

# Standards for Excellence Institute



The Honorable Charles E. Grassley, Chairman  
The Honorable Max Baucus, Ranking Minority Member  
United States Senate Committee on Finance  
219 Dirksen Senate Office Building  
Washington, DC 20510

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Re: March 3, 2006 Roundtable on Nonprofit Governance

Dear Senator Grassley and Senator Baucus:

The national Standards for Excellence Institute, a program of the Maryland Association of Nonprofit Organizations, (hereinafter "the SFX Institute") appreciates the opportunity we have had, since first meeting with staff of the Senate Finance Committee in the spring of 2004, to participate in the important national discussion of reforms and enhanced standards for governance of tax-exempt nonprofit organizations. We also appreciate the opportunity we had to participate on the Oversight and Self-Regulation Work Group of the Panel on the Nonprofit Sector convened by Independent Sector.

Since the Committee's July 2004 Roundtable, the SFX Institute has continued to promote best practices in nonprofit governance and management, as embodied in our *Standards for Excellence: An Ethics and Accountability Code for the Nonprofit Sector* (enclosed). We have also continued to work with other national nonprofits, state and local associations of nonprofits and management support organizations to build a system of nonprofit sector self-regulation that will be capable of addressing many of the concerns that have been expressed in Congress about governance and management practices in the nonprofit sector.

The Standards for Excellence Institute strongly endorses and supports the recommendations and positions contained in the Panel's June 2005 Final Report. We have summarized below three points of emphasis drawn from this ongoing discussion that we would highlight today, including one area where we differ with the Panel's recommendations

**1. An investment in the infrastructure of the nonprofit sector is necessary to bring about substantial improvements in nonprofit governance and management.**

Regardless of changes in regulations or law enforcement, significant improvement in nonprofit governance and management, particularly for the small and medium-sized organizations that comprise the majority of the nonprofit sector, is largely an issue of available time, resources and knowledge. Without additional 'capacity-building' supports, more rules and requirements will accomplish little to improve the management and accountability of groups that are already under great stress.

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While these issues have not yet been addressed by the Panel, it is clear from our own experience working with nonprofits at the local community level throughout the United States that the most necessary component of an effort to achieve broad improvement in nonprofit accountability and management is increased educational support and technical assistance to nonprofit boards and managers. To state the matter simply, many board members and staff of nonprofit organizations are simply unaware of their roles, responsibilities and the complex web of rules and regulations they are responsible to abide by. A concerted effort at educating them will go along way toward addressing many concerns.

Consequently, we strongly encourage proposals, such as those discussed in the Finance Committee's June 2004 Staff Discussion Draft, that recommended federal appropriations of \$25 million in funding for training and capacity building for nonprofit organizations, and an additional \$10 million for the development of implementation of self-regulatory codes of 'best practice' in nonprofit management and accountability.

## **2. The Panel on the Nonprofit Sector's recommendations on reporting and law enforcement are of particular importance.**

While generally we support the recommendations set forth in the June 2005 Final Report of the Panel on the Nonprofit Sector, there are certain of the recommendations that we believe are worth emphasizing, as follows:

- Many of the concerns expressed in the congressional process relate to the appropriate level of reporting to be required by nonprofit organizations. There should be more precise and objective guidelines and instructions for reporting on the annual IRS Form 990.
- Any new reporting requirements should also be accompanied by clear and objective guidelines and instructions.
- Reporting of 'performance' data should not be required as part of the annual Form 990.
- Organizations with annual revenue less than \$25,000, who are now not required to file annual 990 returns should be required to file a shortened form containing at least basic contact and financial information.
- Electronic filing of required reports with the Internal Revenue Service should be promoted, but we do not support mandating electronic filing without appropriate consideration and support for smaller organizations to avoid additional costs.
- The Chief Executive Officer of reporting charities should be required to sign the annual Form 990
- Additional resources should be provided to both federal and state regulators to enhance enforcement of existing Internal Revenue Code and state charity regulations.
- Federal officials should be allowed to share information in order to support enforcement of state charity regulations, as long as federal and state officials otherwise maintain confidentiality protections.

The Honorable Charles E. Grassley  
The Honorable Max Baucus  
March 2, 2006  
Page Three

**3. More stringent requirements are appropriate in the area of board composition, conflict of interest and board/trustee compensation.**

Nonprofit boards of directors have a critical role as stewards of the organizations they oversee and as trustees for the public interest. The Standards for Excellence Institute recommends more stringent standards for the composition and conduct of nonprofit boards than those contained in the Panel's final report.

- We recommend as a legal requirement for obtaining or maintaining 501(c)(3) status that the board of directors of a charitable organization be composed of at least five (5) unrelated individuals, a two-thirds majority of whom should be independent. With five as a minimum, we recommend at least seven board members as good practice. (The Panel Report suggests a minimum number of three and that a minimum of "one-third" of members qualify as independent)
- We recommend as a legal requirement for obtaining or maintaining 501(c)(3) status, that organizations adopt a conflict of interest policy and annual disclosure process (consistent with guidelines to be determined), and that these policies require that any 'interested party' transaction require approval by at least a majority of the disinterested directors. (The Panel suggests that a conflict of interest policy should be recommended as good practice for nonprofits but should not necessarily be legally required.)
- We recommend that compensation of directors or trustees of charities, including foundations, be allowed only when, and in such amount, determined appropriate and reasonable by a committee established (1) to review possible compensation and make this determination, and (2) composed of individuals who are not compensated by the organization and have no financial interest in the determination. We agree with the Panel that board compensation should be discouraged. (The Panel's recommendation for heightened review of board compensation is suggested as a matter of practice within the nonprofit community rather than a legal requirement.)

Thank you for this opportunity to supplement the views expressed in our July 15, 2004 comments in response to the Staff Discussion Draft on Charity Oversight and Reform. As we stated previously, the quality of governance, management and operations of nonprofit organizations is of vital interest to the people and communities nonprofits serve. Best practices standards are important to assure the long-term viability of nonprofit organizations and to enhance their ability to serve the community.

Sincerely,



Peter V. Berns  
Chief Executive Officer  
Standards for Excellence Institute