Principles for Good Governance and Ethical Practice

A Guide for Charities and Foundations

Panel on the Nonprofit Sector
Convened by Independent Sector

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Panel on the Nonprofit Sector

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

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

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

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

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Preamble

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

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

The variety of purposes, forms, and motivating beliefs that make up the charitable community in the United States is one reason why it has consistently earned widespread support from large numbers of Americans. In recent decades, the percentage of survey respondents expressing confidence in the ethics and honesty of U.S. charities and voluntary organizations overall has hovered around two-thirds.[1] For individual charitable organizations, responses are even more favorable, some reaching above 70 percent. In 2006, 20 percent of all Americans—more than 61 million of them—volunteered in some capacity in an assortment of different kinds of nonprofit activity.[2] Individual donations totaled more than $207 billion, which came on top of the $41 billion given by corporations and foundations created from private money.

Preserving this diversity, adaptability, and capacity for innovation depends in large part on maintaining the public's trust. The public has high expectations for both the ethical standards and the impact of the country's 1.4 million charitable organizations, but often has trouble distinguishing one nonprofit from another. Unethical or improper conduct by an individual organization, though rare, can thus jeopardize the human and financial support on which countless other activities rely. Yet government attempts to prevent such abuses, if not carefully pursued, can themselves diminish the unique value that nonprofits bring to American life. Too heavy a regulatory hand, or too uniform and inflexible a set of legal restraints, could stifle the very creativity and variety that makes nonprofit activity worth protecting and encouraging. Government appropriately sets rules for the organizations and activities that are exempt from taxes and eligible to receive tax-deductible contributions: for example, government has determined that such contributions may not be used for partisan political activities or the private benefit of the donor. At the same time, government has wisely avoided intruding on how organizations pursue their missions, manage their programs and structure their operations.

Just as important, nonprofit organizations have long embraced the need for standards of ethical practice that preserve and strengthen the public's confidence. Many such systems in fact already exist, though none have applied to the entire range of American charitable organizations. The pages that follow therefore set forth a comprehensive set of principles to inform the field. Their purpose is to reinforce a common understanding of transparency, accountability, and good governance for the sector as a whole—not only to ensure ethical and trustworthy behavior, but equally important, to spotlight strong practices that contribute to the effectiveness, durability, and broad popular support for charitable organizations of all kinds.

TOWARD A BALANCED SYSTEM OF LAW AND SELF-GOVERNANCE

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

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

The Panel has been equally committed to formulating effective, broadly applicable methods of self-regulation since its inception in 2004. Its work has proceeded from a belief—among lawmakers and their staffs no less than among charitable organizations—that the best bulwark against misconduct will always be a well-informed vigilance by members of the nonprofit community themselves, including a set of principles they could adopt, promote sector-wide, and improve over time. These principles should be clear enough to be practical and readily implemented in a wide variety of organizations, but flexible enough to allow each organization's governing board and management to adapt them to the dictates of that organization's scope and mission. Widespread use of such principles would enable organizations to improve their operations by learning from each other. Critically, it would also provide a common yardstick by which members of the public can evaluate how to direct their support.

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DEVELOPING SECTOR-WIDE PRINCIPLES TO SUPPORT SELF REGULATION

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

whole sector, the Panel's first step was therefore to commission two studies to review, analyze, and find patterns among these existing systems.

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

> Self-regulation begins with good governance.

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

USING AND ADAPTING THE PRINCIPLES FOR YOUR ORGANIZATION

In the following pages, the Panel sets forth 33 principles of sound practice that should be considered by every charitable organization as a guide for strengthening its effectiveness and accountability. Six of these principles describe actions that all charitable organizations *must* take because they are required by law.[3] The other 27 describe actions that charitable organizations *should* strongly consider following, based on their legal and operational structure and their particular charitable purposes.

This distinction—between firm rules based on law and more flexible principles that must be interpreted and applied differently in different cases—is essential to understanding and using this document. In following this approach, the Panel on the Nonprofit Sector examined a broad continuum of different models, reflecting greater and lesser degrees of uniformity and means of enforcement. At one end of this spectrum are systems of accreditation, such as those for hospitals and institutions of higher education, that carry the force of law and sanctions for violations. Further along on the continuum are standards that members of an association or network of similar organizations, such as associations of land trusts or certain religious institutions, agree to follow. While failure to meet these standards may not force an organization to close its doors, the advantages to being a member in good standing of the umbrella network is usually sufficient to encourage careful adherence to its rules and norms. Finally, there are standards that nonprofits subscribe to on a purely voluntary basis, without any external verification, because they want to strengthen their governance practices and ethical conduct.

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

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

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

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

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

1. **Legal Compliance and Public Disclosure** (principles 1-7, pages 8-12)—responsibilities and practices, such as implementing conflict of interest and whistleblower policies, that will assist charitable organizations in complying with their legal obligations and providing information to the public.
2. **Effective Governance** (principles 8-20, page 13-19)—policies and procedures a board of directors should implement to fulfill its oversight and governance responsibilities effectively.
3. **Strong Financial Oversight** (principles 21-26, pages 20-23)—policies and procedures an organization should follow to ensure wise stewardship of charitable resources.
4. **Responsible Fundraising** (principles 27-33, pages 24-27)—policies and procedures organizations that solicit funds from the public should follow to build donor support and confidence.

