Chapter 1

Ensuring the Future of Philanthropy—An American Tradition—Through Accountability and Ethical Fundraising

CHAPTER OUTLINE

- The Nonprofit Sector
- Definition of Philanthropy
- History of Philanthropy in America
- A Tradition of Volunteerism
- The Relationship Between Volunteering and Charitable Contributions
- How Generous We Are as a Nation
- Profile of the Changing Donor
- Indicators That Affect Giving and Volunteering
- How to Create a Philanthropic Environment
- The Accountable Nonprofit Organization
- Assess Your Organization's Accountability
- Ethical Standards and Practices

KEY VOCABULARY

- Accountability
- Charitable Giving
- Demographics
- Development
- Donor
- Ethics
- Nonprofit Sector
- Nonprofit or Not-for-Profit Organization
- Philanthropy
- Transparency
- Volunteerism

> *"We make a living by what we get, but we make a life by what we give."*
>
> —Winston Churchill

This quote by Winston Churchill captures the heart of the nonprofit sector and the strong sense of mission so prevalent among those who work within it. To successfully raise funds for a nonprofit organization, you must understand what philanthropy is and how it became an American tradition.

THE NONPROFIT SECTOR

The nonprofit landscape in America is a mosaic of diverse organizations that cover an astounding breadth of causes—from homeless shelters to the ivy-covered walls of colleges and universities. Its more than a million organizations include charities, arts and cultural organizations, social welfare organizations, religious institutions and faith-based organizations, academic institutions, foundations, and professional and trade associations. The *nonprofit sector* (or *independent sector*) is the collective name used to describe the institutions and organizations in American society that are neither government nor business. Other names often used include the *not-for-profit sector,* the *third sector,* the *philanthropic sector,* the *voluntary sector,* and the *social sector.* Outside the United States, nonprofits are often called *nongovernmental organizations* (NGO) or *civil society organizations.* Whatever the term used, their numbers are dramatically on the rise.

Each nonprofit distinguishes itself from others through its mission and contributions to society. Yet, together, all the organizations in the nonprofit sector continually shape and reshape the social order, create both the intellectual and social space for Americans to organize, and influence every aspect of the human condition. Through nonprofits, individuals can organize and exercise their rights to advocate for issues and causes in which they truly believe.

It is often said that the nonprofit sector is the heart and soul of society because it connects with communities and makes a difference in the lives of people by fulfilling unmet needs. The nonprofit sector serves as a forum for the discussion and dissemination of new ideas, an efficient vehicle for delivering social

services, and a guardian of our environment, values, and heritage. Millions of volunteers and donors truly make the nonprofit sector a critical player in the world today.

DEFINITION OF PHILANTHROPY

The word *philanthropy* is Greek and means "love of mankind." According to the online dictionary of the Association of Fundraising Professionals (AFP) (Levy, 2006), philanthropy is (1) the love of humankind, usually expressed by an effort to enhance the well-being of humanity through personal acts of practical kindness or by financial support of a cause or causes, such as a charity (e.g., the American Red Cross), mutual aid or assistance (e.g., service clubs and youth groups), quality of life (e.g., arts, education, and the environment), and religion; and (2) any effort to relieve human misery or suffering, improve the quality of life, encourage aid or assistance, or foster the preservation of values through gifts, service, or other voluntary activity, any and all of which are external to government involvement or marketplace exchange. Philanthropy and volunteerism are uniquely American traditions, and their pervasive presence in our lives is often taken for granted.

HISTORY OF PHILANTHROPY IN AMERICA

American philanthropy as we know it today began during colonial times. People focused on religion and higher education during the 18th century. Gradually, health, civic, social causes, and the arts entered the picture as our young nation grew and prospered.

It is interesting to note that philanthropy in America before the American Revolution had its roots in necessity. It was the only means of building and sustaining the service institutions each community needed.

The philanthropic tradition of American life and culture has shaped Americans as a people and a nation. Through voluntary association, Americans have come together; through nonprofit organizations and philanthropy, they have demonstrated care and concern for others, therefore building community within a vastly diverse society. (Wagner, 2002)

A TRADITION OF VOLUNTEERISM

The practice of philanthropy includes volunteer service in addition to gifts. Even in today's world, with the many demands made on our time by family, work, study, and leisure activities, people are undertaking volunteer work. The Corporation for National and Community Service, the federal agency in Washington, DC, that oversees AmeriCorps and other service programs, recently surveyed 60,000 households and found that levels of volunteerism in the United States have reached a 30-year high, as more teenagers, baby boomers, and older adults choose to give back to their communities. According to *Volunteer Growth in America: A Review of Trends Since 1974*, adult volunteerism increased more than 32 percent between 1989 and 2005, largely because of the involvement by three age groups—teenagers between the ages of 16 and 19 years, baby boomers and others aged 45 to 65 years, and older adults 65 years and over. Highlights of the report include the following:

