Leadership

Sprinkled throughout the comments on sustainability of funding and effective business models was grumbling about the role foundations play. The feeling was that while foundations spend a lot of time advocating self-regulation for the sector, few are willing to put up the appropriate level of funding to make it happen effectively. Foundations want individual nonprofits to meet high standards for governance, accountability, transparency, and the like, but offer insufficient acknowledgement of the resources and infrastructure it takes to get there.

Lack of Human and Financial Resources

It became very clear in the interviews that accreditation programs and other forms of self-regulation are expensive to operate. The American Association of Museums, for example, re-accredits its members every 10 years—but if it had the resources it would do so a lot sooner. The AAM also subsidizes a substantial portion of the cost of its members' accreditation as a way to keep costs down for individual museums. According to the Land Trust Alliance, its new accreditation program is expected to take 8-to-10 years before it will be self-sustaining from member dues. The Wise Giving Alliance retains paid staff to monitor inappropriate use of its seal—a necessary though expensive means of ensuring integrity. Lack of human and financial resources to verify information on applications, monitor compliance of members, and investigate and adjudicate conflicts is a formidable obstacle for many regulatory bodies.

Some also talked about pressure to cover more and more organizations—because increased coverage often is taken, perhaps mistakenly, as an indicator of success. Further research might address the issue of coverage and whether or not going to scale creates pressure to hurry the work along or to cut corners.

ISSUE NO. 9
Genesis of Self-Regulatory Organizations

As stated earlier, the charitable sector has a long tradition of self-regulation. Many sub-sectors within the nonprofit community have their own accrediting and standards-setting bodies, some government-affiliated, others independent. Still, in recent years the sector has experienced a relatively new surge in organizations that rate, rank, and set standards for nonprofits at a broader level. It may prove valuable to understand what's triggering the interest in the creation and cultivation of self-regulation entities. We identified five motivating factors:

- The desire to avoid additional government regulation and oversight
- Qualms about dwindling credibility and trust among the public
- Specific interest in providing useful information to the donating public and protecting donors from fraud
- The desire to maximize the ethical conduct and effectiveness of nonprofits
- An entrepreneurial spotting of business opportunity

Desire to Avoid Additional Government Regulation and Oversight

The most obvious motivation is avoidance of new or additional government regulation and oversight of the sector. Recent scandals have caused

[7] ECFA's first standard of "responsible stewardship" is: "Every member organization shall subscribe to a written statement of faith clearly affirming its commitment to the evangelical Christian faith, and shall conduct its financial and other operations in a manner which reflects those generally accepted biblical truths and practices."

a renewed (and seemingly enduring) interest on the part of the Senate Finance Committee in the activities of the nonprofit sector. The resulting attention from the media and politicians provokes a twofold effect: a desire to pre-empt further government intervention, and self-reflection within the sector characterized by a drive to fix what's broken. Wariness of the unintended consequences that the private sector has faced due to the Sarbanes-Oxley Act also contributes to the nonprofit sector's interest in improving and encouraging self-regulation.

Qualms about Dwindling Credibility and Trust among the Public

Concerns about dwindling credibility and trust among the public inspire self-regulatory efforts as well. Americans donate billions of dollars to charities each year, and the sector is acutely aware that it needs the goodwill and financial support of the public in order to continue to do its important work. But scandals have a long shelf life. To this day, more than 10 years after a scandal involving improper use of funds by its president, the United Way still comes up spontaneously when people talk about examples of bad behavior in the nonprofit sector.[8] Taking the initiative on self-regulation is the sector's effort to hold on to the public's trust.

Interest in Providing Useful Information to the Donating Public

Related to the above is a civic-minded desire—characteristic of the nonprofit sector—to provide useful information to potential donors. There are tens of thousands of charitable organizations for individual donors to choose from, and providing comparative information about them is a service the sector can provide. On one level, this is akin to protecting the donating public from fraudulent nonprofits. The sector is not so naïve as to believe there are no bad actors, and the people who make up the nonprofit community recognize that the malfeasance—or ignorance—of a few puts the entire sector in a negative light. Thus some leaders in the sector are motivated to create credible, third-party organizations that facilitate individuals' decisions about donating their time and money to charity.

Desire to Maximize the Ethical Conduct and Effectiveness of Nonprofits

Another impetus for self-regulatory systems is a desire among individuals in the sector to do the right thing. A skeptic might argue that allowing the sector to oversee itself will result in narrowly focused standards that are easy to comply with. But based on these interviews, this does not appear to be the sector's mind-set. Speaking with 23 individuals with a variety of experiences with self-regulation, we found a shared bottom line: to improve public trust by improving the sector's ability to do its work effectively and ethically. Research participants believed that the vast majority of nonprofit employees and volunteers want to achieve good and to do so in an ethical manner. Their purpose as regulatory agencies was to create, instill, and propagate policies and ground rules of behavior to maximize the probability that this would happen.

An Entrepreneurial Spotting of Business Opportunity

Finally, some agencies are motivated by the business opportunity that self-regulation creates. Those entities with the appropriate infrastructure and expertise can capitalize on the need for information and guidance that exist among the vast world of nonprofit organizations. By offering individual nonprofits the opportunity to achieve a stamp of approval, self-regulatory agencies provide nonprofits with a means for differentiating themselves and enhancing credibility. It may be ironic, but the nonprofit field is also a competitive one, and a stamp of approval is a concrete benefit that can be monetized.

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[8] *The Charitable Impulse*, A Report from Public Agenda for the Kettering Foundation and Independent Sector, 2005.

ISSUE NO. 10
The Unique Needs of Small Organizations

Virtually all of the standards-setting organizations reviewed for this research faced a similar dilemma: how to set standards that are flexible enough to take into account the special needs of smaller organizations while still providing meaningful regulation. Small organizations are a big part of the nonprofit community; according to the National Center for Charitable Statistics, 43 percent of reporting public charities in 2003 had annual expenses of less than $100,000. These groups typically have fewer financial and human resources to spare, and so the requirements of participating in self-regulation—whether it's in terms of financial costs or staff time or accounting obligations—can be particularly onerous.

For their part, small organizations may worry that the standards will be created without consideration of their needs. Who sets the criteria for "excellence," and how do the criteria affect frailer or smaller institutions? Small organizations worry that their fundraising, administrative, and program costs may fall outside a regulator's "standard" formula for determining fiscal soundness. As one research participant asked, Is it really possible—or fair—to expect a foundation with a large endowment to meet the same criteria as a homeless shelter that relies on small donors for survival?

Moreover, many small organizations (for example, a neighborhood nursing home or a small liberal arts college) are already required by law to be accredited by a third party. As a result, they may lack the motivation to pursue voluntary regulation and also worry about the possibility of duplicative or conflicting standards and reporting requirements.

The potential for negative impact on small organizations is not lost on the regulators. Virtually all of the entities included in this research that charge a fee offer a sliding scale dependent on size or revenue. Many seemed aware of the drain on human resources a small organization would face in making the application and maintaining required policies. In some cases, they said, it could take as much as several months to several years to complete the original application for accreditation or membership.

As part of this case study, we had a lengthy conversation with the director of a small land trust who provided some idea of the types of challenges a small organization might come across when face to face with self-regulation requirements. On the horizon for this small organization is the Land Trust Alliance's new Land Trust Accreditation Commission. With only two full-time and one part-time staffers (including herself), this director worries that the documentation requirements for applying for accreditation will be a hardship. In the past, a general system of understanding worked for implementing board decisions, but to meet the new accreditation requirements board approval will involve formal procedures. Similarly, recordkeeping and organizational history has rested mainly in the head of a long-time staff member, but accreditation will bring with it official policies and documentation. How can a small land trust do all of these kinds of things and still have energy and time to achieve its goal of "protecting the land"?

Despite the difficulties it is sure to encounter, this small land trust supports the idea of self-regulation. As the director stated: "It's really important that (land trusts) behave professionally and according to the standards of the industry. Accreditation will help land trusts pay attention to making themselves sustainable…. In the long term it's important for the industry to be able to say we have professional standards and we take them seriously and pay attention to them."

CONCLUSION
Implications for the Charitable Sector

Interview participants suggested several ways to improve self-regulation in the nonprofit sector. Here are the ideas that emerged from the interviews:

- *To continue to promote the concept of self-regulation and to actively disseminate best practices.* This strategy could include sponsoring forums, conferences, and other opportunities for members of the sector to discuss the issue and to build visibility and momentum for it.

- *To actively speak out against unethical practices.* An example is manipulative marketing, where a charity lends its name to solicitations knowing that most of the donations will not go towards the charity. The philosophy underlying this approach was that the sector has a responsibility to stand up and speak out about what's good for the public, even if it's not necessarily good for some members of the sector.
- *To recommend that all charitable organizations that receive public donations participate in self-regulation.* This could be through accreditation or membership that requires a commitment to a code of ethics or best practices. Alternatively, one or two research participants suggested that only those organizations accounting for the largest portion of charitable contributions should be subject to self-regulatory requirements. Regulating the organizations that receive the vast majority of donor dollars would not only suffice to protect the sector's integrity, they said, but would be more efficient and cost-effective as well.
- *To explicitly endorse an existing standards-setting or accrediting body as the sole regulatory agency of the charitable sector.* Ultimately, what organizations like Standards for Excellence and the Wise Giving Alliance, for instance, feel they need is the endorsement of a powerful membership organization such as Independent Sector or another similarly situated national organization.
- *To create a list of suitable self-regulatory entities* and recommend publicly that donors or foundations give only to those charities that carry one of the approved imprimaturs. This approach would also include publicly critiquing those charities and nonprofits that do not incorporate some form of voluntary accountability.
- *To protect the diversity of the sector.* The wide variety of types of institutions that make up the nonprofit sector is a strength. A cookie-cutter, one-size-fits-all approach to regulation simply will not work, according to one research participant, and steps in the direction of homogenizing the nonprofit sector will "stifle its creativity, diversity, and breadth."

Finally, a reverberating theme throughout these interviews: Creating and maintaining a standards-setting agency is a challenging endeavor. Any organization considering taking on such a task for the charitable sector should be prepared to face resistance. Interviewees also warned about the dangers of instituting regulations too hastily, and here they pointed to lessons learned from the experience of the private sector. Sarbanes-Oxley is a case where industry regulation was put together in the heat of the moment and under a great deal of political scrutiny. As a result, there continues to be many unintended consequences that haven't been worked out yet in terms of complexity, resistance, loopholes, and inefficiencies. Again, to tread carefully was the cautionary note. Imagine Canada's *Voluntary Codes: A Guide for Their Development and Use* may be worth quoting here:

For many associations, developing and implementing codes may represent new territory, a step away from simply promoting a sector's interest toward actually supervising and even disciplining member organizations. This can be a fundamental change in orientation for the association and it should be undertaken only with the full cooperation of its members.

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[9] *Voluntary Codes: A Guide for Their Development and Use* (March 1998) Office of Consumer Affairs, Industry Canada and Regulatory Affairs Division, Treasury Board Secretariat.

APPENDIX A
Methodology

Participants

A total of 23 in-depth interviews were conducted for this case study research. The list below includes the name of the key people interviewed for this project, their title, and the name of the organization they represent.

American Association of Homes and Services for the Aging
William L. (Larry) Minnix, Jr., President and CEO
Bruce Rosenthal, Director of AAHSA Quality First

American Association of Museums
Edward H. Able, President and CEO
Beth Merritt, Director, Museum Advancement and Excellence

BBB Wise Giving Alliance
H. Art Taylor, President and CEO
Bennett M. Weiner, COO

Charity Navigator
Trent Stamp, President and Executive Director

Council of American Survey Research Organizations
Diane K. Bowers, President
Jim Robinson, Board Member and Director

Council on Accreditation
Richard Klarberg, President and CEO
Ann Morison, Director of Standards

Evangelical Council for Financial Accountability
Paul D. Nelson, President
Dan Busby, Vice President
Tim Maxwell, Director of Member Certification

Land Trust Alliance
Rand Wentworth, President
Tammara Van Ryn, Director, Land Trust Accreditation Commission

Maryland Association of Nonprofit Organizations/Standards for Excellence Institute
Peter V. Berns, CEO
Amy Coates Madsen, Institute Director

Southern Education Foundation, Inc.
Lynn Huntley, President

Description of the Research Process

Pat Read, Senior Vice President at Independent Sector, provided the FDR Group with a list of potential organizations and nonprofit leaders to include in this research. The one exception was the Council of American Survey Research Organizations, which was included by the FDR Group to provide a for-profit perspective. Obviously, there are many other organizations and nonprofit sector leaders that could have contributed useful information and different perspectives to this research. Limited time and busy schedules restricted our ability to include others at this time.

To help broaden the scope of the research and to perhaps get a fuller picture of an organization's approach to self-regulation, we asked research participants to suggest organizations or people from their own membership who they thought might be informative and helpful to us in conducting this research. Several complied, and we conducted an additional four interviews with representatives from small organizations that had either completed the process for accreditation or were currently undergoing it. In an effort to encourage forthright discussion and to protect their privacy, the names of these individuals and their organizational affiliations are not included in this report.

Interviews took place between December 2005 and March 2006. Most were conducted over the telephone; several were face-to-face. Interview length ranged from 30 minutes to several hours. All of the interviews were conducted by Ann Duffett or Steve Farkas of the FDR Group.

About the FDR Group

Farkas Duffett Research Group, LLC, is a full-service opinion research company that uses the tools of public opinion research to help foundations and other nonprofits succeed with their programmatic initiatives and reform efforts. Our expertise is in surveys, focus groups, program evaluation, and organizational evaluation.

