Basics in Nonprofit Corporate Governance

A. Legal Duties of the Directors and Officers

Section 8.01(b) of the Revised Model Nonprofit Corporation Act (1987)\(^1\) (the “Revised Model Act”) provides that subject to certain limitations relating to action required to be approved by members, “all corporate powers shall be exercised by or under the authority, and the affairs of the corporation managed under the direction, of its board.” Corporate directors are subject to two principal fiduciary duties in carrying out their governance responsibilities: the duty of care and the duty of loyalty. Section 8.30(a) of the Revised Model Act codifies these duties, providing as follows:

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 in similar circumstances; and

3. in a manner the director reasonably believes to be in the best interests of the corporation.

(1) Duty of Care

Meeting a director’s duty of care generally requires acting in a reasonable and informed manner under the given circumstances. A common recitation of the standard of care, including in the Revised Model Act, is that which “an ordinarily prudent person in a like position would exercise under similar circumstances.”

A **prudent person** is “a generalist with the ability to select and evaluate senior officers, oversee and evaluate corporate performance, review and approve major corporate plans and actions, and perform other functions normally performed by for-profit directors.”\(^2\) A **like position** may take into account the size, type and complexity of the corporation. It may also factor in the director’s position as an inside or outside

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\(^1\) The Revised Model Nonprofit Corporation Act (1987) was adopted in 1987 by the Subcommittee on the Model Nonprofit Corporation Law, of the Business Law Section of the American Bar Association. The Revised Model Act has been adopted, in whole or in part, in 23 states. The original Model Nonprofit Corporation Act has adopted in 6 other states and the District of Columbia.

\(^2\) Haas, Jeffrey. When the endowment tanks. ABA Business Law Today, v.12, no. 5 (May/June 2003).
director. However, it is less likely that an individual director’s standard of care will be measured against the standard exhibited by other directors on the same board because cases imposing liability on a duty of care claim are often collective actions against the entire board.

Keeping informed (and making reasonable inquiries when appropriate) is a key to meeting a director’s duty of care. It may be prudent to consider the following activities as essential in that endeavor:

- Regularly attend board meetings.
- Assure that the directors receive adequate information before taking appropriate board action (e.g., by requesting materials and asking questions).
- Review the materials provided in connection with board meetings, particularly those used in reference to any contemplated board action.
- Be familiar with the organization, its legal structure, governing documents (e.g., articles of incorporation, bylaws), exempt purposes (as represented in its governing documents, exemption applications and marketing materials), activities, and key stakeholders (including, but not limited to, staff).
- Be familiar with general laws applicable to the organization (including those covered in the following Section B).

Exercising independent judgment is another key to meeting a director’s duty of care. Voting with the majority without independent judgment about whether such action is in the corporation’s best interest may be a breach of the duty. Caution must also be given to simply voting with a director who has purported expertise in an area relevant to the decision. While it may be prudent to give such expert’s viewpoint strong weight, a director should consider other views before making an independent decision regarding the board action.

Reliance. Section 8.30(b) of the Revised Model Act generally provides that directors may rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by (1) officers or employees; (2) counsel, independent accountants and others with professional or expert competence; or (3) board committees on which the director does not serve; provided, however, that: the director reasonably believes that the provider of such information or opinion is competent and reliable with respect to, and authorized to provide, such information or opinion, and that such reliance is otherwise warranted.

Delegation. Section 8.01(c) of the Revised Model Act generally provides authorization for the board to delegate its powers. Indeed, boards generally delegate management of the day-to-day operations of a corporation to the corporate officers and management staff. However, while the board may delegate management of the corporation, it may neither delegate its oversight responsibility nor its function to govern. Among the activities involved in adequate oversight:

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• Prudent selection of officers and management staff.
• Selective and clearly defined delegations of authority.
• Adoption of monitoring policies and procedures to ensure legal compliance and prudent use of organizational resources.

The business judgment rule,\(^4\) which is codified in the laws of some states\(^5\) and recognized by the courts in others, generally provides that a director who performs his or her duties in good faith and in accordance with the appropriate standard of care will have no liability based upon any alleged failure to discharge such person’s obligations as a director absent fraud, self-dealing or other intentional misconduct. This doctrine is based on the rationale that it would be improper for courts, in hindsight, to second-guess corporate management decisions made in good faith and due care.\(^6\) The immunity created by the business judgment rule may raise the threshold for liability from simple negligence to gross negligence for corporate directors.

(2) Duty of Loyalty

Meeting a director’s duty of loyalty generally requires acting in good faith and in the best interests of the corporation. The key to meeting this duty is to place the interests of the corporation before the director’s own interests or the interests of another person or entity.

Conflict of interest. A conflict of interest exists when a director has a personal material interest in a proposed transaction to which the corporation may be a party. Conflicts of interest are neither unusual nor generally prohibited under state law.\(^7\) Indeed, transactions involving a conflict of interest may sometimes be in the best interest of the corporation. For example, it may be perfectly appropriate for a board to approve a transaction with a director in which the director is providing the corporation with some good, service or facility at below market rates.

From a legal perspective, it is the manner in which conflicts of interest (even ones that are favorable to the corporation) are handled by the director and the board that may

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\(^4\) The business judgment rule is also referred to as the “best judgment rule” in the nonprofit corporate context.

\(^5\) See, e.g., Cal. Corp. Code §5231(c).

\(^6\) Note, however, in *Frances T. v. Village Green Owners Ass’n*, 42 Cal.3d 490 (1986), the California Supreme Court opined that the business judgment rule applicable to directors of a California nonprofit mutual benefit corporation, codified in Section 7231 of the Code, is not a bar to a director’s personal liability to a third party injured by the director’s own tortious conduct, even if the director is acting on behalf of the corporation. In *Frances T.*, the Court determined that individual directors of a condominium association who negligently failed to authorize repairs to correct a hazardous condition could be held personally liable to the injured party based on their duty of care, independent of the corporation’s own duty, to refrain from acting in a manner which creates an unreasonable risk of personal injury to third parties. In response to this case, and the difficulty for many nonprofits to secure affordable insurance coverage, the California legislature enacted certain statutory protections applicable to directors of certain nonprofit corporations.

\(^7\) Certain transactions involving a conflict of interest that are permissible under state law may, however, not be permitted under federal tax laws, particularly in the private foundation, supporting organization, and donor-advised fund contexts.
determine whether the director’s duty of loyalty has been breached and whether the transaction may be rendered void. It should be noted, however, that transactions involving even a perceived conflict of interest may subject the interested director and the corporation to a serious loss in reputation. Accordingly, corporations should enter into such transactions cautiously where the directors believe that it could be viewed negatively if brought to light by the media. For all these reasons, a conflict of interest policy is highly recommended.

A conflict of interest may exist in the following examples:

- Employment or independent contractor agreement between the corporation and a director or a member of the director’s family.
- Provision of a good, service or use of a facility to a director, a member of the director’s family or an entity affiliated with a director.
- Provision to the corporation of a good, service or use of a facility by a director, a member of the director’s family or an entity affiliated with a director.
- Decision to engage in a transaction or activity that may otherwise benefit or harm a director’s personal interests.
- “Self-dealing” transactions as defined under state or federal law.
- “Excess benefit transactions” as defined under federal tax law.

**Self-dealing transactions.** State corporate laws may prohibit a transaction to which the corporation is a party and in which one or more of its directors has a material financial interest unless it can be established that the corporation entered into the transaction for its own benefit, the transaction was fair and reasonable as to the corporation at the time it entered into the transaction, the material facts concerning the transaction and the director’s interest in the transaction are fully disclosed or known to the board or board committee, and the board or board committee authorizes or approves such transaction in good faith by a majority vote not counting the vote of the interested director.8

**Corporate opportunity.** The corporate opportunity doctrine prohibits a corporate fiduciary (including a director) from seizing an opportunity for himself or herself if: (i) the corporation is financially able to undertake it; (ii) it is within the corporation’s line of business and is of practical advantage to the corporation; and (iii) the corporation is interested, or has a reasonably expectancy, in the opportunity.9 The corollary states that a fiduciary may take a corporate opportunity if: (i) the opportunity is presented to the fiduciary in his individual and not corporate capacity; (ii) the opportunity is not essential to the corporation; (iii) the corporation holds no interest or expectancy in the opportunity; and (iv) the fiduciary has not wrongfully employed the resources of the corporation pursuing or exploiting the opportunity.10 Accordingly, a director who, in his or her capacity as a director, learns of a prospective transaction that might be considered a

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8 See, e.g., Cal. Corp. Code §5233.
10 Id.
corporate opportunity may find it prudent to first present the opportunity to the board and allow the corporation sufficient time and first right to exploit the opportunity before taking advantage of the transaction in his or her individual capacity.

Confidentiality. A director should keep the corporation’s private information confidential. In addition, a director should exercise reasonable diligence to keep such information confidential. Note that the strategic plans of a corporation may contain confidential information not meant to be disclosed to the general public lest some other person or entity be able to exploit the information to the disadvantage of the corporation.

B. Legal Requirements Affecting the Organization

(1) Section 501(c)(3) Requirements

Organizations described by Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (“IRC”), and tax-exempt under IRC Section 501(a) are defined as:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

The Organizational Test. The Organizational Test provides that a 501(c)(3) organization must be organized exclusively for one or more of the exempt purposes set forth in Section 501(c)(3).11 This test is satisfied if the organization's governing documents meet certain requirements, including limitation of the organization's purpose, and dedication of its assets, to one or more exempt purposes.12

The Operational Test. The Operational Test provides that a 501(c)(3) organization must be operated primarily for one or more of the exempt purposes set forth in Section 501(c)(3).13 Only an "insubstantial part" of the organization's activities may be devoted to non-exempt purposes, such as operating an unrelated business.14 If, however, the organization’s primary purpose is the operation of an unrelated trade or business, it

12 Treas. Reg. §1.501(c)(3)-1(b).
13 Treas. Reg. §1.501(c)(2)-1(c)(1).
14 See id.
may not qualify for 501(c)(3) exempt status, even if all of the profits from such trade or business are to be used in furtherance of its exempt purposes.