Strengthening ethics and accountability is an organic process that requires an ongoing commitment by boards and staff of individual organizations and by the entire nonprofit community.

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

relevant, is likely to foster a greater appreciation of the diverse nature of the sector and a deeper respect for the board's good stewardship.

A reference edition of these principles is available on the Panel's website, www.nonprofitpanel.org. It includes legal background on each principle, a glossary of terms, the two studies on self-regulation systems commissioned by the Panel to inform this work, and the more than 50 existing self-regulation systems and standards that the Panel's Advisory Committee on Self-Regulation studied during its work.

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

A PROCESS OF CONTINUING VIGILANCE AND ADAPTATION

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

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

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

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

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

Principles for Good Governance and Ethical Practice

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Legal Compliance and Public Disclosure

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

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

There are many resources to help charitable organizations and their boards understand the law. The Internal Revenue Service provides a free online workshop at www.stayexempt.org, which covers tax compliance issues relevant to small and mid-sized tax-exempt organizations. Some state attorneys general and other state charity officials, as well as many national, state and regional associations of nonprofit organizations, provide online tools and resources that offer legal guidance. Organizations may also find it helpful to consult with state and local chapters of bar associations for referrals to low-cost or pro bono legal assistance.

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

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

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

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

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

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

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

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

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

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

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

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

The policy should be tailored to the nonprofit's size, structure, and capacity, and it must reflect the laws of the state in which the nonprofit is organized or operates. All policies should specify the individuals within the organization (both board and staff) or outside parties to whom such information can be reported. Small organizations with few or no paid staff may wish to designate an external advisor to whom concerns can be reported without any threat of retaliation. This is a particular concern for family foundations whose board members and staff may not feel comfortable sharing concerns about suspected illegal or unethical practices directly with another family member or close associate of the family. Larger organizations should encourage employees and volunteers to share their concerns with a supervisor, the president or executive director, and/or the chief financial officer of the organization, but should also provide a method of reporting anonymously to either a board member or an external entity specified by the organization. Some large organizations have set up computerized systems that allow for anonymous reports, and a number of private companies offer anonymous reporting services via a toll-free telephone number, email address, or intranet site.

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

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

A written document-retention policy, consistently monitored over time, is essential for protecting the organization's records of its governance and administration, as well as business records that are required to demonstrate legal compliance. Such a policy also helps to protect against allegations of wrongdoing by the organization or its directors and managers. Board members, staff and volun-

teers should be made thoroughly familiar with the policy and informed of their responsibilities in carrying it out.

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

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

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

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

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

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

Even the smallest organizations should have procedures for backing up and preserving electronic and print copies of documents and other information vital to their governance, financial, and programmatic operations. Larger organizations may require more extensive risk management programs, including emergency preparedness and disaster response plans in case of natural or man-made disasters or other crises that may disrupt significantly its programs and operations.

Organizations that employ staff should have written personnel policies that conform to federal and state laws. They should develop appropriate procedures to protect the health and safety of both employees and volunteers while they are at work. Organizations providing services to vulnerable individuals should ensure that appropriate screening, training and supervision procedures are in place to minimize safety risks to consumers and clients, as well as to paid and volunteer staff.

7 A charitable organization should make information about its operations, including its governance, finances, programs and activities, widely available to the public. Charitable organizations also should consider making information available on the methods they use to evaluate the outcomes of their work and sharing the results of those evaluations.

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

A good first step is to provide an annual report that lists the organization's board and staff members, describes its mission, shares information on program activities, and details financial information including, at a minimum, its total income, expenses and ending net assets. Such reports need not be elaborate, can be produced in paper or electronic form, and can direct the reader to other readily available documents (such as the Form 990 return or audited financial statements) for further information. If an organization chooses to produce such reports on a less frequent basis, such as every two or three years, it should ensure that any intervening changes in its board and staff or programs and its current financial statements are provided as an attachment or are otherwise made known to readers of the report.

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

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

Effective Governance

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Boards of directors have the authority to delegate responsibility for maintaining the daily operations of the organization to a chief executive officer. One of the most important responsibilities of the board, then, is to select, supervise, and determine a compensation package that will attract and retain a qualified chief executive. The organization's governing documents should require the full board to evaluate the performance and approve the compensation of the chief executive annually and in advance of any change in compensation. The board may choose to approve a multi-year contract with the CEO that provides for increases in compensation periodically or when the CEO meets specific performance measures, but it is important that the board institute some regular

basis for reviewing whether the terms of that contract have been met. If the board designates a separate committee to review the compensation and performance of the CEO, that committee should be required to report its findings and recommendations to the full board for approval and should provide any board member with details, upon request. The board should then document the basis for its decision and be prepared to answer questions about it.

