



The Center for Public & Nonprofit Leadership

Issues Forum

GOVERNANCE AND ACCOUNTABILITY IN AMERICA'S FOUNDATIONS

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Educating Leaders Who Change the World

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Kathy Kretman, Director, Center for Public & Nonprofit Leadership

Panel Discussion

James Allen Smith, Waldemar A. Nielsen Chair of Philanthropy, Center for Public & Nonprofit Leadership (Moderator)

Pablo Eisenberg, Senior Fellow, Center for Public & Nonprofit Leadership

William Josephson, Assistant Attorney General, New York State Charities Bureau

Lance Lindblom, President & CEO, Nathan Cummings Foundation

Dorothy Ridings, President & CEO, Council on Foundations

Ralph Smith, Sr. Vice President, Annie E. Casey Foundation

Stephanie Strom, Correspondent, New York Times

Dean Zerbe, Chief Investigative Counsel, U.S. Senate Finance Committee

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PANELIST BIOGRAPHIES

James Allen Smith (*Moderator*)

Smith is serving as the Nielsen Chair in Philanthropy at the Georgetown Public Policy Institute and is a senior adviser to the President of the J. Paul Getty Trust. He was the first Executive Director of The Howard Gilman Foundation and the first Resident Scholar at the Rockefeller Archive Center. He serves on the advisory board of the Center for the Study of Philanthropy at the City University of New York and board of the Robert Sterling Clark Foundation. He is the author of three books and a number of articles on public policy, civil society, and philanthropy.

Pablo Eisenberg

Prior to coming to the Georgetown Public Policy Institute as a Senior Fellow at the Center for Public & Nonprofit Leadership, Eisenberg served for 23 years as Executive Director of the Center for Community Change. Eisenberg has a monthly column in *The Chronicle of Philanthropy*, is a founder of the National Committee for Responsive Philanthropy, and has served as President of Friends of VISTA. He serves on the boards of the Environmental Support Center and The Nonprofit Sector Research Fund of the Aspen Institute.

William Josephson

Josephson is the Assistant Attorney General-in-Charge of the New York State Law Department's Charities Bureau. Prior to joining the Department of Law, Josephson served as Partner at Fried, Frank, Harris, Shriver & Jacobson. Josephson is President of the Peace Corps Institute and has served as a member of the New York State Historical Records Advisory Board and as trustee and chairman of the Budget and Finance Committee of the Mexican-American Legal Defense and Educational Fund.

Lance Lindblom

Lindblom is the President and CEO of the Nathan Cummings Foundation. Before he joined the staff of NCF, Lindblom served as a Program Officer at the Ford Foundation, focusing on democratic accountability, economic and social policy, and globalization. Prior to that position, Lindblom was the Executive Vice President at Soros Foundation's Open Society Institute/Open Society Fund. For 13 years, he worked at J. Roderick MacArthur Foundation, first serving as Executive Director and then as President and CEO.

Dorothy Ridings

Ridings is President and Chief Executive Officer of the Council on Foundations. Prior to joining the Council, Ridings served as Publisher and President of Knight-Ridder's *Bradenton Herald* in Bradenton, Florida, and has held editorial and reporting positions. Ridings has served as President of the League of Women Voters of the United States, as a trustee of the Ford Foundation, and as a director of the Benton Foundation and Independent Sector. She is a member of the boards of the Foundation Center and the Commission on Presidential Debates.

Ralph Smith

Ralph Smith is Senior Vice President at the Annie E. Casey Foundation. Prior to joining the Annie E. Casey Foundation, Smith was an Associate Professor of Law at the University of Pennsylvania and served as Executive Assistant to the Mayor of Philadelphia, and Chief of Staff and Chief Operating Officer to the School District of Philadelphia. He currently serves on the boards of directors of the Aspen Institute Roundtable on Comprehensive Community Change and the Council on Foundations.

Stephanie Strom

Strom is a National Correspondent for the *New York Times*. She reports on issues relating to philanthropy and nonprofit organizations across the country.

Dean Zerbe

Zerbe is Senior Counsel and Tax Counsel for the United States Senate Finance Committee. He has served as Associate at Lionel Sawyer & Collins of Nevada, and Counsel for the Senate Small Business Committee and National Commission on Restructuring the IRS.

WELCOME

Kathy Kretman:

Those who labor today in the world of foundations, nonprofit organizations and philanthropies do not rest easy. On any day, the morning paper or the evening news is likely to deliver another bad, shocking or embarrassing report. Consider a few recent headlines: *Some Officers of Charities Steer Assets to Themselves* (Boston Globe); *How Expensive Should Philanthropy Be?* (San Jose Mercury News); *Foundations Resist Measure to Increase Charity Money* (New York Times); and *They're Mad as Hell, and They're Not Making Donations Anymore* (New York Times).

If the headlines are not disturbing enough, the deeds reported in the news articles should be: The foundation trustee who used foundation assets to pay for his daughter's wedding; the donors who threaten to sue nonprofits for failing to handle gifts as expected; the foundation that paid its chairman more than twice the amount it distributed in charitable gifts.

Admittedly, these accounts represent the actions of a small portion of those working in the field. Yet the egregious acts of these few and the outrageousness of some of the behavior damage the integrity and credibility of all. Moreover, these revelations give new resonance to long-standing criticisms from some who believe the sector lacks the necessary rigor, self-discipline and frugality.

For the philanthropic community to successfully emerge from this period of scandal and controversy, it must do more than hunker down and wait until the media's gaze turn attention elsewhere. The community must be willing to wrestle publicly with its demons. It is in that spirit that the Center for Public & Nonprofit Leadership at Georgetown University decided to convene its January 2004 forum addressing Governance and Accountability in America's Foundations.

The timing is appropriate, for reasons beyond the recent news coverage. By virtually all accounts, the nation is entering a period in which enormous amounts of money will be channeled into philanthropic streams. But beyond the sheer numeric growth in available dollars, some analysts predict a sharp rise in individuals' charitable inclinations, as well. Paul Schervish, director of the Social Welfare Research Institute at Boston College, cites the convergence of multiple trends that, he argues, will drive a new "financial morality in an age of affluence" and create not only "quantitative changes in the relationship between wealth and philanthropy ... [but] qualitative changes in the relationship between wealth and self-fulfillment."