**No Private Inurement.** No part of the organization's net earnings may inure to the benefit of any private shareholder or individual. The private inurement doctrine generally prohibits an exempt organization from using its assets for the benefit of a person having a personal and private interest in the organization's activities (i.e., an insider such as a director, officer or key employee). An organization that engages in an inurement transaction (e.g., paying an unreasonable compensation to an insider) may face revocation of its exempt status.

**No Private Benefit.** An organization will similarly fail the Operational Test unless it serves a public rather than a private interest. To satisfy this requirement, referred to as the private benefit doctrine, the organization must establish that it is not operated for the benefit of private interests. This does not mean that the organization may not confer benefits to individuals; rather, it provides that such benefits must be incidental, quantitatively and qualitatively, to the furthering of the organization’s exempt purposes. While the private benefit and private inurement doctrines appear very similar, there are two important differences. One, the private benefit doctrine is much broader than, and indeed subsumes, the private inurement doctrine because it applies whenever an impermissible benefit is being conferred on any private party, not just insiders. Two, unlike the case with private inurement, an incidental amount of private benefit may not cause a loss or denial of exempt status. Instead, excise taxes, referred to as intermediate sanctions, may be imposed on excess benefit transactions between Section 501(c)(3) public charities and disqualified persons. The Internal Revenue Service (“IRS”) takes the position that it may both revoke an organization’s exempt status and apply intermediate sanctions to the disqualified persons and any organizational managers who knowingly approved a prohibited private inurement transaction.

**Excess Benefit Transactions.** Federal tax laws also prohibit certain transactions characterized by a conflict of interest. IRC Section 4958(c)(1)(A), which applies to organizations exempt under either IRC Section 501(c)(3) or 501(c)(4) that are not private foundations, defines an excess benefit transaction as “any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person, if the value of the economic benefit provided by the exempt organization exceeds the value of the consideration (including the performance of services) received for providing the benefit.”

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17 IRC §4958. In this context, a **disqualified person** is (A) any person who was, at any time during the 5-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization; (B) a member of the family of an individual described in (A), and (C) a 35-percent controlled entity (an entity in which persons described in (A) or (B) own more than 35 percent of the total controlled voting power (corporations), profits interest (partnerships) or beneficial interest (trusts and estates)). An excess benefit transaction is any transaction in which an economic benefit is provided by the applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person, if the value of the economic benefit provided by the exempt organization exceeds the value of the consideration (including the performance of services) received for providing the benefit.
18 A **disqualified person** with respect to a transaction is “(A) any person who was, at any time during the 5-year period ending on the date of such transaction, in a position to exercise substantial influence over the
benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit.” An excess benefit transaction is prohibited and may subject the disqualified person and the directors who knowingly approved such transaction to significant federal excise taxes (“intermediate sanctions”).

No Substantial Lobbying. In general, no organization may qualify for Section 501(c)(3) status if a substantial part of its activities is attempting to influence legislation (commonly known as lobbying). A 501(c)(3) organization may engage in some lobbying, but too much lobbying activity risks loss of tax-exempt status. Legislation includes action by Congress, any State legislature, any local council or similar governing body, with respect to acts, bills, resolutions, or similar items (such as legislative confirmation of appointive office), or by the public in referendum, ballot initiative, constitutional amendment, or similar procedure. It does not include actions by executive, judicial, or administrative bodies. An organization will be regarded as attempting to influence legislation if it contacts, or urges the public to contact, members or employees of a legislative body for the purpose of proposing, supporting, or opposing legislation, or if the organization advocates the adoption or rejection of legislation. Organizations may, however, involve themselves in issues of public policy without the activity being considered as lobbying. For example, organizations may conduct educational meetings, prepare and distribute educational materials, or otherwise consider public policy issues in an educational manner without jeopardizing their tax-exempt status.

No Electioneering. All Section 501(c)(3) organizations are absolutely prohibited from directly or indirectly participating in, or intervening in, any political campaign on behalf of (or in opposition to) any candidate for elective office. Contributions to political campaign funds or public statements of position (verbal or written) made on behalf of the organization in favor of or in opposition to any candidate for public office clearly violate this prohibition. Such violation may result in denial or revocation of tax-exempt status and the imposition of certain excise tax. Note, however, that certain activities or expenditures may not be prohibited depending on the facts and circumstances. For example, certain voter education activities (including the presentation of public forums and the publication of voter education guides) and certain other activities intended to encourage people to participate in the electoral process (e.g., voter registration and get-out-the-vote drives), if conducted in a non-partisan manner, do not constitute prohibited political campaign activity.

(2) Charitable Trust Requirements

The charitable trust doctrine is commonly recognized as it applies to gifts explicitly restricted to certain uses by the donee (i.e., restricted gifts). The doctrine provides that such gifts, if accepted, would be subject to any valid legal restrictions imposed by the donor at the time of the contribution. In California, however, the

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affairs of the organization [including directors of the corporation], (B) a member of the family of an individual described in subparagraph (A), and (C) a 35-percent controlled entity.” IRC §4958(f)(1).

19 IRC §4958(a), (b).

The charitable trust doctrine has much broader application, including where the donor does not explicitly impose any restriction on the gift. 21 In essence, there may be no such thing as an unrestricted gift.

The charitable trust doctrine has developed in California to encompass the circumstance where a charitable organization changes its charitable purposes. The doctrine provides that under such circumstance, the unrestricted gifts that the charity received prior to the change in charitable purposes must be used for only the declared charitable purposes at the time the gifts were accepted. The rationale behind the doctrine is that a donor made a gift to the charity in reliance that such gift would be used exclusively to further the charity’s public representation of its charitable purposes. A charity may publicly represent its charitable purposes in its articles of incorporation, bylaws, exemption applications (i.e., IRS Form 1023 and CA Form 3500), information returns (e.g., Form 990), fundraising materials, and dominant activities.

Even revenues from sources other than charitable gifts and donations may be subject to the charitable trust doctrine.22 Some commentators base this expansion of the doctrine on the following premises: (1) the charity’s gifted and non-gifted assets are typically commingled, and (2) the gifted assets supplied the initial capital that enabled the charity to acquire or earn the non-gifted assets.

The charitable trust requirement may be breached where the assets imposed with a charitable trust are diverted to compensate an individual who the charity has no legal obligation to pay.23 A possible example of such improper diversion may be the payment of bonuses to employees without a preexisting agreement that provides for the possibility of such compensation.

An exception to the requirements imposed by the charitable trust laws applies where the declared charitable purpose of the charity becomes illegal, impossible or impracticable to carry out. In such event, the *cy pres* doctrine requires that the assets imposed with a charitable trust be used to further a charitable purpose that reasonably approximates the original declared charitable purpose.

(3) Registration and Charitable Solicitation Requirements

States may impose registration requirements on nonprofit corporations based on their physical presence in the state and on the charitable solicitation activities directed towards residents and other persons in the state. Boards should ensure that they meet the

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21 See *In Pacific Home v. County of Los Angeles*, 41 Cal.2d 844, 852 (1953). In Pacific Home, the Supreme Court pronounced: “All the assets of a corporation organized solely for charitable purposes must be deemed to be impressed with a charitable trust by virtue of the express declaration of the corporation’s purposes, and notwithstanding the absence of any express declaration by those who contribute such assets as to the purpose for which the contributions are made. In other words, the acceptance of such assets under these circumstances establishes a charitable trust for the declared corporate purposes as effectively as though the assets had been accepted from a donor who had expressly provided in the instrument evidencing the gift that it was to be held in trust solely for such charitable purposes.”


23 *Id.* at 371.
applicable registration requirements as well as the charitable solicitation laws of each jurisdiction in which the organization solicits contributions.  

(4) Reporting and Disclosure Requirements

Federal. Generally, tax-exempt organizations must file an annual information return with the IRS. Among the organizations excepted from this requirement are churches, certain religious organizations, and certain state and local instrumentalities. In addition, organizations that have annual gross receipts not normally in excess of $25,000 are currently not required to file the annual information return. However, beginning in 2008, such organizations will be required to file electronically Form 990-N, Electronic Notice (e-Postcard) for Tax-Exempt Organizations not required to File Form 990 or Form 990-EZ.

Tax-exempt organizations subject to the federal reporting requirement that are not classified as private foundations must file Form 990, Return of Organization Exempt From Income Tax, or Form 990-EZ, Short Form Return of Organization From Income Tax. Private foundations must file Form 990-PF, Return of Private Foundation. Forms 990, 990-EZ, and 990-PF must be filed by the 15th day of the 5th month after the end of an organization’s accounting period.

Exempt organizations that have $1,000 or more of gross income from an unrelated business must file Form 990-T, Exempt Organization Business Income Tax Return. Organizations must make quarterly payments of estimated tax if they expect their tax for the year to be $500 or more.

501(c)(3) organizations are required to make to the public their three most recent information returns (Form 990/Form 990-EZ/Form 990-PF), Form 990-T, and their Form 1023 Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code. Names and addresses of contributors may be withheld. Trade secrets also need not be disclosed if the organization establishes in advance that something is a protected trade secret.

In June 2007, the IRS released for comment and discussion a draft Form 990. The IRS hopes to have the new Form 990 ready for use for the 2008 filing year (returns filed in 2009). The redesign of Form 990, which was last overhauled in 1979, is based on three guiding principles:

24 State and local laws may apply with respect to charitable solicitations. For additional information about state registration requirements, refer to the website of “The Unified Registration Statement” at www.multistatefiling.org.
25 IRC §6104(d)(1); IRS Notice 2007-45 (Form 990-T disclosure requirements effective for any Form 990-T filed after August 17, 2006). Note that disclosure of Form 990-T is required of all charities that file the return regardless of whether the charity is otherwise subject to the disclosure requirements of IRC §6104 (e.g., churches, which are exempt from filing Form 990, are required to file Form 990-T to report unrelated business income and disclose such return).
26 IRC §6104(d)(3).
27 Id.
28 The comment period ends on September 14, 2007.
• Enhancing transparency to provide the IRS and the public with a realistic picture of the organization;

• Promoting compliance by accurately reflecting the organization’s operations so the IRS may efficiently assess the risk of noncompliance; and

• Minimizing the burden on filing organizations.

Among the highlights of the new form are the following:

• A summary page providing the organization’s identifying information and a snapshot of the organization’s key financial, compensation, governance, and operational information.

• A portion of the form requiring governance information including the composition of the board, and certain other governance and financial statement practices.