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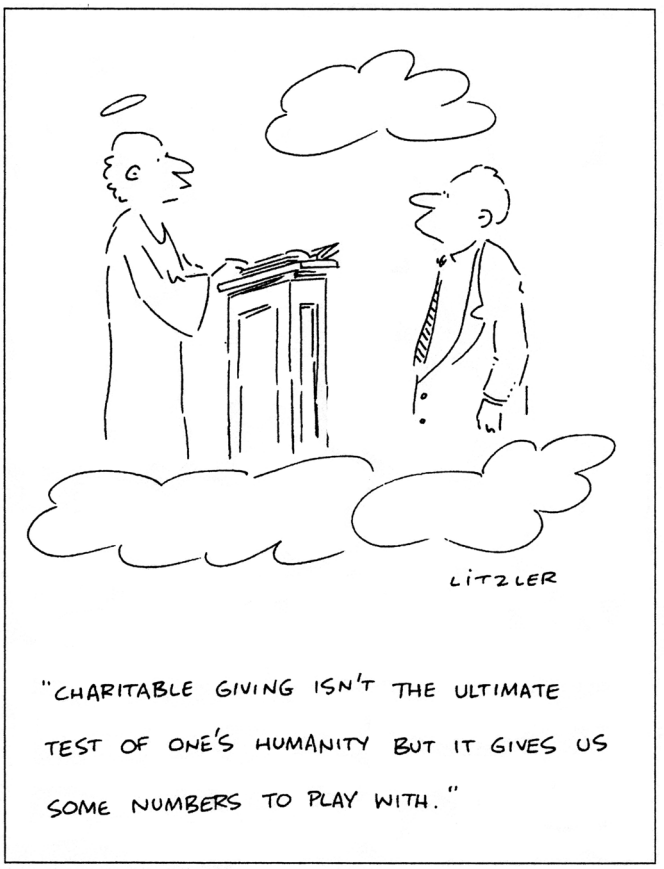

Source: Copyright © Mark Litzler.

- Almost 29 percent of Americans volunteered in 2005.
- Time volunteered by older teenagers (ages 16–19 years) has more than doubled since 1989.
- Older Americans have increased their volunteer time 64 percent since 1974.
- Baby boomers are volunteering at sharply higher rates than did their parents at mid-life.
- Educational and youth-service organizations received the largest increase in volunteers (63 percent) between 1989 and 2006.
- The largest percentage of Americans—almost 35 percent—volunteer at churches, mosques, or other religious groups.

- A greater percentage of women donate their time than men.
- Minorities routinely volunteer less than whites.
- Married persons and parents with children under 18 years of age volunteered at a higher rate than unmarried persons and persons without children of that age.
- The main activity volunteers performed were as follows: fundraising (10.9 percent); tutoring or teaching (10.8 percent). Men and women tended to engage in different main activities. Men who volunteered were most likely to engage in general labor (11.5 percent) or to coach, referee, or supervise sports teams (10.2 percent), while women volunteers were most likely to fundraise (12.5 percent) or tutor or teach (12.5 percent).

A key finding from this report for nonprofit organizations is that about 43 percent of volunteers became involved with their main organization after being asked to volunteer, most often by someone in the organization. A slightly smaller proportion, about two in five volunteers, became involved due to their own initiative of approaching the organization. Thus, it is important for nonprofit organizations to be proactive in outreach for recruiting volunteers.

THE RELATIONSHIP BETWEEN VOLUNTEERING AND CHARITABLE CONTRIBUTIONS

As you can see, "participation" is very much an element of the American philanthropic spirit. But how does one learn to participate or to volunteer? A review of the current research shows that positive volunteer experiences in youth tend to lead to generous giving and volunteering in later life. Adults who belonged to a youth group, volunteered as a youth, did door-to-door canvassing to raise money, or participated in student government are the most likely to give and to volunteer. Parents who volunteered and served as role models for their families are also significant influences, as are active involvement in religious organizations and frequency of attendance at religious services.

Data from many recent studies and surveys clearly establish a relationship between giving and volunteering. Independent Sector's most recent survey revealed that 89 percent of all households gave charitable contributions and that the average gift from households with volunteers was more than two times that of donor households whose members did not volunteer.