Against such a backdrop, thorough debate around issues of foundation governance and accountability seems not merely appropriate, but essential. It is both wise and prudent to deliberate anew some fundamental questions: Who is accountable? To whom are foundations accountable? For what are they accountable? And what structure or system serves to assure that accountability?

While the burden of accountability rests on the broad nonprofit sector, the conversation reflected in this report is focused on charitable foundations: those institutions – and their benefactors and the individuals who control them – that hold wealth over time with the intent of distributing it for

the greater public good and, for so doing, receive incentives from government in the form of significant relief from taxation.

The object of that accountability is more varied. Arguably, foundations are accountable to the general public, which has a natural expectation that they “do good works.” Foundations also are accountable to government, which allows foundations special tax status in recognition of the investments in the public good. Foundations are accountable to their beneficiaries, who realistically expect that funds will be available for use and that those funds will be allocated responsibly and managed over time so as to maximize their worth. And foundations are accountable to their benefactors, those who created them and charted their course and have an expectation that their wishes be carried out.

But for what are they accountable? What is the public’s expectation of “good works”? What is government’s determination of “public good”? Is there any limit to the expectations of beneficiaries? Can benefactor expectations be trumped by time and cultural change?

Complex as these questions are, they are only the first half of the problem. The second half asks that we identify the mechanisms for accountability. Who or what holds foundations to the standard and has the authority to separate out (and punish?) those who fail the accountability test? Does this burden rest with government, owing to the special tax consideration given foundations? Does it rest with the media, which supposedly represents the public interest in these matters? Does it rest with the courts, which might be called upon to protect the interests of beneficiaries and benefactors? Can we even agree on the merits of external measures vs. internal self-policing?

The Georgetown-sponsored conversation suggests that we are far from being of one mind. There are those who seek greater government oversight, and those who favor stronger foundation self-enforcement. The media is more prone to report events than advocate for change. The public, meanwhile, carries perceptions about philanthropy – and the broad nonprofit sector – that, in many ways, are at odds with reality.

The public generally expects a nonprofit sector that develops and delivers effective solutions to social ills, that has the capacity to coordinate the receipt and distribution of huge sums of money while remaining in complete compliance with donor wishes and the demands of beneficiaries; and that does all of this on a modest budget. This perception ignores the complex relationship between government and the independent sector in meeting social need. And it is naïve in its understanding of foundation wealth, which is miniscule next to the wealth held by the for-profit sector or the cash-flow generated by government.

If the sector is to succeed at being accountable – to the public, government or others – it must foster a better understanding of its purpose, work and role in civil society.

In our conversation on Governance and Accountability, we hope to help build that understanding as we focus attention on questions looming over the future of this great resource: Is the governance of foundations adequately rigorous? Are the standards to which foundations hold themselves adequately demanding? And, most important, how might foundations ensure that

they conduct themselves in such a way as to assure their credibility and stability, enabling them to work on behalf of society for generations to come?

I thank each of our distinguished panelists, and in particular, our moderator, James Allen Smith, for their participation in this dialogue. I also thank the World Bank for graciously serving as our host.

PANEL DISCUSSION

James Allen Smith:

Generally speaking, the words “governance” and “accountability” are more likely to empty an auditorium than to fill it. At least that seems to have been the case until about three years ago. In recent years we have seen glaring and costly governance failures in the business and financial world. We have seen boards of directors of prominent companies pursuing their own financial interests to the detriment of shareholders. We have seen the governance of many of our mutual funds rife with conflicts of interests. And we have seen the limitations – in terms of their resources, personnel, and the will to act -- of the agencies that supervise, regulate and enforce the law.

The words “governance” and “accountability” are now in the headlines of the business sections of our newspapers. They are the stuff of editorials. And we now know that when governance and accountability fail, our trust in corporations and financial markets is shaken to the core. If today’s quite sizeable audience is any indication, there is great and growing concern about governance and accountability in both foundations and the wider nonprofit sector of which they are a part – a sector in which public trust, arguably, plays an even more crucial role than it does in the market economy.

Many of us have read the articles in the San Jose Mercury News, the Boston Globe, and The New York Times about self-dealing, excess compensation and other abuses. We have followed the debates about HR-7 and foundation administrative expenses and payout. And some of us with slightly longer memories can recall scandals in the 1980s and early 1990s. Perhaps a few of us can even remember Representative Wright Patman’s eight-year crusade in the 1960s that presaged Congressional hearings and, ultimately, the 1969 Tax Reform Act. That moment was a watershed for American foundations and their governance.

We may well be approaching another such watershed. That is what prompted Georgetown’s Center for Public & Nonprofit Leadership to convene this exceptional panel. Foundation governance and accountability must always be viewed from a number of perspectives because foundations are accountable to multiple constituencies. This group offers varied vantage points:

We have an internal view from foundation board and staff members – Lance Lindblom of the Nathan Cummings Foundation and Ralph Smith of the Annie E. Casey Foundation.

We have a sector-wide view from the largest foundation associations, now numbering some 2,000 members from the ranks of the more than 62,000 foundations in the U.S. – Dorothy Ridings of the Council on Foundations.

We offer a vantage point from the press, which has proved to be a very effective investigative surrogate for the public – Stephanie Strom of the New York Times.

We have a penetrating look from a long-time observer of the sector – Pablo Eisenberg, my Georgetown colleague and a regular contributor to the Chronicle of Philanthropy.

We will hear from a state attorney general's office – William Josephson, Assistant Attorney General in Charge of the Charities Bureau in New York State.

We have a federal viewpoint from the Legislative Branch – Dean Zerbe, senior counsel to the Senate Finance Committee.

These multiple perspectives remind us that our system for assuring foundation accountability is a complicated framework – or perhaps it is not a framework as much as it is a patchwork. Accountability is a mechanism with many interacting parts, some functioning much better than others and some creaking along or perilously close to breaking.

The panel reminds us that accountability depends on both private and public elements. There are private, voluntary means such as codes of good practice and responsive communication strategies through websites and annual reports. There are public, legally enforceable obligations such as filing tax returns and avoiding self-dealing or excess compensation.

All the parts of this complicated mechanism – internal governance procedures, voluntary professional standards, reporting to tax authorities, enforcement of laws and regulations – have the same goal: to preserve the public's confidence in foundations and to assure that these privately governed institutions do, indeed, provide benefits to the public. The parts of the mechanism ought to interact. And we hope today's conversation will stimulate some of that interaction and, in the end, that we can move the conversation toward a consideration of some of the specific proposals that are in the air for improving the accountability of this sector.