• Schedules that will focus reporting on certain areas of interest to the public and the IRS: fundraising, compensation, hospitals, tax exempt bonds and non-cash charitable contributions.

States. Tax-exempt organizations may also be required to file periodic information returns with the appropriate state taxing and corporate authorities, and renewal registrations with the appropriate charities authority (typically the Attorney General). For example, in California, a charitable nonprofit public benefit corporation may be required to file Form 199 with the Franchise Tax Board, Form SI-100 with the Secretary of State (biennial filing), and Form RRF-1 with the Attorney General.

(5) Substantiation and Disclosure Requirements

There are two general rules that charities should be aware of regarding substantiation and disclosure requirements for federal income tax return reporting purposes:

• A donor is responsible for obtaining a written acknowledgment from a charity for any single contribution of $250 or more before the donor can claim a charitable contribution on his/her federal income tax return.

• A charitable organization is required to provide a written disclosure to a donor who receives goods or services in exchange for a single payment in excess of $75.²⁹

Charities should also be aware that, effective January 1, 2007, a donor cannot claim a charitable deduction for any contribution unless the donor maintains a record of

²⁹ More information about disclosure and substantiation requirements may be found in IRS Publication 1771.
such contribution (e.g., a bank record or cancelled check; or written communication from
the charity showing the name of the charity and the date and amount of the
contribution).\textsuperscript{30}

Organizations that dispose of charitable deduction property (property other than
cash or certain publicly traded securities) within 3 years of the contribution date must file
IRS Form 8282 within 125 days after the date of disposition unless: (1) at the time the
donee charity signed the donor’s Appraisal Summary (Section B of Form 8283, Noncash
Charitable Contributions), the donor signed a statement on the Form that the appraised
value of the specific item was not more than $500; or (2) the item is consumed or
distributed, without consideration, in fulfilling the donee charity’s exempt purpose or
function.

(6) Requirements Associated With Other Activities

Although beyond the scope of this program, charities may also need to be familiar
with legal requirements associated with:

- Hiring, managing and terminating employees.
- Managing volunteers.
- Managing organizational assets (including endowment funds).\textsuperscript{31}
- Unrelated business activities.
- Commercial e-mail practices.\textsuperscript{32}
- Managing and/or owning real property.
- International charity.
- Participating in coalitions and joint ventures.
- Entering into a merger with another entity.
- Entering into the zone of insolvency/bankruptcy.

C. Protections from Liability

(1) Directors’ Exposure to Liability

While directors may be protected by the limited liability associated with a
corporation, directors should be aware of several areas in which they may be subject to
personal liability:

- Breach of the directors’ fiduciary duties.
- Breach of charitable trust.
- Self-dealing transaction by an interested director.
- Excess benefit transaction (e.g., excessive compensation).
- Wrongful actions taken outside of the director’s scope of authority.

\textsuperscript{30} Pension Protection Act of 2006.
\textsuperscript{31} See, \textit{e.g.}, Uniform Prudent Investor Act; Uniform Management of Institutional Funds Act.
\textsuperscript{32} See CAN-SPAM Act of 2003.
• Employment claims (e.g., discrimination, sexual harassment, wrongful termination) against responsible directors.
• Discrimination claims by beneficiaries of the charity (e.g., for wrongfully denied benefits) against responsible directors.
• Other claims (e.g., for torts causing personal injury, breach of contract, defamation, intellectual property infringement, professional misconduct) against responsible directors.
• Failure to pay payroll taxes claim against responsible persons.
• Failure to observe corporate formalities (e.g., commingling personal and organizational assets, failure to hold or record minutes of meetings, failure to appoint or elect directors and officers).

The best protection for a director to avoid personal liability is to meet his or her fiduciary duties, acting with due care and loyalty. Additional protections are discussed below.

(2) Indemnification

State laws may allow for the indemnification of agents (including past and present directors, officers and employees) by a nonprofit corporation. Indemnification, in this context, means that the corporation will reimburse a person for any expenses (including attorneys’ fees), judgments, fines, settlements and other amounts actually and reasonably incurred in connection with a proceeding (threatened, pending or completed, whether civil, criminal, administrative or investigative) against such person by reason of the fact such person is or was an agent of the corporation.

State laws may provide that a corporation must indemnify its agent in any proceeding to the extent that the agent has been successful on the merits in such proceeding and any claim, issue or matter therein. State laws may provide that a corporation may indemnify its agent where the agent has not been successful on the merits in certain types of proceedings (e.g., those neither involving a claim of self-dealing nor brought by the Attorney General), upon a determination by the board (majority vote of a quorum consisting of directors who are not parties to the proceeding), the members (not including those to be indemnified) or the court that the agent acted in good faith and in a manner such person reasonably believed to be in the best interests of the corporation and, in the case of a criminal proceeding, had no reasonable cause to believe the conduct of such person was unlawful. Accordingly, indemnification may be permissive where there is a settlement in such proceeding. Finally, state laws may provide the a corporation may not indemnify its agent in certain types of proceedings (e.g., those involving a claim of self-dealing or brought by the Attorney General) where the agent was held to be liable by a court or paid an amount in settling or disposing of a threatened action.

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33 The corporation may be prohibited from indemnifying the agent if the determination by the board or members is contrary to the holding of the proceeding. At the very least, it may be difficult to justify such determination under most circumstances.
The board of a nonprofit corporation may find it prudent to provide for the extent of indemnification desired, and permissible under state law, in the corporation’s bylaws. Indemnification provisions that are permissive in the Code but made mandatory in the bylaws may help in the recruitment and retention of qualified directors.

(3) Insurance

Nonprofit organizations should assess their insurance needs by consulting with a qualified insurance broker. Insurance products may vary widely in terms of coverage and cost among different insurance companies. The following information provides some very basic information about some of the insurance products available to nonprofits.

Commercial General Liability. The Commercial General Liability (“CGL”) insurance policy typically provides broad liability coverage to the insured (i.e., the nonprofit corporation) for acts by the insured causing bodily injury, personal injury, property damage or advertising injury\(^{34}\) to a third party. CGL policies may provide coverage on either a claims made or occurrence basis.

Claims made policies require the claims to be made within the policy period (i.e., while the policy is in force). They may or may not provide coverage for acts occurring prior to the policy period. Generally, an insured nonprofit may prefer to have continuous coverage since its formation that will cover all acts no matter when the claims are made. For this reason, it may be prudent to ensure that a claims made policy has “full prior acts” coverage with no retroactive date as to how long ago the prior act may have taken place. Moreover, it may be critically important that the insured immediately notify the insurance company if it learns of a situation that could lead to a claim or receives notice of a claim. If the insured notifies the insurance company a day after the policy expires, it may not be covered. To address such problem, it may be prudent to purchase an Extended Reporting Period (or “tail”) which extends the claims reporting provisions of the policy for a specific time period. An Extended Reporting Period may be of particular value if the insured switches from a claims made to an occurrence policy.

Occurrence policies provide coverage for acts occurring within the policy period even if the claims arising out of such acts are filed after the policy period terminates. Generally, occurrence policies are preferred by nonprofits over claims made policies without prior acts coverage even though the occurrence policies may be more expensive.

Directors and Officers Liability. The Directors and Officers Liability (“D&O”) insurance policy typically provides coverage of damages resulting from the wrongful acts of directors and officers (and possibly other volunteers and agents of the corporation), including wrongful decisions and actions of the board. D&O policies are different from, and complementary to, CGL policies (e.g., D&O policies generally do not cover bodily

\(^{34}\) Advertising injury is generally defined as an injury arising out of libel, slander, disparagement, violation of the right of privacy, misappropriation of advertising ideas or style of doing business, or infringement of copyright, title or slogan. Advertising injuries are caused by an offense committed in the course of advertising the insured’s goods, products or services (e.g., through marketing materials, oral presentations, written publications and websites).
injury or property damage resulting from negligence). Rather, they may cover claims such as employment-related actions (e.g., discrimination, harassment, wrongful termination) and mismanagement of assets.

D&O insurance may serve not only to provide important protection to the directors, officers and volunteers of the nonprofit, but also to help in the recruitment and retention of such individuals. Many persons with qualifications and experience valuable to a nonprofit will not serve on a board without requiring that the organization maintain adequate D&O coverage.

Other Insurance Products.

- Property coverage.
- Non-owned auto coverage.
- Business-owned auto coverage.
- Professional liability (errors and omissions) coverage.
- Workers’ compensation coverage (mandatory for employers).
- Improper sexual conduct coverage.
- Employee benefits liability coverage.
- Employee fidelity/dishonesty coverage.
- Student/volunteer/participant accident (no-fault) coverage.
- Liquor liability coverage.
- Umbrella coverage.

(4) Statutory Protections

Federal. The federal Volunteer Protection Act of 1997 ("VPA")\(^\text{35}\), which generally applies to volunteers of (i) nonprofit organizations described in 501(c)(3) of the Internal Revenue Code, (ii) other nonprofit public benefit organizations operated primarily for charitable, civic, educational, religious, welfare, or health purposes, and (iii) government entities, provides certain limitations on liability of such volunteers. A volunteer under the VPA is “an individual performing services for a nonprofit organization or a governmental entity who does not receive – (A) compensation (other than reasonable reimbursement or allowance for expenses actually incurred); or (B) any other thing of value in lieu of compensation, in excess of $500 per year, and such term includes a volunteer serving as a director, officer, trustee, or direct service volunteer.”

Except as otherwise provided in the VPA, a volunteer shall not be liable for harm caused by an act or omission of the volunteer on behalf of the organization if:

- The volunteer was acting within the scope of the volunteer’s responsibilities in the organization or entity at the time of the act or omission;
- If appropriate or required, the volunteer was properly licensed, certified, or authorized by the appropriate authorities in the state for the activities taken;

\(^35\) 42 U.S.C. §14501 et seq.
• The harm was not caused by 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; and
• The harm was not caused by the volunteer operating a motor vehicle, vessel, aircraft or other vehicle requiring an operator’s license or insurance.

The limitations on the liability of a volunteer under the VPA shall not apply to misconduct that:

• Constitutes a crime of violence or act of international terrorism for which the defendant has been convicted;
• Constitutes a hate crime;
• Involves a sexual offense for which the defendant has been convicted;
• Involves misconduct for which the defendant has been found to have violated a federal or state civil rights law; or
• Where the defendant was under the influence of alcohol or any drug at the time of the misconduct.