Current research also reveals the most frequently cited important motivations for contributing to an organization:

- believe in the cause or feeling it is the right thing to do
- believe contribution will make an impact
- believe money is being used as intended
- know someone who is affected or who will be a beneficiary of the donation

HOW GENEROUS WE ARE AS A NATION

Today, America's philanthropic spirit remains strong as seen in *Giving USA*, the yearbook of philanthropy published by the Giving USA Foundation™ and researched and written by the Center on Philanthropy at Indiana University. According to the latest issue of *Giving USA 2008*, American giving reached a record high, $306.39 billion for 2007, up 3.9 percent from 2006. Foundation grant making, which made up 12.5 percent of total giving, is the fastest growing source of charitable donations.

Figure 1–1 shows that individuals continue to account for an overwhelming majority of all contributions, estimated at $252.18 billion (including $23.15 billion in bequests), or 82.4 percent of all contributions. The remaining 17.6 percent was contributed by foundations ($38.52 billion, a 10.3 percent increase) and corporations ($15.69 billion, an increase of 1.9 percent over 2006).

Regarding the types of organizations or institutions that receive contributions, not much has changed since the 18th century. Religious institutions remain the major recipients, followed by educational institutions. The breakdown of support for issues and causes is shown in Figure 1–2.

PROFILE OF THE CHANGING DONOR

In recent years, a growing body of research shows what effects the changing demographics in the United States will have on philanthropic trends. Donors in the United States have become more diverse in age, ethnicity, race, religion, gender, sexual orientation, geography, and source of wealth. This has created both challenges and opportunities for nonprofits.

For most nonprofits, the traditional donor is white, non-Hispanic, female, religious, and a member of the World War II

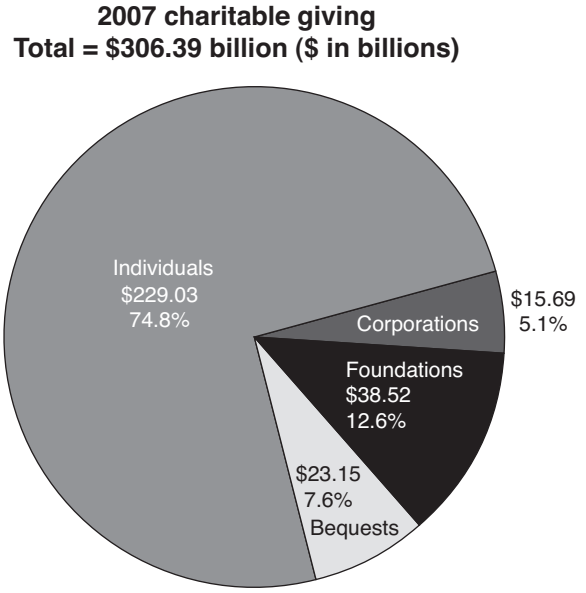

Figure 1–1 Sources of Contributions
Source: Giving USA 2008, Giving USA Foundation.

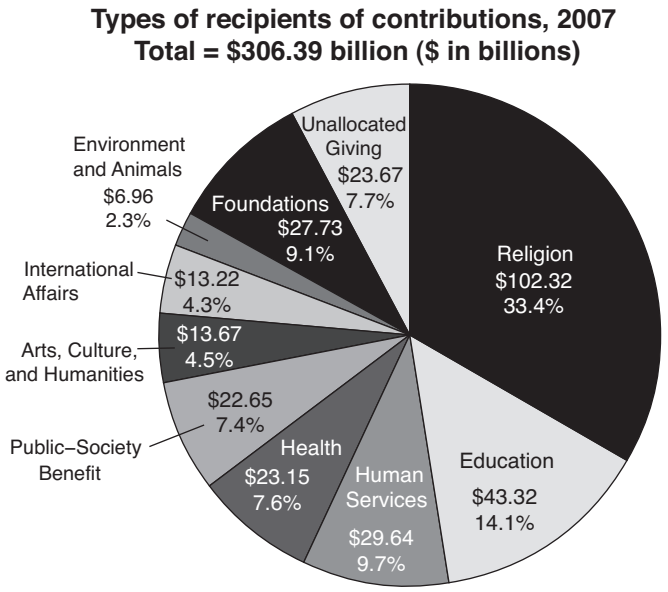

Figure 1–2 Contributions Received by Type of Recipient Organization
Source: Giving USA 2008, Giving USA Foundation.

generation. Because these donors are living longer, many nonprofit organizations have not yet focused on bringing in new donors from Generations X and Y as well as the baby boomers. Due to the continuing rise in immigration among non-whites and Hispanics, the majority population in the United States eventually will consist of groups traditionally referred to as minorities. In order to engage these different generational and ethnic populations, nonprofit organizations must first look to the diversity of their staff, board, and volunteers. They need to utilize different communication styles, understand the different populations' views about money, and learn what they want to support. Opportunities to involve people from younger generations and ethnic populations as staff, board members, and volunteers are key to building a more diverse donor base.