Without adequate accountability the legitimacy of the entire philanthropic enterprise, which has accomplished so much in this country and which has become a model to others around the world, is in jeopardy.

Let me begin with a question for Lance Lindblom, who is now president of the Nathan Cummings Foundation, who has had years of experience in other foundations, including the Ford Foundation, the Open Society Institute and the J. Roderick MacArthur Foundation. Lance, the ways in which those who work in foundations think about accountability depend, in large measure, on what role we think foundations ought to play. How do you think about the role of foundations? And what are the implications for the way that accountability and internal governance ought to be structured?

Lance Lindblom:

When you ask about accountability, the basic question is “to whom and for what?” In order to answer that question, you have to answer, “what is the role of foundations?” Even on this very basic point, I think, there’s a tremendous amount of disagreement within the sector. And I’m talking about just grant making institutions, in this case.

There are some who view foundations merely as a mechanism by which you can distribute money to charitable activities, social service activities, schools, etc. That model demands one set of accountability measures and approaches. If that is your model of philanthropy, I would argue that in many cases it would be better for the government to tax the money and to distribute it democratically.

Others view foundations as a mechanism by which wealth can transcend its own parochial interests, allowing foundations to become innovative institutions in society. That means that they are setup to do the unpopular, to do the things that people might not think of, or to try new experiments – and that they have a social function in doing that. Therefore, they should be accountable as far as the questions of self-dealing and self-interest are concerned; we have authorities who should step in and enforce those rules. But we should be very careful about requiring accountability on a broader scope because of the risk-taking, experimental nature of the work that they do.

Finally, there is the view that foundations are a means to transcend the status quo; to use wealth that is independent to speak truth to power within the society. This presupposes that the foundation is not congruent with the power interests in the society. That presents a unique set of challenges, the resolution of which depends upon the government’s mechanisms and the framework within which the foundation operates.

Of those three basic models, one must make a selection and then ask that basic question: to whom are you accountable, and for what?

Ralph Smith:

Foundations really are vehicles through which benevolent wealth is harnessed to do good and produce value. Foundations produce social benefit by finding, testing and promoting solutions to urgent and important social problems. Because of this unique role, those entrusted with the governance of foundations have a particular obligation of stewardship – stewardship of the *capital* of the foundation. We often think about the endowment as the “capital”. However, the real capital of foundations is the combination of confidence, legitimacy, and credibility that allows foundations to take risks, to stay longer and go deeper, to fail, to pursue the unpopular, to learn and start all over again.

If those of us leading foundations squander that capital, we may find it difficult, if not impossible, to claim the space we need to do our work. Stewardship of this capital, I would argue, is the obligation of this particular vehicle we call a “foundation.”

James Allen Smith:

What sort of challenges does it pose when this sector is composed of tens of thousands of entities, of all different sizes, some with professional staffs and some without, some of whom do not act in ways that protect the sector's credibility – Ralph's broadly defined idea of capital? How does a membership organization such as the Council on Foundations meet this challenge?

Dorothy Ridings:

The Council on Foundations is a membership association. People don't have to belong to the Council on Foundations; foundations and corporate giving programs choose to do so. Therefore, you would expect, and it has been my experience, that those who do belong, who choose to affiliate themselves with others of like mind, are interested in the issues that we are talking about.

Governance issues have been on the Council's agenda ever since 1949, when the organization first began in New York City. In my memory, the first really serious, concentrated attention to these issues came in conjunction with the 1969 Tax Reform Act. In 1973, the Council board widely discussed issues of grantmaking and accountability and governance, and, in 1979, approved a set of recommended principles and practices for effective grantmaking.

The following year, all who joined the Council were required to subscribe to those principles. And indeed that is still true today. Members must reassert their adherence every year when they renew their membership. In the last three to four years, we have revisited those principles and practices and essentially confirmed their validity. There was some updating to be done to account for technological advances, but the fundamentals are sound.

Still, people *choose* to belong to a membership association. What can we say about the larger universe? Through the years, consistent reports from the Treasury Department and others who have been in regulatory roles have reported that, by and large, the foundation field is well managed and well governed. We believe that is still true.

We also believe that there have been some egregious examples of misconduct. I'll be honest: there have been more of those egregious examples than I ever thought existed, and they require exceptional attention in today's world. It is not just because of the enormous growth within the foundation field in recent years, although that is a factor. We think that all of us need to be paying more attention to proposed oversight, remedies, and governance issues. Indeed, a lot of foundations are doing just that.

At the Council, we are beginning a two-year initiative focusing on building strong and ethical foundations. We want to continue to be the educator, the standard bearer, the lifter of standards and good practices. We also want to provide encouragement to the enforcement mechanisms that are in place and have never – never in my mind – been effectively used or effectively financed in order to provide the kind of enforcement and oversight that we badly need.

James Allen Smith:

As Dot Ridings suggests, there have been a number of shocking stories about foundation wrongdoing. Stephanie Strom, you have covered some of them for The New York Times. How extensive are the abuses in the foundation world?

Stephanie Strom:

In fact, the number, or extent, of “problem” foundations is hard to assess. There are between 62,000 and 67,000 foundations in the nation. About two or three times a month, two or three foundations come to my attention with issues that are of concern – something about them raises my eyebrows or shocks me in some way or another. That is, maybe, 24 to 36 foundations a year out of 67,000. But it’s impossible to know how big a problem it is.

The cumulative effect, though, has been profound. Coverage of scandals by the San Jose Mercury News and the Boston Globe and The Washington Post and The New York Times get picked up in local markets, local questions are raised and suddenly, a search engine query returns 50 stories about foundation mismanagement.

James Allen Smith:

Pablo, you have written for decades now about abuses in this sector. They seem to endure, yet they remain urgent to you. Why do they matter?

Pablo Eisenberg:

In my view, these are serious problems because foundations are primarily accountable to the American public. Foundation money is not just private money. It’s public money. It’s *our* money. Therefore, there is an even greater urgency in the face of these scandals to make clear that they are not going to continue. Speaking from a donee perspective, I should stress that there is no group that wants foundations to succeed more, to be more accountable and to do a great job of innovation, than those who receive the money.