Where a volunteer acts within the scope of the volunteer’s responsibilities, but otherwise does not meet the criteria for a complete defense against liability, the volunteer’s liability shall be limited by the VPA as follows:

• Punitive damages may not be awarded against such volunteer unless the claimant establishes by clear and convincing evidence that the harm was proximately caused by an action of such volunteer which constitutes willful or criminal misconduct, or a conscious, flagrant indifference to the rights or safety of the individual harmed.
• The volunteer’s liability for noneconomic loss (e.g., loss for physical and emotional pain, suffering, inconvenience, physical impairment, mental anguish, disfigurement, loss of enjoyment of life, loss of society and companionship, loss of consortium, injury to reputation) shall be limited to the amount of noneconomic loss allocated to the volunteer in direct proportion to the percentage of responsibility of that defendant for the harm.

While the Act may provide a complete defense to an action against a volunteer under certain conditions, it should be noted that the Act does not prohibit a lawsuit against a volunteer. Accordingly, the Act may offer little protection to a volunteer from the potentially substantial monetary and personal costs of defending a claim.

States. States may also have laws to protect directors of nonprofit corporations. While the VPA preempts state laws to the extent that such laws are inconsistent with the VPA, it does not preempt state laws that provide additional protection to volunteers. Generally, however, directors should not rely upon these statutory protections as they often contain several exceptions, exclusions and qualifications, making it easy for a competent plaintiff’s attorney to plead around such protections.
D. Best Practices

(1) IRS

In February of 2007, the IRS released a discussion draft of good governance practices to recommend to 501(c)(3) organizations. The final IRS Good Governance Practices (the “GGP”) is expected to be adopted by the IRS later this year after it receives and incorporates public comment. While adoption of the GGP will not be required for exempt status, the discussion draft provides that “any decision by the Service to conduct a review of operations subsequent to exemption is required will be influenced by whether an organization has voluntarily adopted good governance practices.”

The GGP covers the following nine areas:

3. Due Diligence.
5. Transparency.
6. Fundraising Policy.

(2) Panel on the Nonprofit Sector

The Panel on the Nonprofit Sector (the “Panel”) was convened by Independent Sector in October 2004 to prepare recommendations for Congress to improve the oversight and governance of charitable organizations and more generally to ensure that the nonprofit community remains a vibrant and healthy part of American Society. Many of the Panel’s recommendations shaped the reforms included in the Pension Protection Act of 2006.

A strong theme in the Panel’s recommendations is its emphasis on a strong system of self-regulation and education that balances government regulation and monitoring that might otherwise do more harm (by discouraging legitimate charitable activities) than good. The Panel recently published a draft of principles for effective practices developed by its Advisory Committee on Self-Regulation (the “Draft

37 See http://www.nonprofitpanel.org/.
Principles”). The Draft Principles discuss best practices with respect to board meetings, board structure and composition, the board-CEO relationship, board education and self-evaluation, review of governing documents, and review of goals for furthering the organization’s mission.

(3) BoardSource

BoardSource, a charitable organization that helps other nonprofits develop strong and effective boards, convened a group of governance experts to explore the characteristics of exceptional boards. Their efforts resulted in *The Source – Twelve Principles of Governance That Power Exceptional Boards*, published in 2005. The 12 principles are as follows:

1. Constructive partnership (between the board and the chief executive).
3. Strategic thinking.
5. Independent-mindedness.
7. Compliance with integrity (including establishment of appropriate mechanisms for active oversight).
8. Sustaining resources.
9. Results-oriented.
10. Intentional board practices (to structure itself to fulfill essential governance duties and to support organizational priorities).
12. Revitalization.

(4) BBB Wise Giving Alliance

The BBB Wise Giving Alliance provides information to donors about charitable organizations and provides a seal to national charities that meet its Standards for Charity Accountability (the “BBB Standards”), which became effective in 2003. The BBB Standards are as follows:

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39 “Exceptional boards promote an ethos of transparency by ensuring that donors, stakeholders, and interested members of the public have access to appropriate and accurate information regarding finances, operations, and results.”
1. A board of directors that provides adequate oversight of the charity’s operations and its staff.

2. A board of directors with a minimum of five voting members.

3. A minimum of three evenly spaced meetings per year of the full governing body with a majority in attendance, with face-to-face participation.

4. Not more than one or 10% (whichever is greater) directly or indirectly compensated person(s) serving as voting member(s) of the board. Compensated members shall not serve as the board’s chair or treasurer.

5. No transaction(s) in which any board or staff members have material conflicting interests with the charity resulting from any relationship or business affiliations.

6. Have a board policy of assessing, no less than every two years, the organization’s performance and effectiveness and of determining future actions required to achieve its mission.

7. Submit to the organization’s governing body, for its approval, a written report that outlines the results of the aforementioned performance and effectiveness assessment and recommendations for future actions.

8. Spend at least 65% of its total expenses on program activities.

9. Spend no more than 35% of related contributions on fund raising. Related contributions include donations, legacies and other gifts received as a result of fund raising efforts.

10. Avoid accumulating funds that could be used for current program activities. To meet this standard, the charity’s unrestricted net assets available for use should not be more than three times the size of the past year’s expenses or three times the size of the current year’s budget, whichever is higher.

11. Make available to all, on request, complete annual financial statements prepared in accordance with generally accepted accounting principles.

12. Include in the financial statements a breakdown of expenses (e.g., salaries, travel, postage, etc.) that shows what portion of these expenses was allocated to program, fund raising, and administrative activities.
13. Accurately report the charity’s expenses, including any joint cost allocations, in its financial statements.

14. Have a board-approved annual budget for its current fiscal year, outlining projected expenses for major program activities, fund raising, and administration.

15. Have solicitations and information materials, distributed by any means that are accurate, truthful and not misleading, both in whole and in part.

16. Have an annual report available to all, on request, that includes:
   a. the organization’s mission statement,
   b. a summary of the past year’s program service accomplishments,
   c. a roster of the officers and members of the board of directors,
   d. financial information that includes (i) total income in the past fiscal year, (ii) expenses in the same program, fund raising and administrative categories as in the financial statements, and (iii) ending net assets.

17. Include on any charity websites that solicit contributions, the same information that is recommended for annual reports, as well as the mailing address of the charity and electronic access to its most recent IRS Form 990.

18. Address privacy concerns of donors by
   a. providing in written appeals, at least annually, a means (e.g., such as a check off box) for both new and continuing donors to inform the charity if they do not want their name and address shared outside the organization, and
   b. providing a clear, prominent and easily accessible privacy policy on any of its websites that tells visitors (i) what information, if any, is being collected about them by the charity and how this information will be used, (ii) how to contact the charity to review personal information collected and request corrections, (iii) how to inform the charity (e.g., a check off box) that the visitor does not wish his/her personal information to be shared outside the organization, and (iv) what security measures the charity has in place to protect personal information.

19. Clearly disclose how the charity benefits from the sale of products or services (i.e., cause-related marketing) that state or imply that a charity will benefit from a consumer sale or transaction. Such promotions should disclose, at the point of solicitation:
a. the actual or anticipated portion of the purchase price that will benefit the charity (e.g., 5 cents will be contributed to abc charity for every xyz company product sold),

b. the duration of the campaign (e.g., the month of October),

c. any maximum or guaranteed minimum contribution amount (e.g., up to a maximum of $200,000).

20. Respond promptly to and act on complaints brought to its attention by the BBB Wise Giving Alliance and/or local Better Business Bureaus about fund raising practices, privacy policy violations and/or other issues.41

(5) American Red Cross

American Red Cross published “American Red Cross Governance for the 21st Century” (the “ARC Report”) in October 2006, prompted no doubt by highly publicized criticisms it received for its governance practices, particularly since 2001.42 The following are the governance issues addressed in the ARC Report:

1. Role of the Board.

2. Size and Composition of the Board.


4. Responsibilities and Selection of the Chairman of the Board and the Chief Executive Officer.

5. Board Committees.


8. Governance Oversight of the Chartered Units.


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This memorandum is intended to provide accurate information with respect to its subject matter. It does not constitute legal or professional advice, and it is not an invitation for an attorney-client relationship. If specific legal advice is sought, the reader is advised to retain the services of a competent professional.

41 http://www.give.org/standards/newcbbbstds.asp

42 The ARC Report is available at: http://www.redcross.org/static/file_cont5765_lang0_2202.pdf
Basics, Best Practices, and Trends in Nonprofit Corporate Governance:

*Private Foundations*

ABA Business Law Section
August 31, 2007
San Francisco

Andreas Rosaros,
Attorney and Director, Ethical Standards and Philanthropic Contracts

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Agenda

- Quick facts about foundations
- Key legal issues
  - Self-dealing
  - Compensation
  - Investments
- Governance: Beyond the law
  - Trends
  - Board composition, selection, and development
  - Active oversight
- Surveys and Resources

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Quick facts
Types of Foundations

- Corporate: funds are primarily from a profit-making business
- Family: funds are from a single family and relatives play a significant role in governing and/or managing the foundation
- Independent: run by boards not dominated by the benefactor, a family or business
- Operating: private foundations that use most of their income to provide services or run programs
- Community: publicly supported institution, composed primarily of permanent funds established by many separate donors to benefit the residents of a defined geographic area
- Public: public charities whose primary focus is on grantmaking

Characteristics of Foundations

- Most private foundations are small
  - 66% (47,911) have less than $1 million in assets
  - More than 14,000 have assets under $100,000
- 77% (55,946) have less than $2 million in assets
- Most private foundations are unstaffed
  - 17% (1 in 6) of ~20,000 foundations surveyed in 2004 reported having paid staff
  - 63% of staffed foundations reported having only one or two staff

Source: Foundation Center and IRS

Private Foundation Rules

- Excise Tax ($4940)
- Self-dealing ($4941)*
- 5% Payout ($4942)
- Excess Business Holdings ($4943)
- Jeopardy Investments ($4944)*
- Taxable Expenditures ($4945)*

* Penalties can be imposed on foundation managers
Key legal issues

Self-Dealing

- No transactions with "disqualified persons"
  - Officers, directors, trustees
  - Substantial contributors
  - Family members of the above
  - Businesses they control
- Prohibited Transactions
  - Sale, exchange or leasing of property between foundation and company (in either direction!)
  - Lending money
  - Furnishing goods or service
- Major Exception - Compensation