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

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

Governing boards are responsible for hiring and establishing the compensation of the CEO and for approving the compensation range of other persons in a position to exercise substantial control of the organization's resources. It is the responsibility of the CEO to hire and set the compensation of other staff, consistent with reasonable compensation guidelines set by the board. If the CEO finds it necessary to offer compensation that equals or surpasses his or her own, in order to attract and retain certain highly qualified and experienced staff, the board should review the compensation package to ascertain that it does not provide an excess benefit.

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

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

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

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

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

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

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

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

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

A regular process of evaluating the board's performance can help to identify strengths and weaknesses of its processes and procedures and to provide insights for strengthening orientation and educational programs, the conduct of board and committee meetings, and interactions with board and staff leadership. Many boards will find it helpful to conduct such a self-assessment annually; others may prefer a schedule that coincides with the terms of board service or regular long-range planning cycles. A number of print and online tools, ranging from sample self-assessment questionnaires to more complex evaluation procedures, can help an organization design a board evaluation or self-assessment process that best meets its needs.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Strong Financial Oversight

21 A charitable organization must keep complete, current, and accurate financial records. Its board should receive and review timely reports of the organization's financial activities and should have a qualified, independent financial expert audit or review these statements annually in a manner appropriate to the organization's size and scale of operations.

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

Having financial statements prepared and audited in accordance with generally accepted accounting principles and auditing standards improves the quality of the information. Each organization must ensure that it has its annual financial statements audited or reviewed as required by law in the states in which it operates or raises funds or as required by government or private funders. When an audit is not legally required, a financial review offers a less expensive option that still provides the board, regulators and the public with some assurance of the accuracy of the organization's financial records. Many smaller organizations that have opted to work with an independent accountant have noted that the accountant provided invaluable guidance.

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

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

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

Sound financial management is among the most important responsibilities of the board of directors. The board should establish clear policies to protect the organization's financial assets and ensure that no one person bears the sole responsibility for receiving, depositing, and spending its funds. Day-to-day accounting and financial management should be the task of staff or, in the case of organizations with no or one staff member, designated volunteers who have the necessary time and skills. The board is responsible for reviewing practices and reports to ensure that those staff or volunteers are adhering to the board-approved policies.

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

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

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

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

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

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

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

Charitable organizations have an obligation to devote their resources to the charitable purposes for which they were granted tax exemption, and to spend donated funds on the programs and activities for which the funds were contributed. At the same time, the successful operation of any business or organization—including the responsible pursuit of nearly any kind of charitable purpose—requires effective management and administration. Administrative activities include financial and investment management, personnel services, recordkeeping, soliciting and managing contracts, legal services, and supporting the governing body of the organization. Not only do these elements ensure that the organization complies with all legal requirements, but they also help provide complete, accurate, and timely information to donors, the public, and government regulators.

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

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

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

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

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

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

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

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

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

Responsible Fundraising

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

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

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

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

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

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

In some cases, an organization may not receive sufficient contributions to proceed with a given project or it may receive more donations than it needs to carry out that project. If the organization is unable or unwilling to use the contribution as stated in its appeal or in the donor's communication, it has an obligation to contact the donor and request permission to apply the gift to another purpose or offer to return the gift. Charitable organizations should strive to make clear in materials that solicit contributions for a specific program how they will handle such circumstances,

A charitable organization should carefully review the terms of any contract or grant agreement before accepting a donation. If the organization will be unable or unwilling to comply with any of the terms requested by a donor, it should negotiate any necessary changes prior to concluding the

transaction. Particularly in the case of substantial contributions, the recipient should develop an agreement that specifies any rights it may have to modify the terms of the gift if circumstances warrant. Some charitable organizations include provisions in their governing documents or board resolutions indicating that the organization retains "variance powers," the right to modify conditions on the use of assets. Such powers should be clearly communicated to donors through a written agreement.

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

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

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

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

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

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

must instead sell or otherwise dispose of the property soon after the donation is received.

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

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

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

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

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

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

Compensation for fundraising activities should reflect the skill, effort, and time expended by the individual or firm on behalf of the charitable organization. Many professional associations of fundraisers prohibit their members from accepting payment for fundraising activities based on a percentage of the amount of charitable income raised or expected to be raised. Basing compensation on a percentage of the money raised can encourage fundraisers to put their own interests ahead of those of the organization or the donor and may lead to inappropriate techniques that jeopardize the organization's values and reputation and the donor's trust in the organization. Percentage-based compensation may also lead to payments that could be regarded by legal authorities or perceived by the public as "excessive compensation" compared to the actual work conducted. Percentage-based compensation may also be skewed by unexpected or unsolicited gifts received by the charitable organization through no effort of the fundraiser.

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

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

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

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

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For Further Information

The reference edition of the Principles for Good Governance and Ethical Practice is available for free download at www.nonprofitpanel.org. It provides legal background on each principle with detailed footnotes, a glossary of terms, and additional information on self-regulation in the nonprofit community, including the two studies commissioned by the Panel to inform this work.

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

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