I take it for granted that one of the primary purposes of philanthropy, and particularly foundations, is to promote American democracy, to make our democratic life better and more enjoyable and to foster stronger democratic institutions. Herein lies a fundamental paradox of philanthropy: these very institutions that we have charged with promoting American democracy are, in fact, the most elitist organizations in the country.

For all of us, that is a real dilemma. The boards of directors of foundations, whether they are independent or family institutions, are basically composed of the elite in our country -- the wealthiest and the most highly paid professionals. Their perspective, in a real sense, colors what we do.

The problem is compounded by the fact that there is going to be an enormous number of new foundations formed through the inter-generational transfer of money, foundations that also will be governed by elite boards. Huge foundations such as Gates and others are probably going to grow into our first \$75 billion, \$100 billion foundations. One has to raise the question of “How big is too big?” These are huge amounts of money – in many cases, larger than all but the 30 largest country budgets in the world. In the face of such developments, how can we democratize

philanthropy? How do we get boards of directors that are more diverse, that represent real America -- working class folks, teachers, social workers, neighborhood people, etc.?

I believe one of the most important challenges we face is the issue of democracy. It is reflected, in a sense, in the broadening gap between the large nonprofits and the small nonprofits. The large nonprofits are getting most of the philanthropic money. Small nonprofits, which are in real need – the grassroots, the poor, the social service organizations, the rape crisis centers – are not receiving very much. Is there a way that we can close that gap?

These issues of democracy are really significant. I am afraid that neither philanthropy nor our nonprofits have thought much about it.

James Allen Smith:

The abuses we have read about in the press clearly demand legal investigation and stronger enforcement of the law. Bill Josephson, the Charities Bureau with the Attorney General's office has a number of foundations under investigation in New York. In fact, the New York Attorney General's office has been one of the most vigorous in investigating foundations abuse. What are the obstacles to improving enforcement?

William Josephson:

Enforcement in the United States in the philanthropic area is incredibly spotty. We don't really have an effective Internal Revenue Service in this area. Recent GAO reports make that absolutely clear. The IRS and I can't even work together on a matter. I don't, therefore, refer too many things to the Internal Revenue Service.

For four years now we have been working in the Senate in the House on an amendment to the Internal Revenue Code that would enable the state charities regulators, who are not state tax authorities, to share confidential taxpayer information with the Service. You would think that this is a very simple, self-evidently good proposition. The Senate does think so. There is a good provision in both S-476 and S-882. There has been not quite a good a provision in House-1528 because it is limited to 501(c) 3s. And our jurisdiction actually extends much more broadly than just 501(c)3s.

But we can't get a Senate-House conference. The poisonous atmosphere in Washington is totally different from what I was used to in the Kennedy/Johnson era, where you really did sit down together, Republicans and Democrats, and work out what you thought was best for the country. This is a new, strange thing for me.

At the state level, enforcement is also spotty. Certain states are strong. New York is strong. California is strong. In certain wealthy states, Florida and Texas, for example, enforcement is almost nonexistent. It is very, very difficult, for example when you have a nationwide professional fund raiser scam, to have a national effort to deal with that kind of issue.

My own Charities Bureau's jurisdiction is very broad. We are statutory parties to any charitable trust. We deal with all mergers, consolidations, sales of substantial assets, dissolutions. We have a very, very small but highly qualified team of accountants that plow through our six years

worth of nearly 50,000 registration files and came up with, I am sorry to say, a steady stream of problems. These problems are across the spectrum. They deal with do-good organizations. They deal with the major institutional foundations. They deal with family foundations. There seems to be no end.

The common theme is the question of board responsibility. And that, itself, is complicated. In many of the foundations, the boards are too big. They cannot possibly exercise their fiduciary responsibility. In many of the foundations, particularly the family foundations, the boards are too small. There is no independence. They cannot and they do not distinguish between the money their families have given to these foundations – for which, incidentally, they got a very good tax deduction – and their own money.

Getting attentive, well-informed boards whose members will focus on their responsibilities is the most crucial problem that philanthropy faces. If we can't solve that problem, I have to admit that I have real doubts about whether the board governing structure that's traditional in this country is right for philanthropy.

James Allen Smith:

From your perspective with the Senate Finance Committee, Dean Zerbe, what do you see as the source of the problems within foundations or, indeed, within the larger nonprofit sector?

Dean Zerbe:

First let me make a disclaimer that my comments can only be quoted as “congressional staffer”. Board governance is indeed an issue. With charities, particularly public charities as distinct from foundations, there is a certain “market discipline.” The Senate Finance Committee has looked at The Nature Conservancy; we have looked at the Red Cross; we have looked at the United Way. The pressure that is felt in those organizations by the gentle embrace of the Finance Committee, much less of the press, is enormous. The Nature Conservancy is making good steps and a lot of their work focuses on board governance. They would be the first to state that they just didn’t realize that they needed to be in the hen-house counting the chickens. I think they have a much better sense that they need to be active and involved.

But we don’t have that in the foundation arena. Foundation board members need to understand whose interests they really represent. Too often, they think they are there for themselves or they are there for the “entity.” In actuality, I think, they have three constituencies that they need to be mindful of when they are performing their duties. In a corporation, the primary constituency of the board is the shareholders. For nonprofits, it’s not as straightforward.

First, foundation boards have a duty to all the taxpayers, to the public. The organization received enormous tax breaks, *enormous* tax benefits, with these funds. There is a great duty to each of us here today and to the public fisc and to the government.

Second, they have a duty to the donor, who had good intentions. The board must try to meet that intent. I feel certain most donors did not envision their philanthropy being used to buy \$20 million jumbo jets.

Third, and finally, they have a duty to the beneficiaries – who are the point of it all. The board has an obligation to see that the organization is achieving something that is tangible – real to the folks who are intended to have the largess.

Lance Lindblom:

I’d like to underscore the importance of sound board governance because I think it’s a crucial piece of the total picture. In the coverage of recent scandals, I was shocked by two elements: One was simply what was going on – the behavior of individuals at these organizations. It was unbelievable, in many cases.

The other was the fact that evidence of the activity was obtained from the 990 tax returns. It was on the tax returns, which meant it wasn’t hidden. The authorities had those documents. I’m wondering why there wasn’t any prosecution. If it is a question of resources, then we should provide resources to conduct those prosecutions.