Self-Dealing

- Permissible Benefits
  - Incidental and Tenuous
  - Public Recognition (use of logos)
  - Goodwill
- Penalties
  - Rectify the violation (pay it back)
  - 5% on self-dealer (10% beginning in 2007)
  - 2.5% on managers (5% beginning in 2007)
Compensation

- Exception: Reasonable compensation for "personal services":
  - Foundation management; banking, legal, accounting, investments
  - Not real estate management (maintenance, janitorial, security), interior decoration, most consulting
  - Narrow interpretation by IRS
- Reasonable:
  - What similar people get paid for similar work in similar circumstances
  - Generally no percentage based compensation
- Necessary: Consistent with exempt purposes

Determining Compensation

- Data – use appropriate comparables
- Decision by disinterested governing board or committee (where possible)
- Document, document, document

<table>
<thead>
<tr>
<th>Assets Group (in millions)</th>
<th>Salary</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Median</td>
</tr>
<tr>
<td>$10 to $24.9</td>
<td>$77,175</td>
</tr>
</tbody>
</table>

Other Self-Dealing Issues

- Tickets to Fundraisers
  - Possibly self-dealing if used by a disqualified person
  - No violation if staff has duty to monitor and evaluate
  - OK if value treated as income
  - No bifurcation permitted
- Paying Pledges
  - Assuming a debt of a disqualified person is self-dealing
  - Legally binding pledges may not be paid by the foundation
- Travel Expenses for Family
  - Family member has reasonable foundation duties
  - Treat reimbursement as taxable income to DQP
Investments

- Self-dealing (avoid conflicts)
  - Disqualified persons as investment managers
  - Co-investments
- Jeopardy investments
  - No investments that jeopardize exempt purposes
  - No per se jeopardy investments
  - Modern portfolio theory - each investment considered within the entire risk/asset allocation of all investments
  - Some investments will attract extra IRS attention
- Unrelated business income tax
- No requirement to diversify (if rules are met)

Investments

Limitations on business ownerships

- Private foundation may not own a controlling interest in a for-profit company
  - Generally 20 percent
  - Add up what the foundation owns PLUS all shares owned by disqualified persons.
- 2 percent safe harbor
- 5 years to divest assets

Governance: Beyond the law
“Good governance is a continuing process of rigorous re-examination and renewal.”

- Smithsonian Institution, Report of the Governance Committee to the Board of Regents (June 14, 2007)

Trends

- Active board oversight
- Policies
  - Executive and trustee compensation
  - Travel expenses
  - Conflict of interest (financial and grantmaking)
  - Investments
- Disclosure

Board Composition

- Median Size
  - Total - 11
  - Family - 7
  - Independent - 9
- Who Compensates At Least Some Board Members
  - Total - 25%
  - Family - 30%
  - Independent - 58%
- Limits on Service
  - 71% impose some limits (34% of PFs); 19% limit total service

Board Selection

- Formal Selection Process
  - Total: 61%; All Private: 39%; Public/Community: 39%
- Those Who Reserve Seats for Specific Types of Members
  - Total: 23% (includes Community); All Private: 23%
  - Family Member: All: 42%; Family: 98%; Ind.: 42%
  - Civic/Community Leaders: All: 23%; Private: 16%
  - Nonprofits: 17% (8%); Religion: 12% (5%); Officials: 9% (0%)
- Those With Seats Appointed by Others
  - Total: 11% (Private: 3%)

Source: Foundation Management Series, Twelfth Edition

Board Development

- Board Orientation
  - Total: 82%; Family: 58%; Independent: 82%
- Topics Included in Orientation (if done)
  - Fiduciary Duties: 82%; Family: 76%; Independent: 77%
  - Investment Policies: 92%; Family: 93%; Independent: 93%
  - Foundation History: 98%; Family: 97%; Independent: 100%
- Board Self Assessment
  - All: 26%; Family: 19%; Independent: 20%
- Obstacles
  - Low priority; Lack of Time; Geographic Limitations

Source: Foundation Management Series, Twelfth Edition

Active Oversight

- Independent financial audit
  - Total: 95%
- Audit committee
  - Total: 49%
- CEO performance review (annually)
  - Total: 93%
- CEO salary benchmarked (regularly)
  - Total: 79%
  - Benchmarks annually: 71%

Source: Foundation Management Series, Twelfth Edition
Surveys and Resources

Council on Foundations

- Practices and Standards for foundations (www.cof.org)
  - Stewardship Principles for Family Foundations
  - Stewardship Principles for Corporate Grantmakers
  - Stewardship Principles for Independent Foundations
  - Principles of Accountability for International Philanthropy
  - National Standards for U.S. Community Foundations

Council on Foundations Surveys

- Foundation Management Series
  - Published since 1980 biennial survey
  - 2004 report
    - 1,779 surveys sent, 648 usable responses
    - 342 private foundation responses
  - Key topics
    - Board structure, size and composition
    - Board reimbursement and compensation
    - Administrative expenses in private foundations
Council on Foundations Surveys

- Foundation Management Series
  - By foundation type
    - Community foundation
    - Public foundation
    - Independent foundation
    - Family foundation
  - By asset size
    - 8 asset size categories between $500 million or more in assets and less than $5 million in assets

Council on Foundations Surveys

- Grantmakers Salary and Benefits Report
  - Published since 1980; annual survey
  - 2004 report
    - 2,620 surveys sent; 808 usable responses
  - Key topics
    - Staffing and salaries
    - Issues specific to CEOs
    - Salary administration
    - Employee benefits

Council on Foundations Surveys

- Grantmakers Salary and Benefits Report
  - By foundation type
    - Community foundation
    - Public foundation
    - Independent foundation
    - Family foundation
  - Corporate foundations and giving programs
    - By asset size
      - 6 asset size categories between $250 million or more in assets and less than $10 million in assets
Council on Foundations Surveys

- Investment Performance and Practices
  - Annual survey
  - Published since 1990 for community foundations
  - New for 2005 for private foundations
  - Includes asset allocation

Other Surveys

- Johns Hopkins University Listening Post Project
  - U.S. Nonprofit Governance and Accountability (2005)
  - 443 organizations surveyed, 207 responded
- Grant Thornton
  - National Board Governance Survey for Not-for-Profit Organizations
  - 900 surveyed in 2003; 700 surveyed in 2004
- Commonfund Benchmark Study (Commonfund Institute)
    (investments)
  - www.commonfund.org

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Basics, Best Practices, and Trends in Nonprofit Corporate Governance

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CALIFORNIA’S NONPROFIT REGULATORY SCHEME

- AG authority under 3 statutory schemes
  - Supervision of Trustees and Fundraisers for Charitable Purposes Act
  - Nonprofit Corporation Law
  - Trust law
AG Has Primary Supervisory Authority Over Charitable Trusts and Corporations

- Historical perspective
- Applicable to
  - Charitable corporations
  - Unincorporated associations
  - Trustees
  - Fundraising professionals

Nuts and Bolts of Jurisdiction

- Components
  - Registration
  - Reporting
  - Compliance and enforcement activities
- Exemptions
  - From registration and reporting only
SOX Amendments to California’s Regulatory Scheme

- Nonprofit Integrity Act of 2004 – effective January 2005
- Amendments to Supervision Act
- Governance provisions
  - Audit – over $2 million in gross revenue*
  - Audit Committee*
  - Executive Compensation Review

*Exemptions apply

APPLYING SOX TO THE NONPROFIT SECTOR

- Is there a need?
  - Nonprofits are trustees of charitable assets
  - Importance of transparency
  - SOX applies to governance and fiscal controls
  - Nonprofit governance subject to few constraints
  - Lack of education and guidelines
  - Lack of comprehensive enforcement
APPLYING SOX TO THE NONPROFIT SECTOR

- Provisions that Specifically Apply to Nonprofits
  - Whistleblower protection
  - Document destruction

- Provisions to Incorporate into Best Practices
  - Independent audit
  - Independent and competent Audit Committee
  - Rotating auditors/audit firms
  - Conflict of interest
  - Disclosure

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APPLYING SOX TO THE NONPROFIT SECTOR

- Controversy: certification of financial reports

- Sector’s Response:
  - See www.boardsource.org and www.IndependentSector.org

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STATE REGULATORY INITIATIVES - 2005

- 15 states introduced bills incorporating SOX provisions
- Including:
  - Audit
  - Audit committee
  - Ban on personal loans to officers/directors
  - Adoption of conflict of interest policies

*See [www.ncna.org](http://www.ncna.org) for summary of state legislation

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STATE REGULATORY INITIATIVES – 2006

- Bills introduced by 25 states*
- Bills that passed –
  - CA – new registration statement
  - DE – facilitates transfer of trusts to successor charities
  - IL – requires registration of ‘collectors of charitable contributions’
  - ME – broadens oversight of solicitation, co-venture, grant writers
  - PA – raise audit threshold ‘for some nonprofits’ to 300K
  - SC and UT – amendments to board action

* See [www.ncna.org](http://www.ncna.org) for summary of state legislation

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STATE REGULATORY INITIATIVES

- 2007 – 25 states introduced bills that impact nonprofits*
- None relating to “SOX” issues except:
  - ME – prohibits compensation in excess of $250,000 for O/D of some nonprofits
  - MI – updates to Supervision Act: enhances enforcement options, assesses fees, raisees audit threshold
  - NY – solicitation regulation
  - PA – telemarketing restrictions

*Source: www.ncna.org

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ENFORCEMENT

- Effective enforcement of regulatory scheme
  - Adequate funding, personnel and resources
  - Adequate statutory scheme
- California’s approach
  - Education
  - Compliance
  - Enforcement actions

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TRENDS

- Larger nonprofits
- Statewide nonprofit associations
- State charity officials
- Internal Revenue Service

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I. Background – Why all this fuss?

A. Real and Perceived Abuses and Other Factors

1. Criminal Behavior
2. Breaches of Fiduciary Duty
3. Negligence (or worse)
4. Bad Judgment (or worse)
5. Failure to Honor Donor Intent
6. Fundraising Abuses
7. Abuse of Charitable Deduction – Overvaluation
8. Use of Nonprofits as Tax Shelter Facilitators
9. Excess Commerciality
10. Lack of Transparency
11. Smugness of the Sector

All fueled by investigative journalists and greater availability of 990's.