APPENDIX B
Descriptions of Participating Organizations

www.aahsa.org
The American Association of Homes and Services for the Aging (AAHSA) is a membership association of mission-driven, not-for-profit organizations that offer the continuum of aging services: adult day services, home health, community services, senior housing, assisted living residences, continuing care retirement communities, and nursing homes. It offers a voluntary, self-guided program to its members called Quality First, which is a framework for earning public trust based on a commitment to continually assess and improve quality in all aspects of operations, governance, care, and services.

www.aam-us.org
Founded in 1906, the American Association of Museums (AAM) is dedicated to promoting excellence within the museum community. Through advocacy, professional education, information exchange, accreditation, and guidance on current professional standards of performance, AAM assists museum staff, boards, and volunteers across the country to better serve the public. AAM currently represents more than 16,000 members—11,500 individual museum professionals and volunteers, 3,100 institutions, and 1,700 corporate members. Every type of museum is represented, including art, history, science, military and maritime, and youth museums, as well as aquariums, zoos, botanical gardens, arboretums, historic sites, and science and technology centers.

www.give.org
The BBB Wise Giving Alliance (the Alliance) arose from the desire for accountability to constituents as well as donors, although the work it does is aimed at helping donors have information at their disposal when making contribution decisions. The Alliance evaluates an organization according to a set of 20 standards for critical areas that organizations should promote, such as how its board is organized, truth in solicitation practices, donor privacy, financial management, and overall effectiveness. Certified organizations can pay a fee to use a BBB Wise Giving Alliance logo on their materials to promote that they meet the standards.

www.charitynavigator.org
Charity Navigator's primary goal is to help charitable givers make intelligent giving decisions by providing information on more than 5,000 charities and by evaluating the financial health of each of these charities. Charity Navigator evaluations are devised to be user friendly and are freely available to the public.

www.casro.com
The Council of American Survey Research Organizations (CASRO) was included in this research to provide a for-profit perspective to the discussion on self-regulation. CASRO itself is a nonprofit entity, but its membership consists mainly of for-profit companies. CASRO is the trade association of survey research organizations, representing more than 275 companies and research operations in the United States and abroad.

www.coanet.org
The Council on Accreditation (COA) is an international, independent, not-for-profit, child- and family-service and behavioral health care accrediting organization. In 2005, COA accredited or was in the process of accrediting more than 1,500 private and public organizations that serve more that 7 million individuals and families in the United States, Canada, Bermuda, Puerto Rico, England, and the Philippines. COA partners with human service organizations worldwide to improve service delivery outcomes by developing, applying, and promoting accreditation standards.

www.ecfa.org
ECFA is an accreditation agency dedicated to helping Christian ministries earn the public's trust through adherence to 7 Standards of Responsible Stewardship. The standards focus on such things as board governance, financial transparency, integrity in fundraising, and proper use of charity resources. It is comprised of more than

1,100 charitable, religious, missionary, social, and educational tax-exempt, nonprofit 501(c)(3) organizations. ECFA also serves as a resource to its members around current matters of common concern.

www.lta.org
The Land Trust Alliance (LTA) promotes voluntary private land conservation to benefit communities and natural systems. It is the national convener, strategist, and representative of more than 1,500 land trusts across America. The LTA has just established a new voluntary program of accreditation that was designed to help ensure public accountability in voluntary land conservation and build strong and lasting land conservation organizations.

www.standardsforexcellence.org
The Standards for Excellence Institute (SEI) was begun as part of the Maryland Association of Nonprofit Organizations in response to several scandals in the mid-90s, increased scrutiny from the media, growth in the number of nonprofits, growing public distrust, and gaps between expectations and performance. The SEI program of 8 principles and 55 standards is based on a code of conduct and is a consensus model for how the most responsible and well managed nonprofit organizations operate. As part of this program, association members are asked to pledge their commitment to the guiding principles. The intent is not merely to promulgate standards, but also to give members the resources they need to implement recommended practices in their organizations.

www.sefatl.org
The Southern Education Foundation, Inc. (SEF) is the only organization in this list that is not directly affiliated with administering accreditation or standards. SEF is a public charity that is in the business of advancing creative solutions to ensure fairness and excellence in education for all. Through a variety of programs and strategies involving research, analysis, advocacy, technical assistance, and outreach, SEF works to improve educational excellence and equity in the South.

Study on Models of Self-Regulation in the Nonprofit Sector

Conducted for the Panel on the Nonprofit Sector by the National Center on Philanthropy and the Law

OVERVIEW

This Report analyzes self-regulatory structures, defined for this purpose as situations in which one organization (other than a government) sets standards for, oversees, accredits, or regulates other organizations. There is another common and correct meaning of "self regulation": the adoption by an organization of standards or procedures for its *own* activities. This Report does not attempt to discuss such single-entity self-regulation, and thus does not examine recent developments in "best practices" for governance of nonprofit organizations, despite the importance of those developments and the growth of a substantial literature dealing with them.

The project undertaken by the NCPL and reflected in this Report was not intended to provide a census or enumeration of self-regulatory organizations. Rather, the Report presents a suggested approach towards a taxonomy of self-regulatory models. Although the Report does contain several examples of specific self-regulatory models,[1] its focus is on the categorization and analysis of those aspects of the models that we believe might significantly affect their effectiveness. Based on our research, we believe that an analysis of the sort reflected in this Report is unique: we have not been able to discover any comparable rigorous analytical effort in any of the literature we have examined.

The Report identifies factors or attributes of self-regulatory schemes that, alone or in combination, may help to describe the critical differences among various types or categories of self-regulation and that may also assist in analyzing (or predicting) which types of self-regulation are likely to be more effective. Stated another way, this Report seeks to identify factors or attributes of self-regulatory structures that correlate with success.

Correlation is not necessarily causation. For example, there is a significant correlation between the length of a person's feet and the person's mathematical ability: new-born infants are not good at analytical geometry or tensor calculus. It does not follow that stretching feet will contribute to an improvement in mathematical prowess. Nevertheless, some of the factors identified in this Report *may* be causally connected to improved self-regulatory functions. In the conclusion to this Report, some tentative suggestions will be tendered about which factors may so qualify.

The conclusions set forth in this Report derive from our analysis of the factors that we selected for analysis and represent our best understanding as to why each system is more or less effective. In preparing this Report, we did not engage in any empirical research. Accordingly, our conclusions as to the efficacy of the examined self-regulatory systems are based on literature searches, conversations, and anecdotal evidence—and our own experience and judgment—rather than on empirical analysis.

This Report puts forth a taxonomy. Like all taxonomies, that results in some good news and some bad news. The good news is that taxonomies, if useful, identify important similarities among disparate things and thus help to organize them into distinguishable groups. The bad news is that taxonomies tend to reduce attention to the possible significance of differences among things that have been grouped together.

Although this Report reflects a careful selection of factors that we believe are significant in influencing the efficacy of self-regulatory models, certain factors that might be relevant to this determination are not taken into account because of the difficulty of properly measuring them. For example, the talent of the leadership of a self-regulatory organization and the logic and comprehensiveness of the organization's standards both indisputably impact its effectiveness, but because they are very

[1] Some of the examples were suggested by the Panel or by staff at Independent Sector.

difficult to quantify they have not been analyzed in the conclusions reached in this Report. Furthermore, because of problems in ascertaining relevant data, certain factors discussed in this Report proved to be not particularly useful in our analysis of the efficacy of self-regulatory systems. For example, the information contained under the factors entitled "ratio of regulatory staff to organizations and issues regulated" and "ratio of budget to organizations and issues regulated" in most cases reflect aggregate staff and budget for the overall regulating entity rather than staff and budget specifically allocated to its self-regulatory functions. None of the entities that we examined provides the type of precise allocation between regulatory and non-regulatory functions that would be necessary to undertake a useful comparison of the impact of those factors.

Because we found few prior analyses to assist us, our taxonomic factors must be viewed as tentative. We may have overlooked, over-emphasized or under-emphasized, misdescribed, or otherwise distorted relevant factors. We hope our taxonomy is a helpful effort, but we solicit and welcome comments and criticisms in order to improve its utility.

FACTORS AFFECTING THE EFFECTIVENESS OF SELF-REGULATORY SCHEMES

The following factors reflected in self-regulatory schemes may have an impact on the effectiveness of the self-regulation:[2]

I. Sanctions. One group of factors that may influence the effectiveness of self-regulatory schemes involves sanctions that may be imposed by the self-regulating organization. Sanctions may be subdivided into two categories: (1) sanctions with *legal enforceability* are those that are imposed and enforced by the legal authority of the regulatory body or some other entity; (2) sanctions with *other enforceability* are those that are more informal and not enforced by law. The latter category of sanctions might include, for example, fines, loss of membership, or public censure.

A second factor in assessing the effectiveness of particular sanctions is the organization's *history of enforcement* with respect to the penalty or sanction. This factor is relevant to the credibility of the self-regulatory body and the likelihood that the regulated will abide by standards because of a perception of the reality of sanctions. Finally, a practice of *disclosure of sanctions* or other similar public shaming by the regulatory body might make a regulatory scheme more effective.

II. Value of Accreditation. Another set of factors that influences the effectiveness of self-regulatory systems involves accreditations controlled or mandated by the self-regulatory body. The factors to be considered in assessing the effectiveness of accreditations include: (1) the impact of the accreditation on the regulated organization's *ability to market to funders* and the *ability to market to members* (i.e., the usefulness of the accreditation issued by the regulatory body in marketing an organization's products or services to potential or current funders or members); (2) *Industry "buy-in"*—acceptance of the regulatory body's rules, standards, and accreditation by industry members in their dealings with peers in the industry; and (3) a regulatory body's *monopoly power*, as a gate-keeper, to prevent or significantly disadvantage non-accredited entities from functioning in the relevant market.

III. Specificity. Issues of specificity may also affect the effectiveness of self-regulatory schemes. One type of *specificity is specificity of the sector or subsector regulated*. For example, a self-regulatory scheme might apply to all charitable organizations, or to all health-care organizations, or to all hospitals, or to all hospitals in New York State, or to all hospitals in New York City. Each successive example is more specific than its predecessor either by sectoral scope or geography. Another sort of specificity

[2] This text should be read in connection with the charts attached as Appendix A, Appendix B, and Appendix C.

is *specificity of activity regulated*. For example, a self-regulatory scheme might address all issues of good governance, or only financial issues, or only portfolio management. Of course, self-regulatory schemes may be specific both as to subsector regulated and as to activity regulated, e.g., the Evangelical Council for Financial Accountability. Because greater specificity may make possible better "fitting" and precision of standards, it may increase the effectiveness of the self-regulatory scheme.

IV. Transparency. Both *dissemination of standards and disclosure of processes* of the regulating body are relevant in assessing the effectiveness of self-regulatory schemes. The more widely standards are known, the more likely they are to be effective. The better the understanding of standards-enforcement processes (at least if they are then perceived to be both rigorous and fair), the greater should be the acceptance of their outcomes.

V. Others. Other factors also impact the efficacy of self-regulatory schemes. Some of these factors reflect the size of the resources of the regulating entity as compared to the scope or impact of its standards. For example, the ratio of regulatory *staff to organizations and issues regulated* and the *ratio of budget to organizations and issues regulated* will influence effectiveness of the self-regulatory organization.[3] Another related factor is the focus of the self-regulatory entity, as shown by the importance of its regulatory functions relative to its overall functions.

A further factor that may impact the effectiveness of a self-regulatory scheme is the scope of *pre-certification and post-certification processes*, i.e., whether the regulatory body requires regulated entities to engage in pre- or post-certification training or education in order to retain membership, accreditation, funding, or other privileges.

The *immediacy of the threat of government regulation*, i.e., whether the government is perceived as poised to adopt regulations affecting the sector or activity currently self-regulated, is a factor that may influence the effectiveness of a particular regulatory scheme. The *source of funding* of the regulating entity (i.e., from those regulated or from unrelated sources) is another factor to consider. Other relevant factors include *whistle blower protection* (whether the regulatory body encourages whistle blowing by offering effective protection against retaliation), *investigatory power* (i.e., the authority of the regulatory body to issue subpoenas or otherwise compel disclosure of the activities and records of regulated entities), *robustness of process*, and *site visits*. Finally, whether the *regulating body does self-evaluations* may be a factor to be considered.

SELECTED SELF-REGULATORY ENTITIES

Set forth below is a description of selected entities and their self-regulatory models.[4] As requested by the Panel, the selected entities are organized into three groups: (1) entities that regulate organizations, (2) entities that regulate individuals, and (3)

[3] As mentioned above, the information contained under the factors entitled "*ratio of regulatory staff to organizations and issues regulated*" and "*ratio of budget to organizations and issues regulated*" in most cases reflect total staff and budget for the regulating entities rather than staff and budget specifically allocated to their self-regulatory functions. Because the data listed are not specific to the regulatory function of the organizations, they are less useful in the analysis of the impact of these factors on the effectiveness of the examined self-regulatory schemes. None of the entities that we examined maintain the sort of allocation between regulatory and non-regulatory function expenses and staff hours that would be necessary to undertake a careful analysis of those factors.

[4] Only a small number of entities were selected for this Report. Although they were cho-sen as helpful examples, no inference should be made about the effectiveness of any orga-nization by virtue of being included in or excluded from discussion herein.

entities that regulate both organizations and individuals. We have grouped the selected entities in this manner because we have been requested to do so. We do not wish to suggest that this tripartite categorization is necessarily the best or most effective way of grouping self-regulatory entities.[5]

1. Entities that Regulate Organizations: The following entities regulate organizations:[6]

   a. **American Association of Museums:** The AAM Museum Accreditation Program sets standards and best practices through a self-regulating program of quality assurance and accountability. The AAM's self-regulatory scheme is quite effective based primarily on (1) the importance of (and in some cases, requirement for) AAM accreditation to museum funders and (2) the robustness of the accreditation process, which includes site visits and a complex evaluation.
   b. **American Bar Association:** The ABA is the largest voluntary professional association in the world. The ABA provides law school accreditation, continuing legal education, information about the law, programs to assist lawyers and judges, and initiatives to improve the legal system for the public. This Report focuses on the ABA law-school-accreditation function, which is an effective self-regulatory model based primarily on its monopoly power. A law school that fails to meet ABA standards will lose or be denied accreditation. Graduates from unaccredited law schools cannot practice law in most jurisdictions and credits from unaccredited schools generally are not transferable to accredited schools.
   c. **American Board of Medical Specialties:** The ABMS is the umbrella organization for 24 approved medical specialty boards in the United States. The ABMS serves to coordinate the activities of its Member Boards and to provide information to the public, the government, the profession, and its Members concerning issues involving specialization and certification in medicine. Over 180 certifying medical specialty boards, however, are not members of ABMS, making it less effective as a self-regulatory model since it lacks (1) monopoly power, (2) funder buy-in, and (3) legal enforceability.
   d. **Australian Council for International Development:** The ACFID is an independent national association of Australian non-government organizations working in the field of international aid and development. It administers a Code of Conduct committing its 80 members to standards of integrity and accountability and withdraws membership status from any entity that does not comply with its standards. It is effective as a self-regulatory entity because membership in ACFID is required for eligibility for government funds in Australia.
   e. **BBB Wise Giving Alliance:** The Wise Giving Alliance reports on nationally-soliciting charitable organizations that are the subject of donor inquiries. These reports include an evaluation of the subject charity in relation to voluntary standards. In addition, the Wise Giving Alliance offers national charities that meet its standards the option of applying for a BBB national charity seal that can be displayed both online and in solicitation materials. The effectiveness of the Wise Giving Alliance is constrained because (1) compliance with its standards is purely voluntary, (2) its standards have no legal enforceability, (3) a relatively small number of eligible organizations have sought a seal (indicating a low level of industry buy in), and (4) seals are not typically required for funding by government or private sources.

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[5] The federal experience leading up to the enactment of intermediate sanctions (under sec-tion 4958 of the Internal Revenue Code of 1986, as amended) illustrates that limiting regu-lation to sanctions against organizations, rather than individuals, in some instances results in enforcement that may be either insufficiently meaningful or, alternatively, overly harsh. This suggests that self-regulation may be more effective if it addresses the conduct of both organizations and individuals.