James Allen Smith:

Let’s focus for a moment on the 990 forms, the tax returns filed by foundations with the IRS. Much of what we know about foundations is contained in these annual filings, which are all available to the public.

Dean Zerbe:

One of the stunning things I've seen in my work -- and Stephanie could probably speak to this, too -- is the lack of timeliness of the 990s. I can't tell you how many 990s are late, late, late.

William Josephson:

Dean, are you going to stop the Internal Revenue Service from automatically granting 990 extensions? We can't get current information because the IRS has a policy of automatically extending the time to file. We have 990s that come in years later.

James Allen Smith:

Is it still the case that approximately 25 percent of them have errors?

Stephanie Strom:

I looked at a 990 this morning where, in one year, something was described as an asset. It was a building. Then, four years later, it was written off as an uncollectible debt. I think there is a lot of error. People play fast and loose because they know the chances of the IRS actually looking at their return are slim to none.

Dorothy Ridings:

I feel obligated to jump in, though, and say an awful lot of this really is done innocently. Everyone in this room probably has looked at a lot of 990s. You have probably filled out a lot of them. I see nodding heads. It is not an easily understood mechanism. I don't want to throw it all off on a bad reporting form. But it is a bad reporting form. It does need the kind of updating that is being worked on with some order.

Stephanie Strom:

Compounding that is the fact that the public is relying more and more on the 990 to judge organizations. I don't ever take anything on a 990 for fact without calling somebody and asking, "Is this what this actually means?" Very often I have found people who say, "Oh. No. No. No. No. That's not what it means. That's just how we classified it because we didn't know what else to do with it." Woe is the person who tries to figure out what's going on from a 990.

Dean Zerbe:

We are concerned about making the 990 clearer and giving better guidelines and also providing better information that folks actually want to use. But I also think we can bring some concentrated attention to those who file the 990, with an eye toward making sure that they get it right. For us, that means looking more and more at certain things, akin to what the Securities and Exchange Commission does with publicly traded companies. Charities are, basically, a public good. Having better reporting primers out there is important, but so is reporting discipline. I believe the SEC is far less tolerant of whether I get my quarterlies in this year or wait until next year.

William Josephson:

This conversation reminds me of a quote I recall from an ERISA case, regarding fiduciary responsibility: "A pure heart and an empty head are not enough."

You can look at the 990 just like you can look at your 1040. And you can become paralyzed. But for some reason or another, we overcome our 1040 paralysis. And we file annually.

And what do we see in the 990s? Let me just give you two very, very simple examples. In the private foundation world, you are probably familiar with the question of whether or not there have been any self-dealing transactions. And of course, everybody checks “no.” They check “no” even when their schedules show “board compensation, officer compensation, and other foundation manager compensation.” You know, this is not a problem for rocket scientists. You should check “yes” and put in the explanation.

How many times do organizations claim they have no fund raising expense? Fifty percent of the time. We know that’s false. The organizations know that’s false.

Ralph Smith:

A decade from now, I think folks are going to find it remarkable that an entire field would choose to abdicate its responsibility for self-regulation and turn instead to the IRS. This is a setup for the IRS. Its job is to collect taxes. It is not and ought not to become the ethics police. What will happen in five years is that somebody is going to accuse the IRS of conducting politically inspired audits. Somebody is going to yell, “Well, the IRS isn’t looking just at taxes, they are looking at grantmaking.” If I were the IRS, I would look down the road a bit, turn to the field and say, “No. Thank you.”

Earlier in my career, I negotiated with the teachers unions. I constantly reminded them that teaching would not be taken seriously as a profession until unions figured out how to be both unions and professional organizations committed to improving practice and disciplining wayward practitioners. I believe that the same is true of philanthropy. We will not long retain the confidence of the public if we fail to develop meaningful hard-edged responses to the challenges we face. In truth, this is a problem of culture. It is a problem of ethics. It is a problem of professional responsibility. It is a problem of leadership. It is everything but a tax problem. That is why it is absurd for us to pretend that the IRS has or is the solution.

We ought to expect and require philanthropy to take the issue of self-regulation seriously. And we ought to begin doing so now.

Pablo Eisenberg:

Yes, there should be more self-regulation. And there needs to be greater, more responsible leadership, on the part of individual foundations and such infrastructure groups as the Council on Foundations and the Philanthropic Roundtable.

But that is no substitute for what is absolutely essential: regulations and enforcement by the federal and state governments.

People have talked about self-regulation for years. It has never happened. It is illusory to pretend that we can have a system in which foundations and nonprofits will be able to impose high standards, enforce them and clean up their act.

Enforcement and self-regulation must go hand-in-hand. The federal and state governments have the primary responsibility for overseeing and policing the field. Nonprofits must make certain that the regulations are tough and fair and that the regulators have the resources to do their job. Within this framework, nonprofits must pressure their colleagues to abide by the rules.

Interestingly, many of those who advocate strengthening the IRS and attorneys general offices have yet to lobby to use that excise tax for its original purpose of oversight. Those who want better IRS and AG enforcement should put their energy and money where their mouths are.

It is also worth noting that the IRS listens to the political leadership. Unless the political leadership – of both parties – says firmly to the IRS and attorneys general that their responsibility is to regulate and enforce regulations so that the sector is more accountable, there will not be much of a change of attitude at the IRS. The Congress must give that clear and tough charge to the regulators.

William Josephson:

I hope my friend Pablo is wrong. But I fear he may be right. I really do honestly believe that self-regulation is critically important. But I have concerns, as I've expressed, about the boards. I also have concerns about their lawyers and their accountants. I see too many instances in which my profession – the legal profession – is not only failing to do its job but is profiting, in an incredible way, from the problems in the private foundation arena. I see far too many instances where the paid preparers are not doing their job.

If it comes down to enforcement, I will not feel good. In my annual review with Attorney General Eliot Spitzer last January, he said, “You know, Bill, I am getting tired of all these negotiated settlements. I am getting tired of all these civil enforcement actions. I want you to start bringing criminal cases.”

We have had a very sad situation with a very important Harlem icon, Hale House, where we were forced to bring larceny indictments against the principals of that foundation. I have just indicted my first career criminal professional fund raiser. I am preparing to indict another. We have just indicted four directors and officers of an important community health operation in the Bronx for larceny and false filings and three employees for grand jury perjury.