B. Congressional Rumblings and Deliberations

1. Senate Finance Committee 2004 White Paper and Hearings

For the Senate Finance Committee's 19-page discussion draft of charitable reforms, see finance.senate.gov/hearings/testimony/2004test/062204stfdis.pdf.


4. House Ways and Means Committee, Hearings on the Meaning of Charity (April 20, 2005). Witness statements are available at waysandmeans.house.gov/hearings.asp. The House's inquiry was broader and more theoretical than the Senate's, focusing on the "meaning of charity" and whether a clearer definition (or specific statutory boundaries) are needed.

5. Senate Finance Committee's Inquiries to Nonprofit Hospitals. Finance committee chair Charles Grassley asked ten large hospital systems to provide detailed information about issues such as their charity care and community benefit activities, patient billing, and joint ventures with for-profit firms. Additional questions probed the details of every facet of the targeted hospitals' operations. The Committee press release is available at finance.senate.gov/press/Gpress/2005/prg052505.pdf.

6. House Ways and Means Committee Hearings on Tax Exemption Standards for Hospitals (May 26, 2005). IRS Commissioner Everson told the committee that it was becoming increasingly difficult to differentiate for-profit from nonprofit health care providers. He welcomed a thorough review in the hope that the community benefit standard could be refined with additional bright line tests. Witness statements are available at waysandmeans.house.gov/hearings.asp.

7. Senate Finance Committee Hearings on Land Donations (June 8, 2005), focusing on a voluminous report on the Nature Conservancy's operations and transgressions.

8. Tax Relief Bill of 2005 ("2005 Bill"). Passed by the Senate on November 18, 2005. The House also passed a tax bill in November that did not include any charitable provisions.

9. In 2006, more hearings and investigations on hospitals, the NCAA, donor-advised funds and supporting organizations.

10. In 2007, with a new Congress, the rumblings have abated.

C. Selected State Law Developments

1. California Nonprofit Integrity Act
2. Other states – New York, Massachusetts, Texas (e.g.)

D. The Sector’s Response – Panel on the Nonprofit Sector


E. Pension Protection Act of 2006

1. Legislative History


2. What it Did (broad overview)

a. Sticks

Definitions and a new regulatory regime for donor-advised funds; anti-abuse provisions aimed at supporting organizations; doubled penalties for violations of private foundation excise taxes (§§ 4941-4945); expanded intermediate sanctions rules; closed perceived overvaluation “loopholes” for charitable contributions of clothing and household effects, fractional interests in personal property, facade easements, and taxidermy property; more rigorous appraisal requirements and stiffer penalties for overvaluation; rules to prevent use of exempt organizations as tax shelter facilitators.
b. Carrots

A few charitable giving incentives, the most prominent of which is a temporary (and very limited) benefit for rollovers of IRAs by individuals age 70-1/2 and older.

3. What it Didn’t Do (similar overview)

Quite a bit that had been proposed in earlier bills – e.g., no charitable deduction for non-itemizers; no explicit payout requirement for donor-advised funds, or at least not yet; no provisions on nonprofit governance rules (which would have intruded on traditional state law turf).

F. Major Law Reform Projects

1. Uniform Prudent Management of Institutional Funds Act

   http://meetings.abanet.org/weupload/commupload/CL580000/sitesofinterest_files/MNCAexposuredraft.doc

3. Uniform Trust Code

4. ALI Principles of Nonprofit Organizations

II. Panel on the Nonprofit Sector: Self-Regulation

The latest project of the Panel on the Nonprofit Sector is to develop a set of principles of self-regulation to guide board members, staff, and advisers of nonprofit organizations. A revised draft of proposed principles was released in early 2007 and is available on the Panel’s web site (see p. 3 for link). The Panel’s Advisory Committee on Self-Regulation is still soliciting comments and expects to issue a final draft in the fall of 2007. These principles are a useful and up-to-date checklist of best practices and are accompanied by background commentary and explanations of the rationale for each principle. The full text of each principle is set forth below, along with selective brief commentary.

A. Principles for Facilitating Legal Compliance and Public Disclosure

1. Duty of Obedience to the Law. A charitable organization should be knowledgeable about and 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 should also abide by applicable international law, regulations and conventions.

Comment: Nonprofit boards should be familiar with basic legal rules and requirements and should seek legal advice when necessary. Resources available are IRS website; state AG’s online services; online tools and resources from associations of nonprofits; and programs like this one. See Appendix to this outline.

2. **Mission and Strategic Direction.** 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 of the organization.

3. **Conflicts of Interest.** 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 avoided or appropriately managed through disclosure, recusal, or other means.

Comment: The principles strongly encourages boards to establish a conflict of interest policy requiring full disclosure of all material conflicts.

4. **Whistleblower Policy.** A charitable organization should establish and implement policies and procedures that enable individuals to come forward with credible information on illegal practices or violations of organizational policies. This “whistleblower” policy must specify that the organization will not retaliate against individuals who make such reports.

Comments: Auditors will recommend (or require) a whistleblower policy, even for small organizations where it is difficult to construct. The principles note that this policy can be tailored to a nonprofit’s size, structure and capacity. Sample policies are available online.

5. **Document Retention/Destruction Policy.** A charitable organization should establish and implement policies and procedures to protect and preserve the organization’s important documents and business records.

Comment: More Sarbanes-Oxley, imported to the nonprofit sector.
6. **Transparency and Disclosure.** A charitable organization must make information about its operations, including its governance, finances, programs, and activities widely available to the public. Charitable organizations should also make information available on the methods they use to evaluate the outcomes of their work and are encouraged to share the results of those evaluations.

Comment: Form 990's are the main event; also websites, audited financials, annual reports, and publicly available program evaluations for larger nonprofits.

**B. Principles for Effective Governance**

1. **Regular Meetings.** The board of a charitable organization must meet regularly enough to conduct its business and fulfill its duties.

Comment: It’s ok to use committees, but the full board should consider and vote on all committee recommendations.

2. **Board Size and Structure.** The board of a charitable organization should establish and review periodically its size and structure to ensure effective governance and to meet the organization’s goals and objectives. The board should have a minimum of five members.

Question: Should there be a legal minimum or maximum size for a board? Experts disagree.

3. **Composition and Expertise of the Board.** The board of a charitable organization should include members with the diverse skills, background, expertise, and experience necessary to advance the organization’s ability to fulfill its mission. The board should include some individuals with financial literacy.

Comment: Should this be a legal requirement? What if the board is unable to recruit a person with financial expertise? Will a non-board advisor suffice?

4. **Independent Directors.** A substantial majority of the board of a public charity should be independent – i.e., they should be individuals (1) who are not compensated by the organization as an employee or independent contractor; (2) whose compensation is not determined by individuals who are compensated by the organization; (3) who do not receive, directly or indirectly, material financial benefits from the organization.
except as a member of the charitable class served by the organization; and (4) who are not related to (as a spouse, sibling, parent or child), or do not reside with, any individual described above.

Comment: Only five states require a majority of financially “disinterested” persons. Should this be a condition of tax-exempt status for a charity? What about family foundations?

5. **Board Role in Selection and Oversight of CEO.** The board should hire, supervise, and annually evaluate the performance of the chief executive officer of the organization, as well as approve annually and in advance the compensation of the chief executive officer unless there is a multi-year contract in force or there is no change in the compensation except for an inflation or cost-of-living adjustment.

Comment: The principles admonish boards to examine comparability data and use consultants as necessary in setting compensation. Process seems to be the watchword here, and the entire board (not just the compensation or executive committee) should be aware of the CEO’s compensation package.

6. **Separation of Key Staff Positions.** The board of a charitable organization that has paid staff should ensure that the position of chief executive officer, board chair, and treasurer are held by separate individuals. Organizations without paid staff should ensure that the positions of board chair and treasurer are held by separate individuals.

Comment: Checks and balances are protections against fraud; the principles warn against concentration of power. Auditors will want someone other than check signers to reconcile the bank statement.

7. **Education and Communication.** The board should establish an effective, systematic process for educating and communicating with board members to ensure that the board carries out its oversight functions and that individual members are aware of their legal and ethical responsibilities and are familiar with the programs and activities of the organization.

Comment: The key elements of education are orientation of new board members; special training for special duties; and sufficient communication of information about the organization, particularly its finances.
8. **Self-Evaluation.** Board members should evaluate their own performance as a group and as individuals no less frequently than every three years. The board should establish clear policies and procedures on the length of terms, the number of consecutive terms a board member may serve, and the removal of board members.

9. **Review of Governance Structure.** The board should review organizational and governing instruments no less frequently than every five years.

Comment: The rationale is to ensure the organization is following its own rules and consider whether changes are appropriate—e.g., to the Articles or Bylaws.

10. **Obedience to Mission.** The board should establish or review goals for implementing the organization’s mission on an annual basis and evaluate no less frequently than every three years the organization’s programs, goals, and activities to be sure they advance the mission and make prudent use of the organization’s resources.

Comment: Legal scholars and courts disagree about whether there is a separate “duty of obedience” to mission. Some argue that boards of nonprofit corporations (as distinguished from trusts) should have more leeway to change an organization’s activities/purposes to adapt to changing times and societal needs.

11. **Board Compensation.** Board members are generally expected to serve without compensation, other than reimbursement for expenses incurred to fulfill their board duties. Charitable organizations that provide compensation to board members should have it reviewed by an independent, external source and should, upon request, make available to anyone relevant information that will assist in evaluating the reasonableness of such compensation.

Question: When is it appropriate to compensate board members in that capacity?

C. **Principles for Strong Financial Oversight**

1. **Policies and Procedures.** The board of a charitable organization should institute policies and procedures to ensure that the organization (and, if applicable, its subsidiaries) manages and invests its funds responsibly and prudently. The full board should review and approve the
organization’s annual budget and should monitor actual performance against the budget.

Comment: This is one of the most important board functions. Boards without any members with financial expertise too often delegate these responsibilities to staff, with minimal oversight.

2. **Audited Financials.** 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.

Comment/Question; When is a full-fledged audit overkill? When would a less expensive “review” suffice? What are appropriate legal sanctions for organizations that fail to fulfill these responsibilities?