[6] See Appendix A.

f. **Council on Foundations:** The Council on Foundations is a membership organization of more than 2,000 grant making foundations and giving programs worldwide. Each member must subscribe to and follow a set of Principles and Practices for Grantmakers and, in theory, can lose membership for failing to comply with these guidelines. The Council, while a powerful and efficient source of information and guidance for its members, is not a particularly effective self-regulatory model because (1) its guidelines are not legally enforceable, (2) most of its members (other than community foundations) do not solicit funds and therefore can easily operate without membership, and (3) the sanction of loss of membership is rarely invoked.

g. **Evangelical Council for Financial Accountability:** ECFA is an accreditation agency for Christian ministries comprising over 1,100 charities. ECFA members are required to comply with its Standards of Responsible Stewardship which focus on board governance, financial transparency, integrity in fund-raising, and proper use of charity resources. ECFA is particularly effective as a self-regulatory model within its specific arena because of (1) the value of its certification to funders, (2) the robustness of its process, which includes site visits and an annual recertification process, (3) its history of enforcement through suspension of members, which lends credibility to its standards, and (4) its broad disclosure of violations and sanctions, which makes noncompliance more threatening.

h. **InterAction American Council for Voluntary International Action Inc. Membership:** InterAction accredits US nonprofits involved in international humanitarian work primarily through a system of self-certification. The organization is somewhat effective as a self-regulatory body because of the value of its accreditation to certain funders, although the fact that certification is not generally required by funders limits the impact of the regulatory system.

i. **InterAction American Council for Voluntary International Action Inc. Child Sponsorship Accreditation Program:** InterAction's Child Sponsorship Accreditation Program is a relatively new initiative that uses a formal certification process to accredit member child sponsorship programs. In its first year, five members were accredited. This accreditation is likely to become more effective in the future if it evolves into a prerequisite for funding for such programs.

j. **Joint Commission on Accreditation of Healthcare Organizations:** The Joint Commission evaluates and accredits more than 15,000 health care organizations and programs in the United States. In 1965, Congress passed the Social Security Amendments of 1965 with a provision that hospitals accredited by JCAHO are "deemed" to be in compliance with most of the Medicare Conditions of Participation for Hospitals and, therefore, able to participate in the Medicare and Medicaid programs. Accordingly, JCAHO's accreditations have legal authority, making the self-regulatory scheme particularly effective. In addition, JCAHO is effective because (1) its accreditation is significant to funders, members, and the healthcare industry in general, (2) it discloses serious violations of its standards to the government or to licensing agencies, and (3) its process, which is quite robust, includes site visits and integrates extensive analysis of outcome and other performance measurements.

k. **Land Trust Alliance:** The LTA requires land trust members to adopt the LTA Standards and Practices and to evidence that adoption with a Board resolution. The impact of the LTA as a self-regulatory body rests on the fact that some public funders require potential grantees to provide a statement of adoption of LTA Standards and Practices. However, LTA membership is not a mandatory prerequisite for these grants, which tends to limit the significance of LTA membership. The effectiveness of the LTA regulatory scheme is further limited by (1) the lack of any real sanctions and (2) the absence of processes for determining compliance with the guidelines.

l. **Maryland Association of Nonprofit Organizations Standards for Excellence Institute:** Maryland Nonprofits offers a voluntary, peer-review, certification program for nonprofit organizations interested in demonstrating that they carry out the Standards for Excellence. Certified organizations are given permission to use the Seal of Excellence, which can be denied or revoked for failure to meet all of the Standards. Although the Seal may be important to some funders, it generally is not required for funding, which limits the effectiveness of the self-regulatory system.

m. **Middle States Association of Colleges and Schools Commission on Higher Education:** The Middle States Commission on Higher Education is a voluntary, non-governmental, membership association that accredits schools through a peer-evaluation program. The Higher Education Act of 1963, Title IV Student Assistance Program, requires schools to be accredited by a certified accrediting agency such as the MSCHE for school eligibility for federal funding and for student eligibility for federal grants. This is a particularly effective self-regulatory scheme because (1) accreditation is legally required for certain federal funding, (2) the MSCHE is the only regional body for the middle state region that accredits entire institutions, and (3) the accreditation process is quite robust as it requires an extensive application process and site visits.

n. **National Council of YMCAs of the USA:** The National Council accredits member YMCAs and can revoke membership of a YMCA that is not in compliance with the YMCA mission and non-discrimination policy. The effectiveness of this self-regulatory scheme depends on the fact that an unaccredited organization cannot use the YMCA name. Its effectiveness is limited by its lack of robust process.

o. **Public Company Accounting Oversight Board:** The PCAOB is a private-sector, nonprofit corporation, created by the Sarbanes-Oxley Act of 2002 to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports. The PCAOB is authorized to impose fines, remedial measures, quality control procedures, the appointment of an independent monitor, and revocation of registration. The PCAOB self-regulatory scheme is particularly effective because (1) it is created and enforced by law, (2) its sanctions are real and significant, (3) its process is robust, and (4) it has significant investigatory powers.

p. **United Way of America:** The UWA certifies local United Ways for membership and can revoke or deny membership to organizations not meeting its Accountability and Financial Standards. This self-regulatory scheme is effective because (1) the sanction of revocation of membership and the right to use the "United Way" name is real and enforceable, (2) membership is important to funders, and (3) 59 local United Ways have lost membership since 2003, creating a genuine threat of enforcement.

q. **Western Association of Schools and Colleges:** The WASC is one of six organizations regional associations that accredit public and private schools, colleges, and universities in the United States. The Higher Education Act of 1963, Title IV Student Assistance Program, requires schools to be accredited by a certified accrediting agency such as the WASC for school eligibility for federal funding and for student eligibility for federal grants. This is a particularly effective self-regulatory scheme because (1) accreditation is legally required for certain federal funding, (2) the WASC is the only accrediting body for its region, and (3) the accreditation process is quite robust as it requires an extensive application process and site visits.

We conclude, based on our analysis of the selected self-regulatory entities, that certain factors, alone or in combination, were the most significant for creating an effective self-regulatory scheme. Probably the single most significant factor is *legal enforceability* of sanctions. A second significant set of factors is the authority to accredit organizations coupled with the authority to withdraw the accreditation, particularly when this certification or accreditation is required either (1) to enable to the organization to engage in the activities for which it is formed (*monopoly power*) or (2) for funding by government and private grant makers (*ability to market to funders*). These factors may be even more powerful when the self-regulatory entity has a strong history of enforcing its sanctions, when the processes of accreditation and required reaccredidation are robust (particularly if site visits are required), and when adequate staff and budget are allocated to the regulatory function.

American Association of Museums

www.aam-us.org
EIN Number: 53-0205889
NTEE Code: A03

Factor	Description
SANCTIONS	
legal enforceability	No.
other enforceability	The AAM's members risk losing membership if they fail to pay their dues, for "due cause," or for "use of membership in the Association to work for purposes inconsistent with the mission and objectives of the Association and any standards which the board of directors may require." (AAM Constitution Article 3, §2). Reputational considerations associated with loss of accreditation are another sanction. Some donors (including the State of Florida) require accreditation before they will provide funding.
history of enforcement	The AAM was established in 1906. From Dec. 2002–Dec. 2003, 163 institutions were reviewed. The results were: 42 Accreditations Tabled; 84 Accreditations Awarded; 1 Accreditation Awarded Pending; 21 Interim Approvals Granted; 1 Interim Approval Tabled; 4 Accreditations or Interim Approvals Denied. On average, 5 museums lose accreditation each year for failure to pay dues or for violation of standards.
disclosure of sanctions	No. The only action that the AAM takes is to remove the sanctioned museum from its List of Accredited Museums.
VALUE OF ACCREDITATION	
ability to market to funders	Yes. Some funders (including the State of Florida with respect to state funding) require accreditation for grants.
ability to market to members	Yes.
industry "buy-in"	Yes. 743 museums are accredited, and 72 museums are "applicants."
monopoly power	No.
SPECIFICITY	
specificity of sector or sub-sector regulated	All museums in the United States that volunteer to undergo the accreditation process.
specificity of activity regulated	AAM accreditation concerns all aspects of a museum's operations and programs.

American Association of Museums, *continued*

Factor	Description
TRANSPARENCY	
dissemination of standards	Yes. Its Standards and Best Practices are available online, and other standards resources are available from the AAM.
disclosure of process	Yes. The AAM's accreditation process is outlined in detail online.
OTHERS	
staff ratio to organizations regulated	The AAM accreditation staff of 3 is relative to 743 museums and 72 applicants.
budget ratio to organizations regulated	The AAM's revenue in 2003 was $8,180,777, a significant portion of which is dedicated to the accreditation process. This is relative to a membership of 743 museums and 72 applicants.
focus of the entity	Accreditation is part of a larger organization that provides other member services such as publications, conferences, etc.
pre-certification	Pre-accreditation, the museum must be "essentially educational in nature" and "open to the public for at least 2 years."
post-certification	Reaccredidation is required at least every 10 years, and more often if accreditation was granted with concern.
immediacy of the threat of gov't regulation	No.
source of funding	Funding comes from contributions, program services, investments, sales, membership dues and fees.
whistle blower protection	No. But the AAM requires accredited museums to provide whistle blower protection.
investigatory power	The AAM requires the applicant museum to allow an AAM investigation.
robustness of process	The process includes an application with a fee, self-study by the museum, site visits, and a final accreditation decision by the Accreditation Office.
site visits	Yes. Conducted at the applicant's expense for accreditation and reaccredidation.
regulating body does self-evaluations	AAM's Code of Ethics requires it to have an annual Independent Auditor's Report, which it posts on its website.

American Bar Association

www.abanet.org/legaled.home.html
EIN Number: 36-2384321
NTEE Code: Y30

Factor	Description
SANCTIONS	
legal enforceability	The Higher Education Act of 1963 (20 U.S.C. 1099b(a)(3)(1994)) states that the Department of Education requires that educational institutions be approved by an established accrediting agency in order to be eligible for federal programs, including funding.
other enforceability	If a school does not meet ABA standards, it faces denial or loss of accreditation. Graduates from unaccredited law schools cannot practice law in most jurisdictions, and credits from these schools are not always transferable to accredited schools.
history of enforcement	The ABA was established in 1878; its most recent denial of accreditation (to MA Law School) was upheld by MA District Court in 1997. Mass. Sch. of Law at Andover v. ABA, 846 F. Supp. 374 (E.D. Pa. 1994), aff'd, 107 F.3d 1026 (3d Cir. 1997), cert. denied, 522 U.S. 907 (1997). In 1994, the Department of Justice began investigating the ABA, resulting in the ABA agreeing to the entry of a consent decree, requiring the ABA to modify its accreditation process. Changes included amending the role of the House of Delegates in adopting or amending any rule, allowing appeals on accreditation decisions to go to the House of Delegates, and removing House authority over the Council.
disclosure of sanctions	Yes; the ABA publishes a list of accredited schools. If a school loses its accreditation, this information is made public.
VALUE OF ACCREDITATION	
ability to market to funders	Yes.
ability to market to members	Yes.
industry "buy-in"	Yes.
monopoly power	The ABA is the only national organization that provides law school accreditation. A few states will accredit law schools not accredited by the ABA and accept those graduates for practice in the state. The Department of Justice has investigated the ABA on anti-trust claims, resulting in a consent decree that caused the ABA to change its governance structure.
SPECIFICITY	
specificity of sector or sub-sector regulated	All American law schools.
specificity of activity regulated	The ABA standards cover every aspect of law school operations.
TRANSPARENCY	
dissemination of standards	Yes. Detailed standards are available online.
disclosure of process	Yes. Process details are available online.

American Bar Association, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	The ABA accreditation staff of 12 is relative to 189 approved law schools.
budget ratio to organizations regulated	The annual budget of the ABA is more than $100 million, relative to 189 approved law schools. Only a fraction of this amount is spent on the accreditation process.
focus of the entity	The regulation of law schools is part of the activities of a larger organization. The ABA is engaged in lobbying, member services and publications, standards for lawyers and the judiciary, continuing education, pro bono work, among other activities.
pre-certification	Prerequisites for accreditation include being in operation for at least 1 academic year and the completion of a Site Evaluation Questionnaire.
post-certification	The ABA initially requires renewal of accreditation after 3 years, then subsequently every 7 years.
immediacy of the threat of gov't regulation	There is no current threat of government regulation.
source of funding	Member fees and dues provide a majority of ABA funding.
whistle blower protection	
investigatory power	The ABA conducts extensive investigations.
robustness of process	The accreditation process involves extensive fact-finding by the Accreditation Committee including site visits, interviews, self-evaluations, and many stages of approval. The burden to demonstrate full compliance is on the school.
site visits	The ABA conducts site visits that last several days and involve multiple meetings and interviews.
regulating body does self-evaluations	No.

American Board of Medical Specialties

www.abms.org
EIN Number: 23-7304902
NTEE Code: H99

Factor	Description
SANCTIONS	
legal enforceability	No.
other enforceability	Certificates may be inactivated; approval may be denied.
history of enforcement	The ABMS has approved boards since 1934; 24 are currently approved. 3 certificates were inactivated in 2003.
disclosure of sanctions	No. One can access lists of approved boards online; to access listings of certified physicians, one must register for the site's services.
VALUE OF ACCREDITATION	
ability to market to funders	N/A.
ability to market to members	Yes.
industry "buy-in"	No. While there are currently 24 approved boards, 180 boards are not ABMS approved.
monopoly power	No.
SPECIFICITY	
specificity of sector or sub-sector regulated	US medical specialty boards.
specificity of activity regulated	Broad. The Essentials for Approval of Examining Boards in Medical Specialties cover many areas of board practice.
TRANSPARENCY	
dissemination of standards	Yes. Standards are available online or from ABMS publications.
disclosure of process	Yes. The details of the process are available online.

American Board of Medical Specialties, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	The ABMS' 5 full-time staff handles 24 approved boards.
budget ratio to organizations regulated	Revenue $291,926 (FY 2003) is relative to 24 approved boards.
focus of the entity	The ABMS publishes a directory and provides Doctor Verification Services, publishes books, and conducts conferences.
pre-certification	Prerequisites for approval include presenting a plan for developing graduate education in the specialty, evidence of broad professional support for the board, and evidence that there is not already a board for that specialty.
post-certification	
immediacy of the threat of gov't regulation	No.
source of funding	ABMS funding comes from direct public support, interest and program services.
whistle blower protection	
investigatory power	No.
robustness of process	Low. The ABMS accepts proposals, may conduct hearings, and provides for appeals, but its process is not robust.
site visits	No.
regulating body does self-evaluations	No.

Australian Council for International Development

www.acfid.asn.au
EIN Number: N/A
NTEE Code: N/A

Factor	Description
SANCTIONS	
legal enforceability	Member adherence to the ACFID's Code of Conduct for Non Government Development Organizations is required for eligibility for the AusAid matching grant scheme.
other enforceability	If a member is not in compliance, ACFID responds by withdrawing the member's affiliation status and publishing its name and the nature of its breach. Other sanctions include resolution of the violation through a reconciliation process or notification of AusAid.
history of enforcement	
disclosure of sanctions	Yes. Names of organizations in breach of obligations are published by the ACFID.
VALUE OF ACCREDITATION	
ability to market to funders	Yes. Access to the AusAid matching grant scheme is attractive to donors.
ability to market to members	Yes.
industry "buy-in"	Yes.
monopoly power	Yes. If the organization wants to be eligible for government funds.
SPECIFICITY	
specificity of sector or sub-sector regulated	Non Government Development Organizations in Australia.
specificity of activity regulated	The Code covers broad areas of organizations' practices.
TRANSPARENCY	
dissemination of standards	Yes. Standards are widely available.
disclosure of process	Yes. The process is detailed online.