INDICATORS THAT AFFECT GIVING AND VOLUNTEERING

Even though the American people have a strong tradition of volunteering and charitable giving, many factors can affect this tradition. They include

- an individual's current and future economic well-being
- the impact of changes in tax policy
- public trust and involvement
- management of charitable organization
- ethical and honest fundraising practices

HOW TO CREATE A PHILANTHROPIC ENVIRONMENT

As mentioned earlier in this chapter, an organization's mission and contribution to society is what distinguishes it from others within the nonprofit sector. The organization's mission defines its purpose and values as realized through its programs and services. To create an environment conducive to philanthropy, key messages that describe how the organization's mission is put into practice must be developed and used in all verbal and written communications. In other words, the organization's mission must be articulated in human terms. People are of primary importance; systems are secondary. If the organization remains focused on its mission, it will be able to build a stronger case for philanthropic support.

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To begin to build a philanthropic environment, an organization's board and staff leadership must first review the organization's mission statement. Questions to consider include these:

- Is the mission statement clear?
- Is the mission as vital to society today as it was when the organization was first founded?
- If the answer to the above question is no, does the mission statement need to be rewritten?
- Do the current programs and services reflect the mission?
- Do programs and services being planned reflect the mission?

Next, the organization's board and staff leadership should determine if the messages being used in communicating verbally and in writing with the general public clearly articulate the organization's mission and programs. Do the messages reflect the needs of the community, not the organization, and do they describe how people will benefit? Given the increasing competition for funds in the nonprofit sector, the organization needs to communicate how its approach to solving a problem or advancing an issue has been successful in human terms and will continue to be successful in the future. Donors want to know that their investment—their contribution—will have an impact on society.

Last, the organization's board and staff leadership should review current programs and services to see how they reflect the mission in practice. It may discover that, due to shifting societal needs and the interests of funding sources, some programs or services may not be as true to the mission as others. These programs and services should then undergo further review and analysis in order to help the organization advance its mission.

A philanthropic environment also focuses more attention on donor needs. See Appendix 1–A for A Donor Bill of Rights. Keep

in mind that today's donors are looking for organizations that are focused on their mission, have identified priorities, are well managed, use resources wisely, and produce results. Since today's donors view themselves as "investors," they are more discerning and demand demonstrable accountability from the nonprofits they support.

THE ACCOUNTABLE NONPROFIT ORGANIZATION

Accountability in the nonprofit sector means being open and ready to answer to those who have invested their trust, faith, and money in your organization. Nonprofits are accountable to many stakeholders, including donors and funders; local, state, and federal agencies; volunteers; program recipients; and the general public. Everyone who works for a nonprofit shares a degree of responsibility for ensuring that the organization remains answerable to its constituents and true to its mission.

In general, nonprofits that are accountable are able to raise more money by building public confidence in the organization and by making processes more effective, as well as providing more time for focusing on delivering on the mission—the most important part.

Maintaining the public trust is paramount to the nonprofit sector. Recent surveys, however, show that public confidence that dropped after September 11, 2001, is rising slightly but still has not returned to the level of trust experienced before that day. According to *Confidence in Charitable Organizations, 2006,* a national telephone survey of 1,000 randomly selected adults, conducted in July 2006 by the Robert F. Wagner Graduate School of Public Service at New York University, 69 percent of Americans expressed a great deal or a fair amount of confidence in charities. That figure represents a 5-percent increase from the July 2005 survey and a 9-percent increase from the September 2002 survey. While the responses suggest that public confidence is beginning to rebound, the current level of trust is still significantly lower than the 90 percent of respondents who expressed a great deal of trust in charities pre-September 11, 2001.

Other findings included the following:

- 73 percent said charities have the right priorities but do not spend money wisely.
- 18 percent of Americans said charitable organizations do a very good job running their programs and services, compared with 19 percent in 2005.
- 18 percent said charitable organizations do a very good job being fair in their decisions, compared with 16 percent in 2005.

The study found that the most powerful predictor of confidence in charities was confidence and trust in the American Red Cross, followed by the second most powerful predictor, confidence and trust in the United Way of America. The major issues surrounding the American Red Cross's use of funds raised for the September 11 victims' families seriously affected the public's confidence and trust not only in the American Red Cross but also raised doubts about how charities in their communities were using contributions. For that reason, nonprofit organizations must commit to the principles of honesty and transparency in order to live up to their role as stewards of the public trust.