None of this makes me happy or feel good when I go home at night. I can't believe that's what you really want. I would like to make a plea for true self-regulation and true responsibility. I would like you to work me out of my job.

James Allen Smith:

Ralph, you have spoken about the need to create an independent standard-setting body, something like an accreditation system. How would that form of self-regulation work?

Ralph Smith:

I must admit that when I say “self-regulation,” I intend a harder edge than the term usually implies. That is why I can't quite see how a voluntary membership organization could make self-regulation work. Now I am a strong supporter of the Council on Foundation's “Doing it

Right” Initiative. I think there is something important and valuable about lifting up the standards, identifying best practices and encouraging good behavior. But I wonder about the compliance piece of it. That is why I looked at the National Association of Securities Dealers, the public board created for the accounting profession and various other models. It is much too early to come to firm conclusions. Even so, it seems as though some formal recognition by Congress and by state attorneys general and real authority to set and enforce standards are essential for any entity to have a hope of being effective.

From a different point of view, foundations have encountered the perfect storm. We are at a moment of widespread cynicism about public institutions, corporations, government, public officials, and even clergy. It is not surprising that foundations also are targets for public scrutiny. This is part of the periodic process of democratic renewal. Every now and then, the public takes a hard look at powerful institutions and invites them to live up to our expectations.

There also is the sense that we are in a financial crisis. A lot of nonprofits are struggling financially, battered by cutbacks in funding for even their most demonstrably successful efforts. They can’t understand why foundations are so committed about perpetual existence, looking out to the distant future while the present is still so perilous for so many of their grantees.

And we have made quite a point of being at the threshold of great generational transfer of wealth. To many it feels as though this wealth is without purpose. No one has yet made a compelling case for the problem-solving potential of these trillions of additional dollars. Without that compelling purpose, with hardship in the sector and with a time when we are really examining our institutions, it is not surprising that the public at large is impatient and outraged by reports of excessive compensation fees and conflicts.

But if we simply accept the terms of the current debate, we could lose the big picture; we end up with accountability that is about behavior that is negative accountability – what we ought *not* to do. We avoid completely the far more consequential conversation about what we *ought* to do, about the important role, the important charge, the important mission of philanthropy as practiced by foundations.

We must transform the current moment into an opportunity to focus on positive accountability. When this pressure is off and the perfect storm blows over, I hope we are in an era where we hold foundations accountable not only for avoiding the bad but also for doing the good.

Dean Zerbe:

I think you need to keep your feet on the ground regarding self-regulation. Accounting firms do self-regulation: it’s not been an emblem of joy for us to see how that has worked out. You need to be cautious in assessing how much you can truly accomplish that way.

In reworking the CARE Act, we are looking at the possibility of having a second tier: the first tier is, obviously, a 501(c)3 but, in addition, one must also be a member in good standing of professional organization X or, perhaps, one of two or three such organizations, and to be in good standing and subject to the self-regulation of that group. We would be happy to consider looking at that for foundations as well.

It is wonderful that we have had the press coverage of these issues. It is wonderful that we have the turnout we have today. But I can tell you, three years from now or three years ago, this auditorium would be empty. There would not be interest. Things come in cycles. Things come in seasons. You need to think beyond this cycle and put things into place that will be there after the circus parade has passed by.

Congress, shockingly perhaps, is not always attuned to the long-term and tends to look at things of the moment. As you consider reforms, you must remove some factors that will not be there. You will not always have the benefit of the Boston Globe or The New York Times assigning full-time reporters to your issues. I would imagine eventually, after several years, Ms. Strom's editor would say enough stories on foundations.

Finally, do not be concerned about "setting up" the IRS. I deal with folks constantly who say, "The IRS went after me because of this, they went after me because I said I don't like this president or that president." We look at cases both on the left and the right. My boss is very happy to look at all problems from all sides regardless of their origin. There are lots of people who think they see ghosts in the corners and shadows. It's not to say sometimes the IRS doesn't do something that is a little bit goofy -- we all have those days. But we have not seen that kind of IRS activity for years and years. I think it's wrong to worry that the IRS is going to come hopping down based on the political leanings of grantees. They've got enough fish to fry.

Ralph Smith:

Let me be clear and insist that my point is not to worry about the intentions and behavior of the IRS. This is an agency that is very good at what it does—collecting taxes. And is proving with its Earned Income Tax initiatives that it can sensitive to the needs of vulnerable taxpayers. The IRS has an important enforcement role with respect to nonprofit organizations. But it is and has no magic bullet. Nor do the state attorneys generals. The magic may be in the mix of efforts to ensure (1) more effective disclosure by improving Form 990; (2) stronger, more explicit codes of conduct; (3) better internal controls along the lines suggested by Sarbanes-Oxley; (4) enhanced professional development such as "Doing it Right" (5) some hard-edged industry-led self-regulation. All are currently in play. And it will take them all to make a meaningful and lasting difference.

Stephanie Strom:

What I hear from you is that this is a cultural thing. It will all blow over.

William Josephson:

I don't think it will blow over at all. I think it will always be there. I just think the attention won't be there. That's our greatest concern. I am concerned that we will see some folks just decide to hunker down and, as the surfers say, let the wave run over them, and then just come back again.

This is the window of opportunity. We have the CARE Act coming forth. If we are going to do something, this is the time because, to use a very bad pun, there are very few people who care about CARE in the Congress. But there are a few and this is our vehicle. And this is not just an

effort to kick the can. But there are those – and this is not unique to foundations – who, to use a basketball metaphor, are just trying to play four-corner defense hoping the time runs out.

Dorothy Ridings:

I am drawn to the big picture that Ralph has encouraged us to embrace and it prompts me to point out that the focus of our discussion today is a very tiny slice of foundation activity. It is a very visible, awful slice. But if we fail to recognize the values that foundations have brought to this nation, to this world, then we are being very, very shortsighted.

However, there are miscreants, there are bad behaviors, and we need to be aggressive in rooting them out. And we do need enforcers. We really do. We need somebody to be the ultimate authority, to serve as a deterrent for people who are tempted toward bad behavior. The IRS, right now, is all we've got. We have lobbied hard, in both the Congress and through IRS, for more resources to be used in oversight. But I see no appetite for that. I see no real interest in that. Nonetheless, there are 65,000 or so foundations and the IRS audited 120 of them last year. That's not enforcement. That's just not what we need. That's not even going to begin to do it.