Australian Council for International Development, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	14 staff is relative to 80 members.
budget ratio to organizations regulated	In 2004, ACFID's revenue was $1,300,638, relative to 80 members.
focus of the entity	The ACFID focus is the Code's implementation and enforcement.
pre-certification	Accreditation application including audited financial statements.
post-certification	Signatories are required to provide an annual report and annual audited financial statements.
immediacy of the threat of gov't regulation	The ACFID works in partnership with the government.
source of funding	Government grants and member fees provide funding for ACFID programs.
whistle blower protection	Yes. In addition, the Code promulgated for members contains a whistle-blowing protection provision. However, the ACFID does not pursue anonymous complaints.
investigatory power	The Guidance Document to the Code outlines the investigatory power of the ACFID. This includes the ability to collect information with the consent of the organization being investigated, and only when necessary for the investigation.
robustness of process	The process is highly robust, including a complaints procedure, outlined penalties, and an appeals process.
site visits	Yes. Investigations are conducted with the consent of the party being investigated.
regulating body does self-evaluations	No.

Better Business Bureau Wise Giving Alliance

www.give.org
EIN Number: 52-1070270
NTEE Code: S03

Factor	**Description**
SANCTIONS	
legal enforceability	No.
other enforceability	The only enforceability the BBB has is to refuse the BBB seal to noncompliant organizations.
history of enforcement	The Wise Giving Alliance was formed in 2001 as a result of the BBB Foundation's Philanthropic Advisory Service and National Charities Information Bureau; it performs about 500 national reports each year.
disclosure of sanctions	If the BBB revokes an organization's seal, the information would be available online.
VALUE OF ACCREDITATION	
ability to market to funders	Yes.
ability to market to members	Yes.
industry "buy-in"	Yes.
monopoly power	No. Adherence to the Wise Giving Alliance's standards is entirely voluntary.
SPECIFICITY	
specificity of sector or sub-sector regulated	Charities.
specificity of activity regulated	Broad.
TRANSPARENCY	
dissemination of standards	Yes. Standards are available online, and in print by request.
disclosure of process	Yes.

Better Business Bureau Wise Giving Alliance, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	10 Wise Giving Alliance staff, supported by BBB staff, is relative to thousands of nonprofit organizations.
budget ratio to organizations regulated	The Wise Giving Alliance's revenue in 2003 was $1,593,513 relative to thousands of nonprofit organizations.
focus of the entity	The focus is on reporting and the BBB Seal only.
pre-certification	No.
post-certification	No.
immediacy of the threat of gov't regulation	No.
source of funding	Funding comes from public support, program service revenue, and interest on savings and investments.
whistle blower protection	
investigatory power	No. The Wise Giving Alliance will request information from organizations that are the subject of donor inquiries.
robustness of process	Low. Investigations are based on information provided by the nonprofit organization.
site visits	No.
regulating body does self-evaluations	Yes. The Wise Giving Alliance adheres to all of its own standards.

Council on Foundations

www.cof.org
EIN Number: 13-6068327
NTEE Code: T50

Factor	Description
SANCTIONS	
legal enforceability	No.
other enforceability	In egregious situations, the COF will inform government agencies of member misconduct. The COF can revoke membership for non-compliance with their Principles and Practices for Grantmakers. Community foundations must meet separate standards to have access to certain benefits, such as marketing materials.
history of enforcement	The COF has over 50 years of history in the field. They have required corrections of violations by private foundations and community foundations, but none have lost membership.
disclosure of sanctions	Yes. If a member is on probation or membership is revoked, that action is not private. The decision of whether to publish the results of a review is made on a case-by-case basis.
VALUE OF ACCREDITATION	
ability to market to funders	Yes. Community foundations can market to funders. Private foundations do not fundraise.
ability to market to members	Yes.
industry "buy-in"	Yes.
monopoly power	No. Membership is not mandatory.
SPECIFICITY	
specificity of sector or sub-sector regulated	The COF regulates all member foundations. Private foundations and community foundations are members; the accreditation process is more stringent for community foundations.
specificity of activity regulated	Regulations concern all aspects of the sector's activities.
TRANSPARENCY	
dissemination of standards	Yes.
disclosure of process	Yes.

Council on Foundations, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	87 COF staff is relative to 1,921 member foundations.
budget ratio to organizations regulated	In 2003, COF revenue was $14,681,062, relative to 1,921 member foundations.
focus of the entity	The COF's focus is member services, including lobbying on behalf of its members, as well as regulation with compliance with Standards.
pre-certification	To apply, an organization must certify that it has complied with all appropriate state registration and reporting requirements. It also must state that it subscribes to the recommended Principle and Practices for Effective Grantmaking of the Council on Foundations. It must submit the Form 990 or Form 990PF at the time of application.
post-certification	While the COF offers educational conferences and online resources, there are no post-certification requirements. There is no regular review of members unless a problem is brought to the attention of the COF.
immediacy of the threat of gov't regulation	No.
source of funding	The COF's funding come from dues, grants and contributions, professional development, publications and investments.
whistle blower protection	No. However, they are in the process of establishing a policy.
investigatory power	Yes. This investigation consists of an examination of publicly available information or information provided by the foundation in question.
robustness of process	Low. The COF inquires into reports brought to its attention by any source, including the media and the general public. It relies on information provided by the foundation for its investigation.
site visits	No. The COF does not conduct site visits.
regulating body does self-evaluations	Yes. The COF makes an Independent Auditor's Report available online but does not otherwise self-evaluate.

Evangelical Council for Financial Accountability

www.ecfa.org
EIN Number: 93-0744698
NTEE Code: X21

Factor	Description
SANCTIONS	
legal enforceability	No.
other enforceability	If the member is cooperative, there is generally an opportunity for correction. Otherwise, there may be a resignation, suspension, or termination of membership and accreditation.
history of enforcement	The ECFA has been in operation for 26 years. In the last 10 years, there has been a high of 11 annual terminations and a low of 1 annual termination. Requests for correction are more common. The threat of expulsion is a serious possibility.
disclosure of sanctions	Yes. The ECFA discloses sanctions on its website and on the annual membership list. In particularly egregious situations, the ECFA will issue a press release.
VALUE OF ACCREDITATION	
ability to market to funders	Yes.
ability to market to members	Yes.
industry "buy-in"	Yes.
monopoly power	No. Membership is not mandatory.
SPECIFICITY	
specificity of sector or sub-sector regulated	Christianity-based charity organizations are eligible for membership in the ECFA.
specificity of activity regulated	Narrow. The ECFA focuses on financial accountability.
TRANSPARENCY	
dissemination of standards	Yes. Standards are widely available.
disclosure of process	Yes. The process is disclosed online.

Evangelical Council for Financial Accountability, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	A staff of 4 full-time and 6 part-time regulators is joined by a Standards Committee with 10 pro bono members. This is relative to 1,150 member organizations.
budget ratio to organizations regulated	The budget for regulation is about $1.3 to $1.5 million, relative to 1,150 members.
focus of the entity	The focus of the entity is regulation and accreditation.
pre-certification	Pre-certification includes an application and a statement of faith.
post-certification	Every fiscal year, members must submit audited financials. 35-40% of members do not get recertified each year without some additional required compliance.
immediacy of the threat of gov't regulation	No.
source of funding	Funding derives primarily from dues, which range from $300 to $8,000, depending on the size of the organization.
whistle blower protection	Yes. The ECFA will not disclose the identity of any whistle blower. But, the ECFA cannot protect any whistle blower within his or her own organization.
investigatory power	Yes.
robustness of process	The robustness of process is high.
site visits	Yes. The ECFA conducts mandatory site visits; timing is at the discretion of the ECFA.
regulating body does self-evaluations	No.

InterAction American Council for Voluntary International Action Inc. Membership

www.interaction.org
EIN Number: 13-3287064
NTEE Code: Q03

Factor	Description
SANCTIONS	
legal enforceability	No.
other enforceability	If a member does not complete its annual self-certification, it is suspended from membership. If there is another violation, the member has a year to correct the violation. If it does not do so, it is suspended from membership.
history of enforcement	Since InterAction allows for correction in the case of a violation, it is rarely required to suspend a member. Suspension has only occurred once since InterAction was formed in 1984.
disclosure of sanctions	No. The only disclosure is that InterAction removes the suspended organization from its membership list.
VALUE OF ACCREDITATION	
ability to market to funders	Yes.
ability to market to members	Yes.
industry "buy-in"	Yes. InterAction has more than 160 members, and coalitions in Japan and China have used the standards as a model for their own standards.
monopoly power	No. Membership with InterAction is not mandatory.
SPECIFICITY	
specificity of sector or sub-sector regulated	InterAction members are US nonprofits involved in international humanitarian work. InterAction regulates their international operations only. The sector includes child sponsorship organizations, health care agencies, and both faith-based and secular organizations.
specificity of activity regulated	InterAction standards cover a broad array of activities performed by its members, including financial management, fundraising, governance, and program performance.
TRANSPARENCY	
dissemination of standards	Yes. The standards are widely available.
disclosure of process	Yes. The process is disclosed online.

InterAction American Council for Voluntary International Action Inc. Membership, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	InterAction has 35 staff, 2 of whom are dedicated to member certification. This is relative to its more than 160 members.
budget ratio to organizations regulated	From revenue of $5,067,694 in FY 2003, about $500,000 was dedicated to the certification of its more than 160 members.
focus of the entity	The focus of the entity is member services and standard-setting.
pre-certification	The only required pre-certification is that the entity certifies compliance with InterAction standards.
post-certification	Member organizations must self-certify annually.
immediacy of the threat of gov't regulation	There is no immediate threat of government regulation.
source of funding	InterAction funding comes from contributions, government grants, program services, investments, dues, and fees.
whistle blower protection	Yes. InterAction has a whistle blower protection policy.
investigatory power	InterAction's investigatory power is only applicable in cases on known non compliance.
robustness of process	The self-regulation process is not robust. The InterAction website states that the Standards are "best understood as statements of principles and, as such, are not requirements."
site visits	No. Site visits are not performed.
regulating body does self-evaluations	Yes. InterAction self-evaluates.

InterAction American Council for Voluntary International Action Inc. Child Sponsorship Accreditation Program

www.interaction.org
EIN Number: 13-3287064
NTEE Code: Q03

Factor	Description
SANCTIONS	
legal enforceability	No.
other enforceability	If a program is found to be in violation, it will lose its certification.
history of enforcement	This is a new program; there have not been any enforcement actions to date.
disclosure of sanctions	No. The only "sanction" is that InterAction removes the suspended organization from its accredited organization list.
VALUE OF ACCREDITATION	
ability to market to funders	Yes.
ability to market to members	Yes.
industry "buy-in"	Yes. Though new, this program has enjoyed industry "buy-in."
monopoly power	No. Accreditation through InterAction is not mandatory.
SPECIFICITY	
specificity of sector or sub-sector regulated	InterAction members and child sponsorship organizations are able to be accredited through this program.
specificity of activity regulated	InterAction accreditation covers a broad array of activities performed by agencies, including financial management, fundraising, governance, and program performance.
TRANSPARENCY	
dissemination of standards	Yes. The standards are widely available.
disclosure of process	Yes. The process is disclosed online.

InterAction American Council for Voluntary International Action Inc. Child Sponsorship Accreditation Program, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	One in-house staff member is assisted by Social Accountability International. This group is under contract to accredit the child sponsorship agencies and examine them for compliance. This is relative to its 5 accredited entities in addition to new applicants for accreditation.
budget ratio to organizations regulated	The agency being accredited pays all of its accreditation costs.
focus of the entity	Accreditation is part of the work of the larger InterAction organization. This program is distinct from InterAction's general membership certification program.
pre-certification	Pre-certification requirements include applications, document review, and site visits.
post-certification	After certification, site visits at international sites are made twice annually. In addition, the organization must be re-accredited every 4 years.
immediacy of the threat of gov't regulation	There is no immediate threat of government regulation.
source of funding	The organizations being accredited are the exclusive source of funding for the accreditation program.
whistle blower protection	Yes. InterAction has a whistle blower protection policy.
investigatory power	The investigatory power is primarily in the hands of sub-contractor Social Accountability International, which conducts site visits at international sites and monitors agencies for compliance.
robustness of process	The self-regulation process is robust. Accredited agencies are required to provide substantial documentation and permit frequent site visits.
site visits	Yes. Site visits are performed.
regulating body does self-evaluations	Yes. InterAction self-evaluates and this self-evaluation process involves this program as well.

Joint Commission on Accreditation of Healthcare Organizations

www.jcaho.org
EIN Number: 36-2229255
NTEE Code: E03

Factor	Description
SANCTIONS	
legal enforceability	Accreditation "deems organization qualified as a Medicaid/Medicare recipient." Also, serious violations of standards that may jeopardize the health or safety of the public are reported to the government or to licensing agencies.
other enforceability	A list of accredited organizations and their survey results are posted on the JCAHO website.
history of enforcement	The JCAHO has been accrediting healthcare organizations for more than 50 years.
disclosure of sanctions	Yes. The "Quality Check" section of the JCAHO's website provides a search engine to determine what, if any, disciplinary actions have been taken against accredited organizations. Other information, such as how the organization best suits the inquirer's needs and how the organization meets safety goals, is also provided. Quality Check is updated daily. It also lists "Special Quality Distinction Awards" to high-performing organizations.
VALUE OF ACCREDITATION	
ability to market to funders	Yes.
ability to market to members	Yes.
industry "buy-in"	Yes.
monopoly power	Yes.
SPECIFICITY	
specificity of sector or sub-sector regulated	The JCAHO accredits a range of health care organizations (hospitals, healthcare networks, nursing homes, etc.).
specificity of activity regulated	The JCAHO regulates a broad array of activities performed by healthcare organizations.
TRANSPARENCY	
dissemination of standards	Yes. Standards are widely available.
disclosure of process	Yes. The process is available online or in print upon request.

Joint Commission on Accreditation of Healthcare Organizations, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	The JCAHO has more than 1,000 staff, relative to its more than 15,000 accredited organizations.
budget ratio to organizations regulated	With revenue of $85,292,219 in 2003 relative to its more than 15,000 accredited organizations.
focus of the entity	The JCAHO is focused on accreditation only.
pre-certification	Pre-certification requirements include allowing unannounced site visits, called "surveys." Organizations complete an application.
post-certification	Accredited organizations must undergo on-site, extensive reviews at least once every 3 years. Laboratories are accredited every 2 years.
immediacy of the threat of gov't regulation	Yes.
source of funding	The JCAHO receives its funding from program services, such as survey fees, and investment income.
whistle blower protection	Yes. The JCAHO provides whistle blower protection.
investigatory power	Yes. The JCAHO has strong investigatory power.
robustness of process	The robustness of this accreditation process is quite high. One method used is to track a particular patient through his or her entire interaction with an organization and measure the organization's performance. In February 1997, the Joint Commission launched its ORYX® initiative, which integrates outcomes and other performance measurement data into the accreditation process.
site visits	Yes. The JCAHO does conduct site visits, including unannounced visits in the event of a complaint. If an organization refuses to allow this visit, it will lose its accreditation.
regulating body does self-evaluations	Yes. The JCAHO self-evaluates.