3. **No loans.** A charitable organization should not provide loans (or the equivalent) to directors, officers, or trustees.

Comment: This does not prevent loans, where appropriate (e.g., for reasonable housing assistance) to employees.

4. **Spending and Resources.** A charitable organization should spend a significant percentage of its annual budget on programs in pursuance of its mission. An organization should also provide sufficient resources for effective administration of the organization, and, if the organization solicits contributions, for appropriate fundraising activities.

Comment: Spending for an organization’s charitable mission should be commensurate in scope to its financial resources. If an organization raises lots of money but little of it goes to support the mission, it would violate this principle and perhaps even risk loss of tax-exempt status.

5. **Expense Reimbursement Policies.** A charitable organization should establish and implement policies that provide clear guidance on its rules 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 on a cost-effective manner. Charitable organizations should not pay for nor reimburse travel expenditures (not
including de minimis expenses of those attending an activity such as a meal function of the organization) for spouses, dependents, or others who are accompanying individuals conducting business for the organization unless they, too, are conducting business for the organization.

Comment: This very obvious principle has been violated in some of the most notorious reported cases of recent abuse.

D. Principles for Responsible Fundraising Practices

1. **Truthful Solicitation.** Solicitation materials and other communications with donors and the public must clearly identify the organization and be accurate and truthful.

2. **Honoring Donor Intent.** Contributions must be used for the purposes described in the relevant solicitation materials, in the way specifically requested by the donor, or in a manner that reflects the donor’s intent.

Comment: Honoring donor intent is a “hot topic” where the law has been confused and slow to develop. It would be useful to have some clear legal principles; the ALI Project (mentioned below) is focusing on this issue, among others.

3. **Substantiation of Gifts.** Charitable organizations must provide donors, in accordance with IRS requirements, with clear, accurate acknowledgments of charitable contributions, and should provide donors with information to facilitate compliance with tax law requirements.

Comment: Charities are getting better about notifying donors when they have received goods or services in exchange for contributions. Any charity that solicits contributions should have a staff member with expertise on the IRS substantiation rules.

4. **Gift Acceptance Policies.** Charitable organizations should implement clear policies, based on the organization’s exempt purposes, to determine whether accepting a gift would compromise the ethics, financial circumstances, program focus, or other interests of the organization.

Comment: Indeed.

5. **Training Fundraisers.** 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 that they do not employ techniques that are coercive, intimidating, or intended to harass potential donors.

6. **No Revenue-Based Compensation.** Organizations should not compensate internal or external fundraisers based on a commission or a percentage of the amount raised.

   Question: Will this be watered down in the final draft of these principles?

7. **Protecting Donor Privacy.** 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.

E. **Staff Drafts of Two Additional Principles**

   (Not yet reviewed and approved by the Panel’s Advisory Committee.)

1. **Code of Ethics.** A charitable organization should have a formally adopted, written code of ethics with which all of their trustees, staff and volunteers are familiar and to which they adhere.

2. **Risk Management.** A charitable organization’s board of directors should ensure that the organization adheres to a risk management plan that protects the organization’s assets – its property, financial and human resources, and programmatic content and material. The board should review annually the organization’s need for general liability and directors’ and officers’ liability insurance, as well as take other actions necessary to mitigate risks.

III. **American Law Institute – Principles of the Law of Nonprofit Organizations**

A. **Goals and Scope of the Project**

   The American Law Institute is engaged in a comprehensive project to formulate principles of nonprofit law to complement its influential Principles of Corporate Governance. The reporter for the project is Professor Evelyn Brody, who has made considerable progress. The project is still several years away from a final draft that will require approval from the ALI’s membership. Preliminary and
tentative drafts are working their way through the ALI’s rigorous deliberative process.

The goals of the project are to articulate a coherent body of principles to guide legislators, judges, regulators, and legal advisors to nonprofit organizations, whatever their legal form. As such, it is not intended as a “model code” and is not limited to nonprofit corporations; rather, it would apply to all “charities” and noncharitable nonprofits.

The project is currently divided into three parts. Part I is a comprehensive introduction; Part II covers charities; Part III (yet to be drafted) will cover noncharitable nonprofits (known in some states as “mutual benefit” organizations). The emphasis of the ALI project is state law; it steers clear of federal tax law except for references to tax rules when relevant (e.g., intermediate sanctions and self-dealing as they pertain to the duty of loyalty).

An outline of topics covered in Part II (charities) and some of the major issues and “trouble spots” that have emerged in the tentative draft are highlighted below, with elaboration (as time permits) in the presentation.

B. A (Still Tentative) Outline of the ALI Principles for Charities

1. Organization and Structural Change
   - Topic 1 – Organizational Form and Charitable Purposes
   - Topic 2 – Fundamental Transactions and Change of Charitable Purpose

2. Governance
   - Topic 1 – Fiduciary Duties
   - Topic 2 – Remedies for Breach of Fiduciary Duties

3. Gifts
   - Topic 1 – Charitable Gifts and Restrictions
   - Topic 2 – Modifying Gift Restrictions
   - Topic 3 – Consequences of Breach of Gift Agreement

4. Members (not yet drafted)
5. Supervision and Enforcement

Topic 1 – Relationship Between the Charity and the State

Topic 2 – Private Enforcement; Standing

Topic 3 – Derivative Action and Other Proceedings

C. A List of Major Issues Addressed and Positions Taken by ALI Project (to Date)

1. An effort is being made to formulate uniform legal standards for charities without regard to their legal form – i.e., a law of charities, rather than trust law or nonprofit corporation law. Under current law, however, this is not always possible – e.g., unlike a trust, a nonprofit corporation may be able to change its Articles without court intervention.

2. The project squarely addresses the issue of changes in charitable purposes – when they are permissible and how to effect; whether legal form matters; how to handle restricted gifts when a charity changes its mission; whether there is a “duty of obedience” to a particular mission; the difference between charitable “purposes” and “activities.” This is an area greatly in need of clarification.

3. The project also is attempting to formulate a “law of gifts” to address issues regarding enforceability of gift restrictions; the extent and length of donor control (if any); whether gift agreements are contracts that can be enforced as such and, if so, by whom; the consequences of a breach of gift restrictions; procedures to modify or release gift restrictions (cy pres and deviation) and whether the dead hand should be less influential as time goes by; the donor’s role in modification proceedings; donor standing issues; a d a charity’s remedies when a donor breaches a gift agreement. Current law in this area is a hodgepodge of trust, property and contract law; a coherent law of gifts would be a great contribution.

4. A major component of the project is the chapter on governance. Some of the issues are:

   a. Fiduciary duties and standards (the twin duties of loyalty and care). Trust standard (strict) or corporate standard (looser), or a combination?
b. Legal responsibilities of board members; board size and qualifications; alternative structures (advisory directors or “bifurcated” boards); role of committees; and permissible delegation to committees and management.

Note: This was the most debated topic when the governance draft was presented at the May 2007 annual meeting of the ALI.

c. Investment management issues (the project is closely tracking UPMIFA and UPIA).

d. Remedies and sanctions for breach of fiduciary duties; when monetary sanctions should be imposed on directors for breaches; alternative sanctions such as removal from office.

e. Immunity from third-party suit, indemnification, and insurance.

IV. Predictions

You have to attend the presentation for the predictions.
APPENDIX

Highly Selective Nonprofit Governance Resources

Treatises and Books


Jack B. Siegel, A Desktop Guide for Nonprofit Directors, Officers and Advisors: Avoiding Trouble While Doing Good (John Wiley & Sons 2006).

ABA Resources

ABA Coordinating Committee on Nonprofit Governance, Guide to Nonprofit Corporate Governance in the Wake of Sarbanes-Oxley (American Bar Association Section of Business Law 2005).

ABA Section on Business Law, Nonprofit Governance and Management (Victor Futter, editor-in-chief) (2002).

ABA Committee on Nonprofit Corporations, Guidebook for Directors of Nonprofit Corporations (George W. Overton & Jeannie Carmelolee Frey, eds.) (2d ed. 2002).

Other Practical Guides

Board Source, Ten Basic Responsibilities of Nonprofit Boards (Pub. 301).

Daniel L. Kurtz & Sarah E. Paul, Managing Conflicts of Interest: A Primer for Nonprofit Boards (2d ed. 2006).

Bibliographies

Nonprofit Resources; A Companion to Nonprofit Governance (Victor Futter & Lisa Runquist, eds., 2d ed. 2006).

Internet Resources

Academic and Public Policy Centers
Aspen Institute, Nonprofit Sector Research Fund – sponsors research and conferences to expand knowledge of the nonprofit sector and philanthropy. www.nonprofitresearch.org

Association for Research on Nonprofit Organizations and Voluntary Action – international membership organization dedicated to fostering through research an understanding of the nonprofit sector, philanthropy and volunteerism. www.arnova.org

Hauser Center for Nonprofit Organizations at Harvard University – interdisciplinary research center based at the John F. Kennedy School of Government. www.ksg.harvard.edu/hauser

Indiana University Center on Philanthropy—works to increase the understanding of philanthropy and improve its practice through research, teaching, and public service. www.philanthropy.iupui.edu

Mandel Center for Nonprofit Organizations, Case Western Reserve University – mission is to enhance effectiveness of nonprofit leaders and managers and the organizations they serve through education, research, and community service. www.cwru.edu/mandelcenter

National Center on Philanthropy and the Law, New York University School of Law – major legal academic center; website contains a comprehensive bibliography of resources pertaining to nonprofit organization law. www.law.nyu/ncpl

Urban Institute/National Center for Charitable Statistics – economic and social policy research organization; co-sponsors of project to compile and report statistical information on nonprofit organizations. nccs.urban.org/nonprofits/index.cfm and nccsdatalweb.urban.org

Yale Program on Nonprofit Organizations – fosters interdisciplinary research to develop an understanding of nonprofit organizations and their role in economic and political life. Recent focus is on study of international non-governmental organizations and the not-for-profit sector in developing economies. ponpo.som.yale.edu

**Government**

**Federal**

Internal Revenue Service – the IRS web site includes a portal dedicated to charities and other nonprofit organizations. www.irs.gov/charities
FirstGov for Nonprofits – portal that provides links to a wide range of government information and services affecting nonprofits. www.nonprofit.gov/