James Allen Smith:

In New York, there is work being done to enhance the gathering and collecting of data. Many people are interested in the prospects for filing foundation and nonprofit 990's electronically and of using computer software to analyze information filed with the AG's office. Could you speak to some of the technological solutions that might be available?

William Josephson:

One of my frustrations has been trying to get enough money out of the governor and the legislature to automate the registration system. This is an entirely paper-and-pencil system. We finally persuaded the State Ethics Commission to provide the leeway and now, with GuideStar's help and the help of the National Center for Charitable Statistics of The Urban Institute and the cooperation of the Internal Revenue Service and my colleagues in the National Association of State Charities' Officers, we have a coordinating committee that is headed by James Siegal, my assistant attorney general in charge of registration.

We have very favorable reaction from the major funders. The major foundations understand that accountability, transparency and enforcement are important to the good survival of the sector. I expect very quickly now that a serious planning process will begin to identify our needs for hardware and software.

I would expect, not this year or next year but within a very short time, we will have a nationwide filing system that will enable filers to file electronically, and that system will not accept incomplete or internally contradictory 990s. There should be push-button access to donors who want information on charities soliciting them for money, push-button access for journalists who cover this sector. This is a major opportunity to improve the ability of this sector to account for itself.

James Allen Smith:

The foundation excise tax, and the uses to which it is put, have been debated since 1969. How do we use the \$500 million that is collected through the excise tax on foundations? Can we find ways of using it to improve enforcement?

Dean Zerbe:

It has always been hoped that excise tax revenues would be appropriated to support enforcement and oversight. But looking at the history, Congress never officially did it. As we look at the CARE Act, we are looking to link it up again. The problems are not just with foundations. There are bad apples far beyond the foundations. We have seen terrible abuses in other areas. The terrorism financing now going through charities is an issue, too.

When you take general funds and dedicate them to specific purposes, there are two issues. One: you have to pay for them. It amounts to a loss of general revenue. Second: the appropriators do not tend to pop champagne over dedicated revenues. They view this as intrusion on their watch.

We also are considering providing a set amount of money – several millions of dollars – that would go out in some kind of a formula to the state attorneys general, to support good work such as that in New York, California, Pennsylvania and so forth. But so many states – I believe as many as 30 – really have no staff doing this work at all. We might be able to get some kind of presence there.

William Josephson:

Suppose that we can't succeed in getting some portion of the excise or at least the penalty portion of the excise tax allocated. There are alternatives that we need to consider. Someone who is applying for a tax exemption is applying for a major privilege, just as someone who is applying to register a security or a bond for public issuance is applying for a major privilege. Should they pay for that privilege? Might a filing fee come along with your 990 each year that would help you take it more seriously and also finance the process of review and oversight? The Securities and Exchange Commission is funded significantly by the fees of those who benefit from its work. That's a relief to the taxpayer.

James Allen Smith:

As we look ahead at other measures, either public policy changes or internal changes within the foundation sector itself, where should we focus our attention?

Lance Lindblom:

There are some structural issues that we have to face. The first is a broad, cultural issue: We are the *stewards* of this money. It is not our money. It is not the family's money, though the family may still be on the board. It is for public purposes. That is where we start.

We haven't had the leadership within the sector to make some hard decisions about standards. Consider, for instance, the size of foundations – are there some foundations that are too small to be separate entities or have inordinate influence because they are too large? Consider boards – there is a whole check list of things that can add strong governance in an institution. If you have a family board, do you have a substantial number of non-family members? Do you have board

committees that really work in finance and in investment? Does the board hold the CEO and the president accountable? Are people paid reasonably? What are the standards of compensation? Where is that discussion?

Pablo Eisenberg:

Most of us share Dot's view about the importance of the sector. That's not the issue. Let's not kid ourselves. It's not just a matter of a few bad apples in the barrel. There are lots of bad apples in the barrel. We will discover, as the media does its work, that there are many more than we thought.

In many ways, the debate about the scandals, the media exposure, HR-7, the payout issue, and accountability has been a healthy development. For the first time in many years, what foundations do has become a matter of public debate. Legislators are involved. Nonprofits are beginning to get involved. Philanthropy has come out of the shadows into the sunshine. That's important, and that's positive.

When Ralph suggests that philanthropy should establish a vision for what it wants to do in the future, a core question is: who should get the money? Is a fair portion of foundation assets being given to nonprofits? It is important that this question not remain an insider debate. A much broader community has to be involved in the process that you, Dot, at the Council on Foundations and others are starting. Grantees must be involved. The public must be involved. If that happens, then this partnership between foundations and grantees, which is the real philanthropic process, can really be a partnership. The thrashing out of a vision becomes an effort of everybody, not just the Council and a few foundations.

AUDIENCE QUESTIONS

James Allen Smith:

Let's see if we can begin to flesh out that vision by turning to members of the audience for their questions and comments about what they've heard from the panel.

Question:

I am **Larry Schlesinger**. I used to work at the National Center for Nonprofit Boards. I now am the headhunter for foundations and other nonprofits in Washington.

One of the examples mentioned at the beginning was the James Irvine Foundation in California. Why did the people who made those decisions decide what they did? You talked a lot about systems and changes, but at the core of that example and other examples were individual decisions. Why do you think they made those decisions? That organization has on their board people who are very prominent, people who run law firms, the presidents of universities. They are not unsophisticated people. What is the psychology? What is the culture? Secondly, how would any of the solutions that you proposed today have changed what happened at that organization last year?

Pablo Eisenberg:

I don't think sophistication, higher education, or a legal background make very much difference on those boards. Look at the corporate boards. A lot of them were doctors, academics, CEOs, and they made the wrong choices and encouraged the wrong type of compensation. I think it's precisely because Irvine had a very corporate person as chair that some of those decisions took place. I believe it was a lack of self-restraint, both on the part of the board and also on the part of the president.

There is a sad irony in the Irvine story. The president never got credit for the terrific job he did in California. For years he was, arguably, the best of the large foundation CEOs. There was nobody who pushed advocacy, organizing and public policy more strongly. And it was Dennis Collins who first brought together the north and south of California philanthropy. Unfortunately, in all the media stories, these accomplishments were never mentioned.

There was a lack of governance and responsibility. The foundation adopted corporate standards. We find that the Irvine example reflects a runaway train on compensation among the top CEOs in foundations. The president of the United States earns \$400,000. Is it right that the chair of the Lilly Endowment gets \$1.2 million?