Land Trust Alliance

www.lta.org
EIN Number: 04-2751357
NTEE Code: C34

Factor	Description
SANCTIONS	
legal enforceability	No.
other enforceability	Some public funders ask for a statement of adoption of LTA Standards and Practices; this allows local land trust alliances access to greater funding. Also, if a local land trust alliance is not a member of the national organization, it is not eligible for certain matching grants from the LTA. In 2003, the LTA gave $973,000 in matching grants to help build organizational capacity and conserve land; it also distributed $59,400 in scholarships to help train the boards of small land trusts.
history of enforcement	
disclosure of sanctions	No.
VALUE OF ACCREDITATION	
ability to market to funders	Yes.
ability to market to members	Yes.
industry "buy-in"	Yes. The number of land trusts is growing rapidly, having increased 26% from 1998 to 2003. Of the more than 1,500 national land trusts, 1,085 were members in 2003.
monopoly power	No.
SPECIFICITY	
- specificity of sector or sub-sector regulated	Local land trusts are regulated. However, individuals, nonprofit organizations, and professionals may become members as well.
- specificity of activity regulated	Broad. The Standards cover all aspects of operating and managing a land trust.
TRANSPARENCY	
dissemination of standards	Yes. The Standards and Practices, including the 2004 revisions, are available online or in print, upon request.
disclosure of process	No. The process for enforcement of these standards is not publicly disclosed.

Land Trust Alliance, *continued*

Factors	Description
OTHERS	
staff ratio to organizations regulated	The 40-person staff is responsible for more than 1,000 nonprofit land trusts.
budget ratio to organizations regulated	The LTA's revenue of $4,825,974 in 2003 is relative to more than 1,000 nonprofit land trusts.
focus of the entity	Member services are the focus of the LTA, including political activity on the behalf of members, maintaining an online library for their use, publishing materials, holding conferences, and providing matching grants and scholarships to its members.
pre-certification	Prerequisites for land trust membership include certification of 501(c) (3), local/municipal land trust status, certification of adoption of Standards and Practices, and payment of dues.
post-certification	All local land trust must certify adoption of the revised 2004 standards, which will go into effect in mid-2005.
immediacy of the threat of gov't regulation	No.
source of funding	Funding comes from contributions, government grants, program services, investments, and publication sales.
whistle blower protection	
investigatory power	No. Local land trusts self-certify.
robustness of process	The membership maintenance process is not robust.
site visits	No.
regulating body does self-evaluations	No. The LTA follows its own Standards and Practices but does not conduct formal self-evaluations.

Maryland Association of Nonprofit Organizations

Standards for Excellence Institute
www.marylandnonprofits.org
EIN Number: N/A
NTEE Code: N/A

Factor	Description
SANCTIONS	
legal enforceability	No.
other enforceability	If a certified organization does not comply with Standards for Excellence, it would lose that seal or be placed on probation.
history of enforcement	One seal was revoked for failure to meet all standards; one organization was ineligible for recertification, but was given a time frame to achieve recertification.
disclosure of sanctions	Yes. A list of certified organizations is published, and if an organization loses certification, the seal is removed. Loss of certification is announced publicly, though failure to be certified upon application is not announced publicly. The above-mentioned seal revocation was reported and commented on in the Wall Street Journal. (Aug. 18, 2004).
VALUE OF ACCREDITATION	
ability to market to funders	Yes.
ability to market to members	Yes.
industry "buy-in"	Yes. Of the 1,458 members of the Maryland Association of Nonprofit Organizations, 90 already have been certified since the Standards for Excellence was launched in Maryland in 1998. (The Standards for Excellence Institute only has been in existence since June, 2004).
monopoly power	No.
SPECIFICITY	
specificity of sector or sub-sector regulated	The Maryland Association of Nonprofit Organizations (Maryland Nonprofits) has a membership consisting of Maryland nonprofit organizations. The Standards for Excellence Institute has partnerships with nonprofit associations in Pennsylvania, Louisiana, Georgia, North Carolina, and Ohio, and hopes to make its standards national.
specificity of activity regulated	Broad. The Standards cover all aspects of operating and managing a nonprofit organization.
TRANSPARENCY	
dissemination of standards	Yes. The Standards are available online and in print.
disclosure of process	No. The process for enforcement of these standards is not disclosed publicly. Certified organizations receive a license agreement and materials concerning process when they apply for certification.

Maryland Association of Nonprofit Organizations, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	The 3-person Standards of Excellence Institute staff is relative to the 90 certified organizations. There is also a staff member at each location that has entered into replication agreements.
budget ratio to organizations regulated	Maryland Nonprofit's revenue in 2003 was $3,303,693, relative to its 1,458 members. The Standards for Excellence Institute's work is funded by those organizations seeking certification.
focus of the entity	The Standards for Excellence Institute's focus is on certification and replication of the Standards in other jurisdictions. The Institute is part of the larger Maryland Nonprofits, which is focused on certification of its members in addition to member services. These services include training and technical assistance, cooperative buying programs for the purchase of employee benefits, office equipment and supplies, information sharing and networking, public policy advocacy, research, public education, and public relations.
pre-certification	Prerequisites for certification include attendance at a training clinic offered by Maryland Nonprofits, an application, and an application fee.
post-certification	Continuing education is offered, but is not required. Recertification takes place initially after 3 years, and every 5 years thereafter. Seal holders may be requested to provide updated information and documentation.
immediacy of the threat of gov't regulation	No.
source of funding	The Standards for Excellence Institute's major fundraising sources are philanthropic grants and earned income.
whistle blower protection	Certified organizations are required to incorporate whistle blower protections as a prerequisite to earning certification.
investigatory power	Yes. The License Agreement signed by members grants investigatory power to the Institute. Investigations and follow-up activity are overseen by the Ethics and Standards Committee.
robustness of process	The certification process is robust, including site visits, a complaints procedure, etc.
site visits	Yes, the License Agreement gives the Institute authority to conduct site visits if they are deemed to be necessary.
regulating body does self-evaluations	Yes. Maryland Nonprofits conducts Annual Member Satisfaction Surveys and follows its own Standards. The Standards for Excellence program is independently examined by evaluators from Brandeis University.

Middle States Association of Colleges and Schools

Commission on Higher Education
www.msche.org
EIN Number: 23-2786118
NTEE Code: B90

Factor	Description
SANCTIONS	
legal enforceability	The Higher Education Act of 1963, Title IV Student Assistance Program, requires schools to be accredited by a certified accrediting agency in order to be eligible for federal funding.
other enforceability	An unaccredited school faces many difficulties, apart from not being mentioned on the Association's list of accredited schools. Students are not eligible for federal grants, and may not be able to transfer academic credits to other, accredited schools.
history of enforcement	Between November of 2004 and March 2005, the Commission reported that accreditation had been granted to 2 institutions, initial accreditation was granted to 2 institutions, warning removed and accreditation was reaffirmed in the case of 1 institution, substantive change was reported in 16 institutions, and 41 follow-up reports/candidate reports/visits/developments were reported. Loss or denial of accreditation is rare since the application process is long and most "weak" candidates drop out before they face sanctions by the Association.
disclosure of sanctions	Yes. If a school loses its accreditation or has intermediate action taken against it, that information will be made public.
VALUE OF ACCREDITATION	
ability to market to funders	Yes.
ability to market to members	Yes.
industry "buy-in"	Yes.
monopoly power	Yes. The MSCHE is the only regional body that accredits entire institutions. However, there are national and specialized accreditors that can and do accredit entire institutions and/or programs within the institution.
SPECIFICITY	
specificity of sector or sub-sector regulated	Institutions of higher education in Washington D.C., Delaware, Maryland, New Jersey, New York, Pennsylvania, Puerto Rico, and the US Virgin Islands are regulated by the Middle States Association.
specificity of activity regulated	The Association regulates all aspects of the operation of colleges and universities.
TRANSPARENCY	
dissemination of standards	Yes. Standards are widely available.
disclosure of process	Yes. The process is described in detail online.

Middle States Association of Colleges and Schools, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	A staff of 17 is relative to more than 500 institutions of higher education in Delaware, Washington D.C., Maryland, New Jersey, New York, Pennsylvania, Puerto Rico, and the U.S. Virgin Islands. Also, 10 to 15 institutions may be at varying stages in the application process at any time. This is possible because the Association is able to draw on the free services of approximately 3,000 experts who volunteer to participate in the accreditation process.
budget ratio to organizations regulated	The accreditation budget is approximately $3.3 million, which is relative to more than 500 institutions of higher education in Delaware, Washington D.C., Maryland, New Jersey, New York, Pennsylvania, Puerto Rico, and the U.S. Virgin Islands, as well as 10 to15 applicant schools.
focus of the entity	Accreditation activities are a part of the work of a larger organization.
pre-certification	Institutions must file an application and prove that they meet "Characteristics of Excellence" standards.
post-certification	Post-certification requirements include site visits and requests for documentation, a self-study report, and re-accreditation after 10 years, then again after 5.
immediacy of the threat of gov't regulation	No.
source of funding	Funding comes from dues, fees, government grants, and investments.
whistle blower protection	Yes. A complainant's identity is not disclosed to the institution without his or her consent.
investigatory power	Yes. The Association has investigatory power.
robustness of process	The accreditation process is very robust.
site visits	Yes. The Association conducts site visits.
regulating body does self-evaluations	Yes. The Association must meet Department of Education standards.

National Council of YMCAs of the USA

www.ymca.net
EIN Number: 36-3258696
NTEE Code: P27

Factor	Description
SANCTIONS	
legal enforceability	No.
other enforceability	Sanctions include loss of membership or probation if not in compliance with Y mission and non-discrimination policy, or for failure to pay dues. Failure to pay dues is the most common cause for sanctions.
history of enforcement	The Y was established in 1851. In 2003, 132 Y branches had "conditional" membership and 6 were on probation.
disclosure of sanctions	Yes. These disciplinary actions are listed on a members-only website.
VALUE OF ACCREDITATION	
ability to market to funders	Yes.
ability to market to members	Yes.
industry "buy-in"	Yes.
monopoly power	Yes. If an organization wants to use the "YMCA" name.
SPECIFICITY	
specificity of sector or sub-sector regulated	The YMCA of the USA regulates local YMCAs.
specificity of activity regulated	Broad. The national organization's standards include all aspects of Y operation, including funding, facilities, recreation provided, etc.
TRANSPARENCY	
dissemination of standards	Yes. The Y standards are available online or in print upon request.
disclosure of process	Yes. The process is available online.

National Council of YMCAs of the USA, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	The YMCA of the USA's 241 staff is relative to its 974 member YMCAs and 1,601 branches.
budget ratio to organizations regulated	Revenue of $78,770,024 in 2003 is relative to 974 member YMCAs and 1,601 branches.
focus of the entity	The Y provides member services, including publications, products, research, and training.
pre-certification	Prerequisites for membership include basic guidelines such as having a service area of more than 25,000 people within a 7-mile radius, a "start–up fund" of $200,000 to $300,000, and an experienced YMCA senior director on staff.
post-certification	Post-certification, the YMCA of the USA requires an annual report and IRS 990 forms. It also offers continuing education.
immediacy of the threat of gov't regulation	No.
source of funding	The YMCA of the USA's funding comes from public support, government grants, fees and contracts, membership dues, and interest.
whistle blower protection	
investigatory power	No. The YMCA of the USA relies on submissions by local YMCAs to ensure compliance.
robustness of process	This process is not robust.
site visits	No. The YMCA of the USA does not perform site visits.
regulating body does self-evaluations	Yes. The YMCA of the USA is continually audited and monitored to ensure that its services in support of local YMCA associations are effective.

Public Company Accounting Oversight Board

www.pcaobus.org
EIN Number: 74-3073065
NTEE Code: N/A

Factor	Description
SANCTIONS	
legal enforceability	Sarbanes-Oxley §105 (2002) empowers the PCAOB to oversee all registered public accounting firms.
other enforceability	The PCAOB is authorized to impose fines, remedial measures such as training, new quality control procedures, or the appointment of an independent monitor, and revocation of registration.
history of enforcement	This is a new agency which was founded in early January 2003; there have been no public disciplinary actions yet.
disclosure of sanctions	If and when disciplinary actions are taken in the future, that information will be made public.
VALUE OF ACCREDITATION	
ability to market to funders	N/A. The government funds the PCAOB.
ability to market to members	N/A. The PCAOB does not have members.
industry "buy-in"	Yes. Compliance with the PCAOB is required.
monopoly power	Yes. The PCAOB has monopoly power.
SPECIFICITY	
specificity of sector or sub-sector regulated	All registered public accounting firms are regulated by the PCAOB.
specificity of activity regulated	The regulated activity is broad. The PCAOB monitors compliance with its own rules, with any provisions of the securities laws relating to the preparation and issuance of audit reports, and with professional standards. PCAOB rules concern auditing and related attestation, quality control, ethics, and independence standards in preparation and issuance of audit reports.
TRANSPARENCY	
dissemination of standards	Yes. The standards are available online.
disclosure of process	Yes. The process is described online.

Public Company Accounting Oversight Board, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	With 262 employees at the beginning of 2005, the PCAOB expects to increase to 450 by the end of the year. This is relative to the 893 firms in the US and 76 internationally that are regulated by the PCAOB.
budget ratio to organizations regulated	The PCAOB had revenue of $101,247,000 in 2004, relative to 893 firms in the US and 76 internationally.
focus of the entity	The PCAOB is involved in registration, inspection, enforcement, and investigation.
pre-certification	Registration process including a 19 page application form and payment of fees.
post-certification	Annual or triennial inspections are conducted on registered firms.
immediacy of the threat of gov't regulation	The government has created and authorized the PCAOB to do this work.
source of funding	The government is the source of funding for the PCAOB.
whistle blower protection	Yes. The PCAOB recommends that anyone who has complained make a report to OSHA (Occupational Safety and Health Administration) in case of retaliation.
investigatory power	Yes. The PCAOB has power both to "inspect" and to "investigate." It has a continuing program of inspections of registered public accounting firms, as is required by Section 104 of the Sarbanes-Oxley Act of 2002. These inspections are conducted annually for large firms, and triennially for smaller firms. Investigations may be made concerning any acts or practices, or omissions to act, by firms or persons associated with those firms who may have violated any relevant rules. Firms and associated persons are required to cooperate with the PCAOB, including producing documents and testimony. The PCAOB is also permitted to seek information from other persons, including the clients of registered firms.
robustness of process	The process is very robust, including inspection, investigation, hearings, and sanctions.
site visits	Yes. Site visits are conducted.
regulating body does self-evaluations	Yes. The PCAOB self-evaluates. It also hires an independent auditor to complete an audit each year.