Selected States

California Department of Justice, Registry of Charitable Trusts
www.caag.state.ca.us/charities

Massachusetts Attorney General, Division of Public Charities
www.ago.state.ma.us/sp.cfm?pageid=972

New York State Attorney General’s Office, Charities Bureau.
www.oag.state.ny.us/charities/charities.html

Nonprofit Sector

National Organizations

Board Source – mission is to strengthen effectiveness of nonprofit boards of directors.
www.boardsource.org

Foundation Center – fosters public understanding of the foundation field by collecting, organizing, analyzing and disseminating information on foundations, giving, and related subjects. www.fdncenter.org

GuideStar – the preeminent source of online information on nonprofit organizations; includes complete copies of recent Form 990’s and 990-PFs for virtually all U.S. charities. www.guidestar.org

Independent Sector – the major national association for nonprofit organizations; works to encourage philanthropy, volunteering, and citizen action.
www.independentsector.org

National Center on Nonprofit Enterprise – mission is to help nonprofit managers and leaders make wise economic decisions. www.nationalcne.org

Panel on Nonprofit Sector – convened by Independent Sector (see above) at the request of the Senate Finance Committee to study and prepare recommendations to Congress to improve the oversight and governance of charities. www.nonprofitpanel.org

Selected State and Local Organizations

Minnesota Council of Nonprofits – web site includes a useful guide on best practices. www.mncn.org

Nonprofit Coordinating Committee of New York – information source for New York nonprofit organizations; includes useful resource on "How to Read Form 990." www.npccny.org

Pennsylvania Association of Nonprofit Organizations – advocacy, education and services to Pennsylvania nonprofit organizations. www.pano.org

Texas Association of Nonprofit Organizations www.tano.org

Private Foundations

Association of Small Foundations – provides programs, products and services to foundations with small or no staff. www.smallfoundations.org


Investment Fund for Foundations – provides customized investment vehicles and education for private foundations and other § 501(c)(3) organizations. www.tiff.org

Grantmaking

The Forum of Regional Associations of Grantmakers – national service association for philanthropy. www.givingforum.org

National Network of Grantmakers – membership association of funders committed to supporting progressive social change. www.nng.org

Advocacy and Lobbying

Alliance for Justice – national association of advocacy organizations that works to strengthen the public interest community’s ability to influence public policy. www.afj.org
Center for Lobbying in the Public Interest – provides educational resources with the goal of supporting nonprofit advocacy and lobbying.  www.clpi.org

Media

Chronicle of Philanthropy philanthropy.com

Philanthropy and Fundraising

Give.org – an alliance of the Better Business Bureau and the National Charities Information Bureau; designed to help donors make informed giving decisions. search.bbb.org

National Society of Fundraising Executives – professional association for individuals responsible for generating philanthropic support for a wide variety of charitable organizations. www.nsfre.org

National Center for Family Philanthropy – national resource center focusing on matters of importance to families engaged in philanthropy and their effective giving. www.ncfp.org

National Committee on Planned Giving – major national association for charitable gift planning professionals. www.ncpg.org

The Philanthropic Initiative – organization offering philanthropic design and management services to corporations, foundations, individuals and families. www.tpi.org

Women's Philanthropy Institute – a program of the Center on Philanthropy at Indiana University; mission is to inspire, educate and encourage women to effect change through philanthropy. www.philanthropy.iupui.edu/wpi/index.html
Biography of Barbara A. Rosen

Barbara is a partner in the San Francisco law firm of Evans & Rosen LLP where she advises clients on tax issues affecting tax-exempt organizations and nonprofit corporate law. Before forming her own firm, Barbara practiced law for close to five years with Silk, Adler & Colvin in San Francisco.

Barbara earned her J.D. from UC Hastings College of the Law, where she served as Senior Editor of the Constitutional Law Review. Barbara is a licensed California Certified Public Accountant and practiced as a tax accountant for twelve years before attending law school. She received her Masters in Taxation from Golden Gate University in San Francisco and earned her Bachelors degree from Indiana University.

Barbara teaches Nonprofit Law as an Adjunct Professor at UC Hastings College of the Law and has taught Legal Issues Affecting Nonprofit Organizations in the Masters of Nonprofit Administration program at the University of San Francisco. She is a frequent speaker on nonprofit tax and governance issues. Barbara is active in the California Bar Association and currently serves on the Executive Committee of the Taxation Section of the Bar. She is past chair of the Taxation Section’s Exempt Organizations Committee and is a member of the ABA Tax Section Exempt Organizations Committee and the ABA Business Section Nonprofit Corporations Committee.

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Biography

Gene Takagi is an exempt organizations attorney based in San Francisco. He previously practiced in the corporate group of Sheppard, Mullin, Richter & Hampton LLP, where his pro bono leadership efforts earned him Outstanding Barrister of the Year awarded by the Bar Association of San Francisco. He is author of the Nonprofit Law Blog and a popular speaker on nonprofit legal topics. Prior to his legal career, Gene held various management positions in the for-profit and nonprofit sectors, responsible for annual budgets of up to $50 million. Gene holds a law degree from UCLA, a graduate degree in nonprofit administration from USF, and an undergraduate degree in biological sciences from UBC. Gene currently serves on the boards of Net Impact, an international organization of more than 10,000 MBAs and professionals using the power of business to improve the world, and JCYC, a local charity serving over 5,000 young people annually.
Andras Kosaras serves as Director of Ethical Standards and Philanthropic Outreach for the Council on Foundations. He is responsible for the development and implementation of the Council’s "Building Strong and Ethical Foundations: Doing It Right" initiative.


Andras holds a B.A. in Philosophy, summa cum laude, from the University of Massachusetts, Amherst, and a J.D., magna cum laude, from the New England School of Law, Boston, where he was a member of the law review. Andras is a member of the Massachusetts Bar and of the Boston Bar Association’s Tax-Exempt Organizations Committee.
Biography of Belinda Johns

Belinda Johns is the Senior Assistant Attorney General for the Charitable Trusts Section in the California Attorney General's Office.

Ms. Johns has been a member of the Charitable Trusts Section since 1989. As Senior Assistant, she is the statewide head of the Section. From 1989 until late 2004, Ms. Johns specialized in the civil prosecution of charity and charitable solicitation fraud. During that time period she also served as the liaison between the Attorney General’s office and local law enforcement agencies to assist in the detection and prosecution of charitable solicitation fraud and was responsible for enforcement of the Attorney General's charitable fundraising registration program. Ms. Johns is a past president of the National Association of State Charity Officials (NASCO) and is active in charitable trust issues at the national level.
Biography of Stephen Schwarz

Stephen Schwarz is Professor of Law Emeritus at the University of California, Hastings College of the Law, where he has taught in the areas of taxation, nonprofit organizations and estate planning since 1981. Professor Schwarz is the co-author of four leading law school textbooks: Nonprofit Organizations: Cases and Materials (with James J. Fishman), and Fundamentals of Corporate Taxation, Fundamentals of Partnership Taxation, and Fundamentals of Business Enterprise Taxation (with Stephen A. Lind, Daniel J. Lathrope & Joshua D. Rosenberg). He became professor emeritus in 2004 and currently is the chief operating officer of Eucalyptus Associates, a San Francisco family office for which he has been legal counsel since 1979, and also serves as an officer of The Eucalyptus Foundation.

Professor Schwarz is a 1966 graduate of Brown University and received his J.D. in 1969 from Columbia Law School. From 1969 to 1973, he was an appellate attorney in the Tax Division of the United States Department of Justice. He was on the faculty of the University of San Francisco School of Law from 1974 to 1981 and has been a visiting professor of law at the University of Florida, New York University, UCLA and Arizona State University.

Professor Schwarz is a member of the Exempt Organizations Committee of the American Bar Association Tax Section. He currently serves as an adviser to the American Law Institute’s project on the Principles of the Law of Nonprofit Organizations, and has been a member of the Board of Advisors to the National Center on Philanthropy and the Law at NYU School of Law. A native of Summit, New Jersey, he has lived in Sausalito, California since 1973 and tries to relax at Oakland’s McAfee Coliseum (A’s, not Raiders), Phoenix Municipal Stadium (in March only), and Stanford University’s Roscoe Maples Pavilion.
The Council's Statement of Ethical Principles

The Council on Foundations and its members promote the highest standards of ethical behavior. In recognition of the importance of philanthropy toward the public good and those we serve, we adopt these ethical principles.

- **Mission:** Our members are committed to the public benefit and to their philanthropic purposes and act accordingly.
- **Stewardship:** Our members manage their resources to maximize philanthropic purposes, not private gain; and actively avoid excessive compensation and unreasonable or unnecessary expenses. They pursue maximum benefit through their work, how they work, and by supporting the work of partners, colleagues and grantees.
- **Accountability and Transparency:** In carrying out their philanthropic activities, our members embrace both the letter and the spirit of the law. They welcome public interest, take responsibility for their actions and communicate truthfully.
- **Diversity and Inclusiveness:** Our members seek diversity and inclusiveness in order to reflect the communities they serve and to ensure that a range of perspectives contribute to the common good and the development of their mission in a changing society.
- **Governance:** Our members' governing bodies understand and embrace their responsibility to oversee the mission, strategic direction, finances and operations of their respective organizations, and do so honestly and with integrity. They establish clear and understandable policies and ensure that they are followed.
- **Respect:** Members interact respectfully with grantees, colleagues, donors and peers.

Approved: June 28, 2005

The *Statement of Ethical Principles* defines the ethical expectations the Council has for its members. Since this effort began with a careful consideration of the Principles and Practices for Effective Grantmaking, many of those original principles are incorporated within the new document. This *Statement of Ethical Principles* replaces the *Principles and Practices for Effective Grantmaking* for purposes of Council membership and the Council's sanctions process. Accordingly, new Council members will be required to subscribe to the *Statement of Ethical Principles* when they become members and existing members will be asked to reaffirm that commitment each year when they renew. The *Statement of Ethical Principles* also will serve as the basis against which member conduct will be considered for purposes of the sanctions process.

The committee's work also was informed by the work of the various constituent groups that have been developing stewardship principles—the spirit of which are reflected in the *Statement of Ethical Principles*. Practical guidance on governance and grantmaking can be found in numerous constituent and issue-specific resources including those linked at the left and by several regional associations.