Question:

I am **Tim Walter**. I run the Association of Small Foundations. On all of these boards, nothing substitutes for leadership and bravery, for someone who will say, "You know, that's too much." There is just no substitute for that.

Today, I have not heard the donor voice represented by the panelists. One of the things we notice at the Association of Small Foundations is that our members are still donating to their endowments. There is a lot of money yet to come. What are we doing to inspire more generosity and not trample that very human wellspring of creativity and generosity? Can some of these measures work to inspire and create more of that?

Ralph Smith:

This philanthropic impulse – the willingness to put wealth to work, the interest in getting involved – really is at the heart of the work of many family foundations in this country.

The Council on Foundations has been working to articulate a set of principles and practices that would pair that impulse with the best of what we know works. It's a tough task because there are people around who still say, "This is my money." But with support, encouragement, development and education, they can come to appreciate that the best of what they wish to achieve can be accomplished within a framework of high principles, strong practice and real accountability.

William Josephson:

One of the things donors must be careful about, that donors are not sufficiently careful about, is ensuring that those family foundations stay in the family and that the family actually participates. I see too many examples where a donor has put his lawyer or her lawyer and accountant on the board. The family members disperse or die. All of a sudden, you see this lawyer and this

accountant, often to the exclusion of grandchildren and great-grandchildren who may want to participate, running this foundation.

I've got a case in front of me now, actually, where so far we have found five small family foundations that two lawyers are controlling. They are taking home, over six years, \$750,000 worth of compensation. They are giving out \$1.75 million in grants, all plain vanilla. If you look at each foundation, it would be very hard to make a non-commensurate compensation case with respect to each foundation. But if you aggregate them, as I've just done, what do I do now?

And this really could have been avoided if the donors were either very clear that only family members could qualify to be directors or trustees, or, better yet, created donor advised funds in community foundations. There, you'll get professional management and professional investment.

Question:

My name is **Erin Ross**. I run an organization here in Washington called United Leaders. My question is about the transition in foundations over the last years not to support outreach, advocacy and public policy. I wonder if that relates to governance. Is it because boards are politicized? Is it because they don't want to get involved in real politics?

Lance Lindblom:

I have to say that at the Nathan Cummings Foundation, outreach, advocacy and public policy are among the most important things we do. Our goals and mission lead us naturally to the public policy, public advocacy areas. The more profound question is, why isn't there more of that? The major strategic thrust of our foundation is social and economic justice. If you look at the top 150 foundations, probably, in the United States, you'll find a great number of business CEOs and presidents and retired chairpersons of the board. But, I think, you will find not one labor leader, not one. That's astounding. And if you look and see what the interests and perspectives are of most of the people on foundation the boards, you'll find the sort of same kind of congruence of interests. This often leads to more "status quo" approaches, and reluctance to get into changing institutions or systems.

I think some of the best chances for the kind of work that you want to see, actually, are eccentric family foundations that have values, which allow them to transcend parochial interests of wealth, and which have the potential of overseeing this inertia.

Ralph Smith:

I think you also are seeing something else. In many cases, what previously passed for "policy work" reflected ideological predilections of whomever was making the decision on that particular day or in that particular year.

What we are seeing from some foundations today is more attention to the small "p" policy: what's happening on the ground. This is an important and salutary development. As foundations set out to engage the big policy issues, they need to continue to listen to and engage and learn from the folks who live and work and worship and raise their children in urban neighborhoods and rural communities across the country.

Pablo Eisenberg:

What's amazing to me, Erin, is that foundations still talk about themselves as the cutting edge of civil society. Oh, how little cutting they do. How few risks they take. How little they give for public policy, advocacy, organizing, and coalition building. If you look at our history and the history of civil society, these activities are the hallmarks of American civil society: social change, fueled by some philanthropic money and by advocacy organizations. It is the most admired feature of our civil society abroad. And it is the least admired, somehow, by our society here.

Why are our center, progressive, and mainstream foundations so scared to support public policy and advocacy work when, in fact, the conservative foundations have given a majority of their money to making change? They are not worried about Congress getting after them. They have done it with impunity. They have had integrity. They have had a vision. Somehow, our mainstream folks don't see that as model grantmaking. I think the challenge, both for democracy and the future of foundations, is whether foundations can begin to give more of their money to the strategies and tactics of advocacy and change that our society needs and which have been the bedrock of our democracy for some 250 years.

Question:

I'm **Dorothy Weiss** and I currently work for an organization here in town called OMB Watch. I was very struck by the fact that the panel spent a lot of time on the issue of self-regulation versus enforcement. Yet that's the easy issue. The harder issue is the multiple views the American people hold about the role of foundations, and of foundations' need to be accountable to the American people. If we are going to figure out the more technical issues, we first must determine what we as a society think foundations should be doing.

Within 24 hours of the fall of the two towers on September 11th, I had an uneasy feeling in the pit of my stomach because I knew there was going to be a major problem for American philanthropy's reputation. People both wanted the money out the door really fast, and yet they wanted a whole lot of accountability as to where it was going. Clearly, the American people just don't understand. How can we help them better understand?

Stephanie Strom:

Public perceptions of foundations vary dramatically. If you sit in a room with 10 people, they have 10 different ideas about the purpose of foundations and nonprofit institutions. In a lot of places around the world, the things that our nonprofits do are done by government. If you talk to somebody from Japan, for instance, they have no idea why we have this thing called nonprofit health care.

Part of the problem for the sector is the language it uses to explain itself. It is often hard to understand what you are talking about, what you are trying to tell us about your role. A lot of times you want to talk about your work, but you don't want to talk about yourselves.

I became somewhat infamous, post- 9/11, for saying charities are supposed to do good deeds just like Apple is supposed to make computers. So the fact that you are doing something good isn't

necessarily news. I think from the media's perspective, we'd like to know more about you, how you operate, how you make the decisions you make about how to spend money. But you don't do a good job of telling us. And when we ask questions, you tend to become turtle-like and pull in. The more you can explain why you do what you do, the better the public will come to appreciate what you do.

James Allen Smith:

And with Stephanie's comments we must draw this to a close. It is a fitting conclusion—a reminder that public accountability is about rendering an account of what we in the foundations world are capable of doing, and of making our role more widely understood.