United Way of America
http://national.unitedway.org
EIN Number: 13-1635294
NTEE Code: T70

Factor	Description
SANCTIONS	
legal enforceability	No.
other enforceability	The UWA may terminate membership of local United Ways or put local organizations on probation.
history of enforcement	Since the new Accountability and Financial Standards were put in place in 2003, 59 local United Ways have been disaffirmed.
disclosure of sanctions	No. Sanctions are not publicly disclosed. However, upon termination, a local United Way may no longer use the United Way logo or be listed on the UWA website.
VALUE OF ACCREDITATION	
ability to market to funders	Yes.
ability to market to members	Yes.
industry "buy-in"	Yes.
monopoly power	Yes. If a local organization wants to use the name "United Way," it must be part of the larger national organization.
SPECIFICITY	
specificity of sector or sub-sector regulated	Local United Way organizations are regulated.
specificity of activity regulated	All aspects of local United Way management and activities are regulated.
TRANSPARENCY	
dissemination of standards	Yes. The standards are available online or in print.
disclosure of process	Yes. The process is disclosed. The Membership Status Review Procedures for Current Members, adopted on September 10, 2002, are available upon request.

United Way of America, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	The UWA's 10 Membership Accountability staff is relative to 1,348 local United Ways.
budget ratio to organizations regulated	The UWA's revenue of $28,597,444 in 2003 is relative to 1,348 local United Ways.
focus of the entity	Membership accountability is one activity of the UWA's, which is involved in national leadership, public policy, research, and membership support.
pre-certification	Membership requirements include training, submitting IRS form 990, paying dues, and agreeing to the Standards of Excellence.
post-certification	Local United Ways are required to submit annual independent financial audits and self-evaluations triennially.
immediacy of the threat of gov't regulation	No.
source of funding	United Way's funding comes from contributions, government grants, program services, dues, interest, dividends and rental income.
whistle blower protection	No. The UWA does not have whistle blower protection, but local United Ways are required to have whistle blower policies. UWA does not handle anonymous complaints.
investigatory power	Yes, the UWA Member Services Committee has investigatory authority when it finds that a member may be in breach.
robustness of process	The process, while it does include an appeals process, is not robust.
site visits	No, site visits are performed.
regulating body does self-evaluations	Yes, the UWA self-evaluates and holds itself to its own Standards.

Western Association of Schools and Colleges

www.wascweb.org/senior/
EIN Number:
NTEE Code:

Factor	Description
SANCTIONS	
legal enforceability	The Higher Education Act of 1963, Title IV, requires accreditation of institutions of higher education in order to be eligible for government funding.
other enforceability	If a school fails to receive accreditation, or loses accreditation, this will be made public. The Association also may issue warnings. In addition, students at non-accredited schools may not be able to transfer credit to other institutions of higher education.
history of enforcement	The Association issued 3 warnings in 2004-2005.
disclosure of sanctions	Yes. All disciplinary actions except for a "Notice of Concern" are made public.
VALUE OF ACCREDITATION	
ability to market to funders	Yes.
ability to market to members	Yes.
industry "buy-in"	Yes.
monopoly power	Yes. No other accrediting body exists in that region. While accreditation is not mandatory, all schools seek it because of its benefits.
SPECIFICITY	
specificity of sector or sub-sector regulated	The Association regulates all institutions of higher education in California, Hawaii, and the Pacific Basin.
specificity of activity regulated	This regulation is broad. It covers all aspect of operation of institutions of higher education in its region.
TRANSPARENCY	
dissemination of standards	Yes. Standards are available online and in print.
disclosure of process	Yes. The process is disclosed online and in handbooks, available upon request.

Western Association of Schools and Colleges, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	The Association has 25 members of the accreditation commission and 5 staff, relative to 151 accredited institutions.
budget ratio to organizations regulated	In 2003, the entire association had revenue of $6,262,565, relative to 151 accredited institutions.
focus of the entity	Accreditation is the primary activity of the organization.
pre-certification	Prerequisites for accreditation, such as having been in operation for a specified period of time, self-evaluation, etc., and an application process.
post-certification	Each school must file annual reports, will be visited at least every ten years, and undergoes comprehensive self-evaluation every 10 years. It also must report any substantive changes, such as opening a satellite branch, to the Association.
immediacy of the threat of gov't regulation	
source of funding	The source of Association funding is dues and fees, government grants, investments, program services, and sales.
whistle blower protection	Yes.
investigatory power	Yes. The investigatory power is quite broad.
robustness of process	The process is very robust, with a detailed complaints procedure, investigation procedure, and appeals procedure.
site visits	Yes. Site visits are conducted.
regulating body does self-evaluations	Yes. The Association must meet Department of Education standards and is reviewed periodically by the US Department of Accreditation. In addition, the Association self-evaluates.

2. Entities that Regulate Individuals: The following entities regulate individuals:[7]

   a. **American Society of Association Executives:** The ASAE accredits interested members pursuant to a Certified Association Executive Program. The program does not reflect an effective self-regulatory scheme because (1) certification is completely voluntary and not required for ASAE membership, (2) the program lacks any sort of sanctions for failure to qualify for certification, and (3) only 21.5 percent of ASAE's members are certified, indicating very limited industry buy-in and marketability to members.
   b. **Association of Fundraising Professionals:** The AFP is a professional association of fundraisers, with 26,000 members and 171 chapters worldwide. The AFP requires its members to comply with a Code of Ethical Principles and Standards of Professional Practice that is designed to provide guidelines for fundraising professionals. Penalties for violation of the Code include a letter of reprimand, censure and prohibition against holding association and chapter office in AFP for one year, and suspension or permanent expulsion from AFP membership, including withdrawal of any AFP sanctioned credential. Although the AFP process for certification and suspension is robust, the effectiveness of the AFP as a model of self-regulation is somewhat limited because membership is not required for fundraisers, so the organization lacks monopoly power.
   c. **New York State Bar Association:** The NYSBA, with more than 70,000 members, is the nation's largest voluntary statewide association of lawyers. It disseminates the Lawyer's Code of Professional Responsibility and makes recommendations to the courts regarding disciplinary actions against attorneys, but all disciplinary actions and disbarments are handled by the courts. The effectiveness of this regulatory scheme is limited by the NYSBA's lack of sanctions, particularly the authority to disbar attorneys.
   d. **State Bar of California:** Created by the state legislature in 1927, the State Bar is a public corporation within the judicial branch of government, serving as an arm of the California Supreme Court. Membership in the State Bar is a requirement for practicing law in California. Although only the courts can disbar attorneys in California, the State Bar does have several enforceable sanctions available to it, including temporary suspension of attorneys. The State Bar is an effective model of self-regulation based on (1) mandatory membership (monopoly power) and (2) enforceable sanctions for noncompliance with standards.

Our analysis of the selected self-regulatory entities that regulate individuals concluded that certain factors, alone or in combination, were the most significant for creating an effective self-regulatory scheme. Probably the single most significant factor contributing to the effectiveness of self-regulatory models that regulate organizations is legal enforceability of sanctions. A second significant set of factors contributing to the efficacy of self-regulatory schemes that regulate individuals is the authority to accredit individuals coupled with the authority to withdraw the accreditation, particularly when this certification or accreditation is required to enable to the regulated individuals to engage in the activities for which he or she is being regulated (monopoly power). These factors may be even more powerful where (1) the organization has a strong history of enforcing its sanctions, (2) where the processes of accreditation and required reaccredidation are robust, particularly if site visits are required, and (3) where sufficient staff and budget are allocated to the regulatory function of the self-regulatory body.

[7] See Appendix B.

American Society of Association Executives
Certified Association Executive Program
www.asaenet.org
EIN Number: 53-0026940
NTEE Code: Z99

Factor	Description
SANCTIONS	
legal enforceability	No.
other enforceability	An executive faces revocation of membership “for cause,” such as non-payment of dues.
history of enforcement	
disclosure of sanctions	No.
VALUE OF ACCREDITATION	
ability to market to funders	No.
ability to market to members	No.
industry “buy-in”	No. Of members, only 21.5% are part of the Certified Association Executive Program.
monopoly power	No. Certification by the ASAE, while widely recognized, is entirely voluntary.
SPECIFICITY	
specificity of sector or sub-sector regulated	Association executives in the US.
specificity of activity regulated	Narrow. Association management and ethics.
TRANSPARENCY	
dissemination of standards	Yes. Standards are available online.
disclosure of process	Yes. The certification process is detailed online.

American Society of Association Executives, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	134 total staff with 7 staff in membership department relative to 25,000 individual members, and 10,000 association members. 21.5% of individual members take part in the CAE Program.
budget ratio to organizations regulated	In 2003, ASAE revenue was $913,108, compared to 25,000 individual members, and 10,000 association members.
focus of the entity	The ASAE performs member services and certification programs.
pre-certification	The ASAE has prerequisites for certification application, including length of experience requirements and the passing of a stringent examination in association management.
post-certification	Certification requires fulfilling continuing education requirements and applying for renewal every 3 years.
immediacy of the threat of gov't regulation	No.
source of funding	ASAE's funding comes from contributions, program services and special events.
whistle blower protection	
investigatory power	No. The ASAE may revoke membership "for cause," but does not conduct investigations.
robustness of process	Low.
site visits	No. The ASAE does not conduct site visits.
regulating body does self-evaluations	The ASAE conducts annual internal audits by a CPA recommended by the ASAE president or CEO. The ASAE does not generally self-evaluate.

Association of Fundraising Professionals

www.afpnet.org
EIN Number:
NTEE Code:

Factor	Description
SANCTIONS	
legal enforceability	No.
other enforceability	Penalties for violation of the a Code of Ethical Principles and Standards of Professional Practice include a letter of reprimand; censure and prohibition against holding association and chapter office in AFP for one year; suspension of membership in AFP for a stated period; and, permanent expulsion from AFP membership, including withdrawal of any AFP sanctioned credential.
history of enforcement	The AFP was started in 1960 and adopted the Code of Ethics in 1964. In 1992, it adopted its current Procedures for Enforcement of the Code of Ethical Principles and Standards of Professional Practice. There have been approximately 10-15 memberships revoked in the past 7 years.
disclosure of sanctions	Yes. The AFP sends out an AFP-wide publication stating all the disciplinary actions taken by the AFP during the previous period. It will not disclose the name of the organizations involved, however, and is intended for educational purposes only. In the case of membership revocation, information stating the name of the organization involved will be posted on the AFP website and will be included in AFP newsletters.
VALUE OF ACCREDITATION	
ability to market to funders	No.
ability to market to members	Yes. Funders and members are the same; all funding comes from membership and programming dues.
industry "buy-in"	Yes. The AFP has 26,000 individual members and 171 chapters throughout the United States, Canada, Mexico, and China.
monopoly power	No.
SPECIFICITY	
specificity of sector or sub-sector regulated	All fundraising professionals in the United States, Canada, Mexico, and China that want to join.
specificity of activity regulated	The Code covers broad areas of fundraisers' practices.
TRANSPARENCY	
dissemination of standards	Yes. Standards are available online.
disclosure of process	Yes. The process is detailed online.

Association of Fundraising Professionals, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	11 sitting committee members for 26,000 individual members.
budget ratio to organizations regulated	$10 million total budget as compared to 26,000 current members.
focus of the entity	The AFP works to advance philanthropy through advocacy, research, education, and certification programs, primarily through setting and enforcing high ethical standards and principles for members of the fundraising community as set forth in its Code of Ethical Principles and Standards of Professional Practice in order to maintain public trust for every AFP member. AFP provides a self-governed process for addressing ethical concerns.
pre-certification	Yes. There are three different categories of membership based on years of experience in the field. The AFP does not question the type of membership of its applicants and instead relies on the integrity of its members to self-regulate.
post-certification	Yes. Every member organization must reaffirm their adherence to the Code of Ethics each year.
immediacy of the threat of gov't regulation	No.
source of funding	Membership and educational programming fees.
whistle blower protection	No.
investigatory power	The AFP has investigatory power.
robustness of process	The disciplinary process is robust.
site visits	Yes, the AFP's investigation may include site visits.
regulating body does self-evaluations	The AFP's Board of Directors evaluates itself and the organization annually through an internal formal process.

New York State Bar Association

www.nysba.org
EIN Number: N/A
NTEE Code: N/A

Factor	Description
SANCTIONS	
legal enforceability	No. The NY courts handle all disciplinary actions against lawyers. The State Bar is able to make recommendations to the courts about the rules or about individual cases, but its judgments are not final or legally enforceable.
other enforceability	The State Bar may impose loss of membership, but this has never been reported except in the case of a lawyer having been disbarred by the courts first. In addition, it issues letters of caution, admonition, or reprimand.
history of enforcement	No.
disclosure of sanctions	No. Formal ethics opinions issued by the Committee on Professional Ethics can be purchased. These opinions are presented to the Court for its consideration in disciplinary procedures. Letters of caution, admonition, or reprimand are not made public but are retained as part of the attorney's record.
VALUE OF ACCREDITATION	
ability to market to funders	No.
ability to market to members	Yes.
industry "buy-in"	Yes. New York has the largest number of members (70,000) of any state with a voluntary bar. However, many lawyers belong to their local city or county bars instead of the state-wide organization.
monopoly power	No. New York has a voluntary bar.
SPECIFICITY	
specificity of sector or sub-sector regulated	The New York State Bar Association is concerned with legal practice in New York.
specificity of activity regulated	Broad. The Bar is concerned with all aspects of legal practice.
TRANSPARENCY	
dissemination of standards	Yes. The Lawyer's Code of Professional Responsibility is widely available.
disclosure of process	Yes. The process is available online.

New York State Bar Association, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	The NYSBA's staff of 118 is relative to its 70,000 members.
budget ratio to organizations regulated	The NYSBA's budget of $21 million is relative to its 70,000 members.
focus of the entity	Regulation of lawyers is one activity of the organization. It is also involved in influencing legislation, raising judicial standards, advocating voluntary pro bono legal services for the poor, and providing continuing education.
pre-certification	Prerequisites for membership include having passed the bar exam.
post-certification	Continuing education is required by the NY courts to maintain one's license, and continuing membership in the State Bar depends on not being disbarred by the courts.
immediacy of the threat of gov't regulation	No.
source of funding	Dues and fees from members provide the NYSBA's funding.
whistle blower protection	Yes.
investigatory power	Yes. The committee will investigate complaints.
robustness of process	The robustness of the disciplinary process is medium. While the Committee on Standards of Attorney Conduct investigates violations, it has no enforcement capability. The most it can do is to make a recommendation to the courts.
site visits	No.
regulating body does self-evaluations	Yes. The State Bar self-evaluates.

The State Bar of California

www.calbar.ca.gov
EIN Number: 94-6001385
NTEE Code: N/A

Factor	Description
SANCTIONS	
legal enforceability	The State Bar is an administrative arm of the California Supreme Court. Also, Chapter 342, Statutes of 1999, restored the Bar's authority to collect fees from California lawyers at an average rate of $395/year for the year 2000.
other enforceability	The independent State Bar Court recommends to the California Supreme Court whether to suspend or disbar lawyers. The State Bar may temporarily remove lawyers from practice ("involuntary inactive status") when they are deemed to pose a substantial threat of harm to clients or to the public. For lesser offenses, the State Bar may issue public or private reprovals. Suspension or disbarring of lawyers must be approved by the California Supreme Court.
history of enforcement	California was one of the first unified bars in the US, having unified in 1927. In 2002, it received 12,051 complaints. It resolved 4,852 situations. In 2002, the Office of the Chief Trial Counsel issued 69 warning letters, 98 resource letters, 39 agreements in lieu of discipline, 2,867 dismissals, 587 terminations; in 88 cases resignations were tendered with charges pending; 146 stipulated disciplines were filed; and 402 notices of disciplinary charges were filed.
disclosure of sanctions	Yes. Public reprovals may be issued. The public also may check an attorney's bar membership record online.
VALUE OF ACCREDITATION	
ability to market to funders	Yes.
ability to market to members	Yes. Funders and members are the same; all funding comes from membership fees and dues.
industry "buy-in"	Yes. There is mandatory membership.
monopoly power	Yes. California has a unified Bar and therefore membership is mandatory.
SPECIFICITY	
specificity of sector or sub-sector regulated	The legal practice in CA is regulated by the State Bar.
specificity of activity regulated	Broad. The California State Bar regulates all aspects of legal practice.
TRANSPARENCY	
dissemination of standards	Yes. Standards are available online or in print.
disclosure of process	Yes. The process is detailed online.

The State Bar of California, *continued*

Factor	Description
OTHERS	
staff ratio to organizations regulated	With 200,321 lawyers in April 2005, California is the largest integrated bar in the nation. The State Bar Court has 10 judges.
budget ratio to organizations regulated	In 2002, the California's State Bar's general fund budget was $50.8 million, about 80% of which funded the Bar's attorney disciplinary activities. This is relative to California's 200,321 lawyers.
focus of the entity	Regulation of lawyers, while a major activity of the Bar, is part of the organization's larger work. The Bar also provides continuing education, public services, aid in the development of pro bono programs, etc.
pre-certification	Upon passing the bar in California and paying dues, a lawyer becomes a member.
post-certification	The Bar requires 25 hours of continuing education every 3 years. The Bar offers "Ethics School" for attorneys found to be in need of remedial measures.
immediacy of the threat of gov't regulation	No.
source of funding	The state bar relies on dues and fees for its funding.
whistle blower protection	Yes. Complaints can be made anonymously.
investigatory power	Yes. The State Bar Court has investigatory power.
robustness of process	The disciplinary process is robust.
site visits	Yes. The State Bar Court's investigation may include site visits.
regulating body does self-evaluations	Yes. The State Bar self-evaluates.

3. Entities that regulate both organizations and individuals: The following entity regulates both organizations and individuals:

   a. **National Association of Securities Dealers:** The NASD is the primary private-sector regulator of America's securities industry. It is empowered as a regulator by the Maloney Act (15 USCS §780-3). The NASD licenses individuals and admits firms to the securities industry, writes rules to govern their behavior, examines them for regulatory compliance, and disciplines those who fail to comply. The NASD oversees and regulates trading in equities, corporate bonds, securities futures, and options, and provides education and qualification examinations to industry professionals while supporting securities firms in their compliance activities. The NASD has authority to fine, suspend, or expel any brokerage firm or registered securities representative that violates its standards. The NASD is quite powerful as a regulator because (1) its sanctions are legally enforceable, (2) its sanctions, including suspensions and fines, are comprehensible and effective, (3) it has a strong history of enforcing its sanctions, (4) its sanctions are publicly disclosed, and (5) its investigatory powers, guaranteed by law, are quite broad.

Our analysis of the selected self-regulatory entity that regulates both organizations and individuals concluded that the single most significant factor contributing to the effectiveness of this self-regulatory model is legal enforceability of sanctions.

National Association of Securities Dealers
www.nasd.com
EIN Number: 53-0088710
NTEE Code: Z99

Factor	Description
SANCTIONS	
legal enforceability	15 USCS §780-3 (2004) (the "Maloney Act") empowers the NASD to regulate the securities industry.
other enforceability	The NASD has authority to fine, suspend, or expel any brokerage firm or registered securities representative that violates its standards.
history of enforcement	The NASD was established in 1945; in 2003, 1,410 disciplinary actions were reported, 827 individuals were suspended or expelled from industry, and $3 million in fines were collected.
disclosure of sanctions	Yes. These sanctions are made public, and you can "Check Your Broker's Background" on the NASD website. Also, monthly reports of disciplinary actions are posted online.
VALUE OF ACCREDITATION	
ability to market to funders	N/A. The government funds the NASD.
ability to market to members	N/A. The NASD does not have members.
industry "buy-in"	Yes. NASD oversight is mandatory.
monopoly power	Yes.

National Association of Securities Dealers, *continued*

Factor	Description
SPECIFICITY	
specificity of sector or sub-sector regulated	The NASD regulates the securities industry.
specificity of activity regulated	Broad. The NASD regulations affect all aspects of the operations of its constituents in the securities industry.
TRANSPARENCY	
dissemination of standards	Yes. The regulations are readily available.
disclosure of process	Yes. The process is detailed online.
OTHERS	
staff ratio to organizations regulated	The NASD's 2,000 member staff is relative to the 5,100 firms and 659,000 securities representatives that it regulates.
budget ratio to organizations regulated	The NASD's annual budget of more than $500 million is relative to the 5,100 firms and 659,000 securities representatives that it regulates.
focus of the entity	The NASD is involved in licensing and admission to the industry, writing rules to govern their behavior, examination for regulatory compliance, and discipline of those not in compliance with the regulations. It also provides education and qualification exams to industry professionals; oversees and regulates trading in equities, corporate bonds, securities futures, and options; and operates the largest securities dispute resolution forum in the world. It enforces not only its own rules, but also federal securities laws, rules, and regulations, and the rules of the Municipal Securities Rulemaking Board.
pre-certification	The NASD issues licenses for entrance to industry.
post-certification	The NASD examines for regulatory compliance.
immediacy of the threat of gov't regulation	The government already has threatened to regulate, which is why the NASD was formed.
source of funding	The federal government provides the NASD's funding.
whistle blower protection	Yes. The NASD makes the process as confidential as possible, and has tools for filing tips on its website. However, it does not guarantee that the complainant's identity will not be discovered in the course of an investigation.
investigatory power	Yes. The NASD has broad investigatory power.
robustness of process	The robustness of the enforcement process is very high.
site visits	Yes. The NASD conducts site visits.
regulating body does self-evaluations	Yes. The NASD does self-evaluations.

CONCLUSIONS

Self-regulatory structures are frequently important contributors to the integrity, efficiency, and overall health of various economic sectors in our country. They are not merely important but are absolutely critical to the nonprofit sector, and most crucially to charities and social welfare organizations within it. Charities and social welfare organizations are, of course, subject to governmental oversight on both the federal and state levels. The resources dedicated to this vital task are vastly insufficient, however. On the federal level, Internal Revenue Service staffing has increasingly fallen behind the growth of the organizations it oversees. On the state level, there are only a handful of states where the Attorney General's charity office operates meaningfully.

In the resulting partial vacuum of governmental oversight, self-regulation is an indispensable tool for setting standards, identifying malfeasance and misfeasance, and improving the integrity and efficiency of the nation's charities and social welfare organizations. Even if the current Congressional focus results in new legislation, self-regulation will continue to be a centrally important contributor not only to the improvement of nonprofit performance but also to the perception that the sector generally is performing properly. Because the nonprofit sector depends on public support, it must not only be, but be seen to be, subject to careful and vigilant oversight. Government oversight alone never has been and never will be sufficient to accomplish that task.

It follows that improving self-regulation is an extremely important goal for the nonprofit sector. To advance towards this goal, it will be helpful to identify organizations that have done it well, tease out the reasons why they have succeeded where others have not, and ascertain the factors or attributes that most significantly contribute to their effectiveness. Those insights, in turn, have the potential to contribute to improved self-regulation by existing organizations and to the design and implementation of better new self-regulatory systems when and where appropriate.

Expectations, however, should remain nuanced. In a free society, no amount of governmental regulation and oversight, even coupled with vibrant and vigorous self-regulatory initiatives, will prevent all nonprofit fraud, misfeasance, or ineffectiveness. If the virtues of self-regulation are trumpeted with too much enthusiasm, disappointment is inevitable when scandals eventually occur. Protecting and promoting the luster of the sector is important, but that will best be accomplished by moderate, rather than hyperbolic, predictions of the benefits that accrue from self-regulation.

Probably the single most significant factor contributing to the effectiveness of any self-regulatory model is legal enforceability of its standards. This may at first appear to be an oxymoron: if self-regulation is, by definition, regulation by organizations other than governments, how can *legal* enforceability be an attribute of *self*-regulation? There are instances, however, in which non-governmental organizations have been allowed to establish their own standards (not designed or dictated by government) for regulating a sector, but with sanctions for non-compliance imposed by laws adopted by the government. For example, the National Association of Securities Dealers ("NASD") is not a governmental organization, but its standards and procedures for regulating brokers and dealers in the securities markets are sanctioned by federal law. The Public Company Accounting Oversight Board ("PCAOB") is similarly effective based on the legal enforceability of its sanctions.

There is a subtle line to observe here: if government, in addition to providing legal sanctions, intrudes unduly into either the substance of self-regulatory standards or the processes by which they are applied, the so-called self-regulatory organization may become a mere agent of the government. In this report, it is assumed that self-regulatory standards and procedures, even if subject to legal sanctions, will be established and implemented without undue influence from government. While it is not possible to state any precise delimitation of permissible governmental participation, if government moves too far from respectful observer to participating standard setter, the resulting model will not be and should not be considered to be self-regulation.

Short of legally enforceable sanctions, a self-regulatory system with other meaningful sanctions may also be quite powerful. The best example is the authority to accredit organizations coupled with the authority to withdraw the accreditation, when the accreditation is required either (1) to enable to the organization to engage in the activities for which it is formed (monopoly power) or (2) for funding by government and private grant makers (ability to market to funders).

The Middle States Association of Colleges and Schools and the Western Association of Schools and Colleges, like several other similar bodies charged with accrediting U.S. colleges and universities, are not governmental organizations, set their own standards and criteria for evaluating tertiary institutions, and perform their own accreditations. Their findings, however, are relied on by government in granting or withholding funding of the institutions subject to such accreditation. The Middle States Association of Colleges and Schools and the Western Association of Schools and Colleges thus represent two of the most potent examples of self-regulatory schemes based primarily on the impact of their accreditations on major funders.

Other examples of effective self-regulatory schemes, although lacking both legal enforceability and monopoly power, are the American Association of Museums and the Evangelical Council for Financial Accountability. Although membership in both organizations is purely voluntary, funding for regulated organizations is often predicated on membership and accreditation. Both organizations have strong histories of revoking accreditations when appropriate, precipitating a meaningful impact on access to necessary funds. Both organizations also employ robust and complex processes for attaining and maintaining accreditation, including substantial application requirements, recertification, and site visits.

Effective monopoly power without legal enforceability is illustrated by the Australian Council for International Development, the Joint Commission on Accreditation of Healthcare Organizations, the National Council of YMCAs of the USA, the State Bar of California, and the United Way of America. These self-regulatory bodies are quite effective because they have enforceable authority to preclude organizations or individuals from a career or profession or line of business by revoking accreditation. This is a severe sanction and thus sustains substantial compliance with the standards of practice established by those organizations. In order for this factor to be strong, however, the self-regulatory body must control or significantly influence access to a meaningful area of activity or employment, and it must have the necessary staff, budget, powers, and processes to make the risk of expulsion for noncompliance substantial. The organization's history of enforcement is also material.

The specificity of standards is also a factor influencing self-regulatory effectiveness. Standards designed for the regulation of the financial affairs of religious organizations may be more focused and admit of more clarity and precision than standards covering the ethical or managerial behavior generally of all organizations in the nonprofit sector. The tighter the focus—either of the nature of the regulated conduct or of the members of the regulated class—the more likely it is that the self-regulatory standards will be clearly understood by those subject to them, viewed by them as relevant and appropriate, and embraced in practice. Conversely, the broader the coverage of the standards—in substance or applicability —the greater the risk that they may be seen as overly general, perceived as "soft" and perhaps even irrelevant, and given merely lip service. This would be true in any area of self-regulation, but because of the vast diversity within and scope of the nonprofit sector, it is particularly true, there, that one size may not easily fit all.

If one were to structure a model of self-regulation that could effectively impact the integrity, efficiency, and overall health of a sector or subsector, legally-enforceable sanctions would be the single most compelling factor that one could offer. In many realms, however, legal enforceability is either unattainable or undesirable. In those areas, an effective self-regulatory scheme may still be achieved by a combination of some of the more significant other factors of self-regulation analyzed in this Report. These factors would include the authority to accredit organizations coupled with the authority to withdraw the accreditation, particularly when this certification or accreditation is required either (1) to enable to the organization to engage in the activities for which it is formed (monopoly power) or (2) for funding by government and private grantmakers (ability to market to funders). The impact of a self-regulatory scheme manifesting these factors could be augmented if the scheme also reflects the following: (1) a strong history of enforcement, (2) a robust process for accreditation and required reaccredidation, preferably including site visits, and (3) sufficient staff and budget dedicated to the self-regulatory function to implement the scheme in an effective manner.

Finally, the analysis in this Report will benefit from the hoped-for critical engagement of others, whose ideas, insights, agreements, and disagreements are likely to advance understanding of what makes self-regulatory models effective or ineffective. We look forward to those thoughts and contributions.

Respectfully submitted, The National Center on Philanthropy and the Law
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Glossary of Terms

501(c)(3). *See* Section 501(c)(3)

Annual Information Return. *See* Form 990, Form 990-EZ, and Form 990-PF.

Appraisal. An assessment of the value of any type of property (clothing, household goods, art, land) by an authorized person.

Audit. *See* Financial Audit.

CEO or Chief Executive Officer. The highest ranking staff member or volunteer of the organization. Some organizations refer to this position as the executive director or the president. This report also uses "chief staff officer" to refer to the highest ranking paid employee.

Charitable Organization. Any tax-exempt organization recognized under section 501(c)(3) of the Internal Revenue Code. In this report, charitable organization refers to both public charities and private foundations.

Community Foundation. A tax-exempt organization that generally holds a number of permanent funds created by many separate donors, all dedicated to the long-term charitable benefit of a specific community or region. A community foundation is generally recognized as a public charity, and is therefore not subject to the more stringent rules that apply to private foundations. Typically, a community foundation provides grants and other services to assist other charitable organizations in meeting local needs, and also offers services to help donors establish endowed funds for specific charitable purposes.

Compensation. All forms of cash and non-cash payment provided in exchange for services or products. In reporting compensation paid to a board member or employee, organizations are expected to include salary or wages, bonuses, severance payments, and deferred payments; retirement benefits, such as pensions or annuities; fringe benefits; and other financial arrangements or transactions treated as compensation (for example: personal vehicle, meals, housing, personal and family educational benefits, low-interest loans, payment of personal or spousal travel, entertainment, or other expenses, and personal use of the organization's property).

Compensation Committee. A committee authorized by the governing board to review and make recommendations regarding the compensation of the chief executive officer and the compensation range for other persons in a position to exercise substantial control of the organization's resources.

Conflict of Interest Policy. A conflict of interest arises when a board member or staff person's duty of loyalty to the charitable organization overlaps with a competing personal interest he or she may have in a proposed transaction. Some such transactions are illegal, some are unethical, and others may be undertaken in the best interest of the charitable organization as long as certain clear procedures are followed. A conflict of interest policy helps protect the organization by defining conflict of interest, identifying the classes of individuals within the organization covered by the policy, facilitating disclosure of information that may help identify conflicts of interest, and specifying procedures to be followed in managing conflicts of interest.

Corporate Foundation. A private foundation that receives its primary funding from a profit-making business. The foundation is a separate, legal charitable organization even though it often maintains close ties with the founding company, and it must abide by the same rules and regulations as other private foundations. Also known as a company-sponsored foundation.

Disqualified Person. For public charities, a disqualified person is someone who, at any time during the five-year period ending on the date of the transaction in question, was "in a position to exercise substantial influence over the affairs of the organization." Any member of a disqualified person's family falls into this category, as does any entity in which one or more disqualified persons together own, directly or indirectly, more than a 35 percent interest. Disqualified persons of public charities recognized as "supporting organizations" also include substantial contributors and their family members. Disqualified persons of donor-advised funds held by public charities include donors, investment advisors, and their family members. For private foundations, the definition of a disqualified person includes all of the above as well as substantial donors, owners of more than 20 percent of a corporation, trust, or partnership that is a substantial contributor to the foundation, and the family members of any of these persons. Certain government officials are also considered disqualified persons of private foundations. *See also* Substantial contributor.

Donor-Advised Fund. Section 4966(d)(2) of the federal tax code defines a donor-advised fund as a fund or account that is owned and controlled by a sponsoring charitable organization, is separately identified by reference to contributions of a donor or donors, and to which the donor (or an advisor designated by the donor) has or reasonably expects to have advisory privileges regarding the distribution or investment of the assets in the fund. The tax code specifically excludes a fund or account that makes distributions only to a single identified organization or governmental entity or that makes grants for travel, study or similar purposes provided that certain conditions are met. The Pension Protection Act of 2006 (P.L. 109-280) enacted new restrictions on the administration of donor-advised funds.

Due Diligence. The degree of prudence that a reasonable person is expected to exercise in reviewing a particular transaction or investment opportunity before deciding to act. *See also* Fiduciary Duty.

Excess Benefit Transaction. An economic benefit provided by a public charity to a disqualified person that is determined to be in excess of the value of the services or property received in exchange by the public charity. *See also* Disqualified Person, Intermediate Sanctions.

Excise Tax. A tax that applies to a specific type of income, activity, good, or service. For example, private foundations are subject to an excise tax on net investment income. An excise tax may also be imposed on charitable organizations, and their managers and other disqualified persons that engage in certain prohibited activities or approve of prohibited transactions, such as excess benefit transactions..

Fair Market Value. The IRS defines fair market value as "the price that would be agreed on between a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts. If there is a restriction on the use of the property (such as a conservation easement), the fair market value price should reflect that restriction." (IRS Publication 561, Determining the Value of Donated Property.)

Fiduciary Duty. The legal responsibility for investing money or acting wisely on behalf of another. Members of the governing board of a charitable organization have a fiduciary duty to act in the best interests of the organization.

Financial Accounting Standards Board (FASB). A professional standards board created by accountants to establish standards of financial accounting—known as Generally Accepted Accounting Principles or GAAP—and reporting in the private sector, including charitable organizations. FASB is officially recognized as authoritative by the Securities and Exchange Commission and the American Institute of Certified Public Accountants. FASB operates under the auspices of the Financial Accounting Foundation, a public charity, and its work is primarily funded by mandatory fees paid by issuers of securities.

Financial Audit. A formal examination of an organization's financial records and practices by an independent, certified public accountant with the objective of assessing the accuracy and reliability of the organization's financial statements. An audit must follow standards set forth by the American Institute of Certified Public Accountants to be accepted universally.

Financial Review. An examination of an organization's financial records and practices by an independent accountant with the objective of assessing whether the financial statements are plausible. A financial review does not involve the extensive testing and external validation procedures of an audit and generally provides less credibility than an audit. A review offers a lower-cost method of providing some assurance to board members and other managers of an organization that the financial systems and statements are in reasonable order.

Form 990 Series. Used in this report to refer to the three forms (Form 990, Form 990-EZ and Form 990-PF) filed annually with the Internal Revenue Service by charitable organizations. By law, a charitable organization must make its forms (with required schedules attached) publicly available.

Form 990. The IRS form that tax-exempt organizations (other than private foundations) that have annual revenues of $100,000 or more or total assets above $250,000 must file annually to report on their financial and program operations. Religious congregations and specific related institutions, specified government agencies, and other organizations identified by the IRS are exempt from this filing requirement.

Form 990-EZ. The IRS form that tax-exempt organizations (other than private foundations) that have annual revenues of $25,000 up to $100,000 or total assets between $100,000 and $250,000 must file annually to report on their financial and program operations. Religious congregations and specific related institutions, specified government agencies, and other organizations identified by the IRS are exempt from this filing requirement.

Form 990-PF. The IRS form that all private foundations are required to file annually to report on their financial and program operations.

Form 1023 Application for Recognition of Exemption Under Section 501(c)(3). The IRS form filed by organizations to obtain recognition of exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code. Its filing is mandatory for all charitable organizations that want to be tax-exempt, except for religious congregations, certain organizations affiliated with religious congregations, and charitable organizations that have gross receipts in each taxable year of normally not more than $5,000.

Form 8282. The IRS form that charitable organizations must file if they sell or dispose of donated property valued at $5,000 or more (based on the value claimed by the donor on Form 8283) within two years of receiving the donation.

Form 8283. The IRS form that taxpayers must file with their annual tax return if they claim deductions for non-cash contributions with a total value of $500 or more. If the value of any single donated item or collection of items exceeds $5,000, the taxpayer must have the Form signed by the appraiser who certified the value of the property and the charitable organization that received the donation.

Generally Accepted Accounting Principles (GAAP). The accounting principles set forth by the Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants (AICPA) that guide the work of accountants in reporting financial information and preparing audited financial statements for organizations.

Intermediate Sanctions. The name given to Section 4958 of the Internal Revenue Code that allows the IRS to impose penalties on the individuals who benefit from or approve an excess benefit transaction, rather than penalizing the organization. Prior to the passage of this law in 1996, the IRS's only penalty for such transactions was to revoke the tax-exempt status of the organization, thus these "intermediate sanctions" offer penalties that stop short of this severe sanction on the organization. Intermediate sanctions rules apply to all 501(c)(3) organizations (except private foundations) and to organizations exempt from taxes under section 501(c)(4) of the Internal Revenue Code. *See also* Excess Benefit Transactions; Rebuttable Presumption.

Lead Director. A board member appointed by the board to serve as chair during a particular board discussion or meeting to handle issues in which the chairperson has a conflict of interest.

Nonprofit Organization. *See* Tax-exempt organization.

Non-Operating Foundation. A private foundation that furthers its charitable purposes primarily by making grants to support charitable programs conducted by other organizations. *See also* Operating Foundation.

Office of Management and Budget (OMB) Circular A-133. The instructions provided by the Office of Management and Budget (OMB) regarding audits of states, local governments, and nonprofit organizations that receive federal funding. Under OMB Circular A-133, nonprofit organizations that receive $500,000 or more in federal funds grants per year must have their financial statements audited.

Operating Foundation. A private foundation that uses the bulk of its income, usually earned from assets contributed by a single individual, family, or company, to provide charitable services or to run charitable programs of its own, as opposed to making grants to other organizations. *See also* Non-Operating Foundation, Private Foundation, Public Charity.

Premium Travel. According to federal regulations, premium travel is any class of accommodation above coach or economy class, such as first or business class.

Private Foundation. A charitable organization under IRS Section 501(c)(3), typically established by a single individual, family, or company, that receives more than two-thirds of its support from its founders or from investment income earned by an endowment. Private foundations are subject to substantially more restrictive rules than public charities governing their operations, and their donors receive less favorable tax treatment for contributions. If a public charity fails to meet its "public support test" of receiving at least one-third of its income from the public in the form of contributions and grants, it is generally reclassified as a private foundation. *See also* Public Charity.

Public Charity. A charitable organization, recognized under IRS Section 501(c)(3), that generally receives at least one-third of its support from a broad segment of the general public or from a governmental unit. 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. There are specific federal rules for the operation of certain public charities established as medical research organizations, charities that operate as credit counseling organizations, and certain supporting organizations, as well as for donor advised funds held by a public charity.

Rebuttable Presumption. A rule under intermediate sanctions law that delineates procedures a public charity must follow in order for the IRS to presume that the compensation the charity provided to a disqualified person(s) in return for services or property is reasonable. The IRS may "rebut" this presumption by presenting evidence showing the compensation was excessive. The rules call for compensation to be approved in advance by the board (or other authorized committee) and further specifies that the members must not have a conflict of interest with respect to the transaction. The board must use information such as salary surveys, appraisals, or other appropriate data to help determine comparability or fair market value of the compensation, and it must also document the basis for its decision.

Revised Model Nonprofit Corporation Act. The Revised Model Nonprofit Corporation Act was adopted in 1987 by the American Bar Association to encourage all states to modernize and harmonize their laws governing nonprofit corporations.

The model act lays out requirements for the formation and dissolution of a nonprofit corporation, as well as for multiple aspects of corporate governance, including the duties of board members. States may adapt or use the model act when drafting their own laws. It has been adopted in whole or modified form by 23 states. The original Model Nonprofit Corporation Act (issued in 1952) has been adopted in whole or in modified form by six other states and the District of Columbia.

Sarbanes-Oxley Act of 2002. Signed into law in July 2002 in response to corporate scandals, the Sarbanes-Oxley Act imposes obligations and penalties on corporate officers and directors of publicly traded companies and mandates increased disclosure by corporations to the Securities and Exchange Commission.

Section 501(c)(3). The section of the Internal Revenue Code that defines tax-exempt organizations eligible to receive tax-deductible contributions. To qualify, an organization must be operated exclusively for charitable, religious, educational, scientific, or literary purpose, to name a few examples. 501(c)(3) charities are further defined as public charities or private foundations. *See also* Private Foundation; Public Charity.

Section 509(a). The section of the Internal Revenue Code that defines the rules for determining that an organization is a public charity (as opposed to a private foundation) and thereby eligible to receive tax-deductible contributions on more favorable terms.

Self-Dealing. Any financial transaction between a private foundation and its disqualified persons, other than reasonable compensation for services. Such self-dealing transactions, even those that provide a below-market rate benefit to a disqualified person, are prohibited under Section 4941 of the Internal Revenue Code. *See also* Disqualified Persons, Excess Benefit Transaction.

Sponsoring Organization. A sponsoring organization is a public charity that maintains, owns, and controls one or more donor-advised funds. *See also* Donor-advised fund; Public Charity.

Substantial Contributor. A substantial contributor is generally defined as any person who contributed or bequeathed the greater of $5,000 or 2 percent of the total contributions received by a charitable organization in a given tax year. A substantial contributor also includes the original donor or creator of a private foundation, donor-advised fund, or supporting organization. A substantial contributor to a private foundation, donor-advised fund, or supporting organization is deemed a disqualified person. *See also* Disqualified Person.

Supporting Organization. A public charity that is organized and operated to support other specified public charities, and is therefore not required to demonstrate that it receives at least one-third of its support from a number of unrelated donors (as do most other public charities). There are three categories of supporting organizations, Type I, Type II and Type III. Each of these organizations must meet a specific legal test designed to ensure that the organization(s) being supported has some influence over the actions of the supporting organization.

Tax-Exempt Organizations. Organizations that meet an approved tax-exempt purpose and thus do not have to pay federal and/or state income taxes, except with respect to income earned by a trade or business that is unrelated to the purpose for which the organization was granted tax-exemption. The Internal Revenue Code defines more than 25 categories of organizations that are exempt from federal income taxes, including charities, business associations, labor unions, fraternal organizations, and many others. Whereas other types of nonprofit organizations benefit the private, social or economic interests of their members, charitable organizations must benefit the broad public interest and Congress has therefore provided, with very limited exceptions, that only those charities organized under section 501(c)(3) are eligible to receive tax-deductible contributions. *See also* Charitable Organization, Private Foundation, Public Charity.

Uniform Management of Institutional Funds Act (UMIFA). Model legislation put forward in 1972 by the National Conference of Commissioners on Uniform State Laws to govern the management and expenditure of investment assets held by charitable organizations. UMIFA has been adopted in some form by most states and the District of Columbia. Generally, UMIFA is not applicable to charitable trusts.

Uniform Prudent Management of Institutional Funds Act (UPMIFA). Model legislation approved in July, 2006 by the National Conference of Commissioners on Uniform State Laws to govern the management and expenditure of investment assets held by charitable organizations. UPMIFA has been adopted by 16 states and is under consideration in another 14 states.

Uniform Prudent Investor Act (UPIA). Model legislation approved in 1994 by the National Conference of Commissioners on Uniform State Laws to govern the investment practices of fiduciaries. UPIA is based on the General Standard of Prudent Investment set forth in the Restatement (Third) of Trusts, which was released in 1992 and reflects modern portfolio theory, which has become universally accepted. The Uniform Trust Code promulgated by NCCUSL in 2000, and amended in 2001, 2003 and 2005, incorporates UPIA wholesale as the standard applicable to the investment of trust assets. UPIA has been adopted in more than 40 states and the District of Columbia. .

Volunteer Protection Act of 1997, P.L. 105-19. Federal legislation that limits liability of uncompensated volunteers, including board members, for injuries caused by negligent conduct of the volunteer while acting within the scope of authority provided to him/her as a volunteer of a governmental agency or a charitable organization. The Act does not provide protection from claims of gross negligence, willful or criminal misconduct, reckless misconduct, or conscious, flagrant indifference to the rights or safety of the individual harmed by the volunteer.

Whistleblower Protection Policy. A policy to encourage staff and volunteers to come forward with credible information on illegal practices or violations of adopted policies of the organization. The policy specifies that the organization will protect the individual from retaliation. It also identifies those staff or board members or outside parties to whom such information can be reported. Such policies may be known by another name, such as a policy on reporting malfeasance or misconduct.

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For Further Information

Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations is also available in an abridged format without the legal background and appendices included in this reference edition. Ordering information is available at www.nonprofitpanel.org.

Independent Sector, which provided leadership in convening and supporting the Panel on the Nonprofit Sector, will continue to offer resources through its programs and website (www.independentsector.org) to facilitate putting these principles into practice.

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