Exhibit 1–1 is a statement of principles adopted more than a decade ago by the Board of Directors of the Association of Fundraising Professionals but still relevant and needed today. It outlines the operations and procedures a nonprofit undertakes to show it is accountable to donors, the people it serves, and the general public.

ASSESS YOUR ORGANIZATION'S ACCOUNTABILITY

Peter Wolk is the founder and executive director of the National Center for Nonprofit Law, a 501(c)(3) organization that conducts training seminars on a wide range of nonprofit organizational and legal topics. He also has a private law practice dedicated to creating, advising, and representing nonprofit organizations. He helps nonprofit organizations understand why they need to devote time and attention to the legal issues surrounding fundraising. According to Wolk, the first reason is because noncompliance can

Exhibit 1–1 The Accountable Nonprofit Organization

The accountable nonprofit organization is responsible for mission fulfillment, leadership on behalf of the public interest, stewardship, and quality.

The accountable nonprofit is also responsible for the following:

Mission fulfillment

- doing what it says it will do
- maintaining relevance by meeting needs in a changing environment

Leadership on behalf of the public interest

- enhancing the well-being of communities and society
- promoting inclusiveness, pluralism, and diversity within society
- educating the public, business, nonprofit organizations, and government, including appropriate advocacy and lobbying

Stewardship

- maintaining effective governance and management
- generating adequate resources, managing resources effectively, supporting and recognizing volunteers, and appropriately compensating staff
- avoiding conflict of interest and abuse of power

Quality

- striving for and achieving excellence in all aspects of the organization
- evaluating the total organization and its outcomes on an ongoing basis

Source: Courtesy of the Association of Fundraising Professionals (AFP), Arlington, Virginia.

cost money. Organizations can be fined for failure to file documents, be distracted by avoidable internal disputes, or be sued for failure to follow the applicable rules and laws. Second, noncompliance can cost an organization its good reputation. Third, related to these two reasons, noncompliance can cost an organization its effectiveness at securing future board members, program partners, and funds from the community. And finally, compliance is not particularly expensive, especially when compared to noncompliance. Nonprofit leaders that guide their organizations to serve charitable and educational purposes also have the opportunity—and some may say the obligation—to position their organization not only for minimal legal compliance, but to be a legal role model.

Today, nonprofits are operating in an environment of heightened expectations and accountability. An organization's failure to meet these expectations is increasingly likely to become known and can erode the confidence of its potential funders and supporters and invite government enforcement or audits. At a larger level, the nonprofit sector's failure to meet these expectations could invite the government to introduce new legal requirements and the bureaucratic compliance assurances that often accompany those requirements.

In Appendix 1–B, Peter Wolk highlights the most important steps nonprofit organizations should take to satisfy and exceed applicable legal expectations. It is presented in the form of an annotated checklist to identify and explain the salient points as a self-assessment so you can determine your organization's legal readiness to receive and properly expend gifts, grants, and other funding.

ETHICAL STANDARDS AND PRACTICES

As mentioned earlier in this chapter, a recent study showed that public confidence and trust in nonprofit organizations can often be related to the latest activities of nationally known organizations reported in the news. Because we rarely know when such news stories will appear, it is critical that a nonprofit organization establish ethical standards and practices to ensure maintaining the public trust. The Donor Bill of Rights in Appendix 1–A sets out key donor-focused guiding principles that today's donors expect from the organizations they support. A number of nonprofit boards of directors are taking an important step by adopting the Donor Bill of Rights as the ethical foundation of their development programs.

Nonprofits that practice ethical fundraising do the following:

- focus on the organization's mission
- educate as to their capacity to be effective
- are truthful in requests for funds
- use gifts for the purposes they are given
- respect confidentiality of information about gifts and donors

Staff whose primary role is raising funds must play a leading role in ensuring that their nonprofit organizations solicit funds ethically and legally. They serve as stewards to be certain that the intent of the donor is honestly fulfilled, which is why AFP adopted a Code of Ethical Principles for its members in 1964 and keeps it updated to reflect the latest best practices (see Chapter 18, Working with Consultants, Exhibit 18–5 for complete code). To become a member of AFP, an individual must agree to uphold the code by signing the membership form. Every year members recommit to complying with the code when they renew their membership.

Standards of professional practice focus on the following:

- not engaging in activities that will harm the organization, clients, or profession
- not exploiting relationships with various constituencies to benefit the member or member's organization
- complying with all applicable laws
- ensuring all solicitation materials are accurate and reflect the organization's mission, contributions are used in accordance with donors' intentions, and donors receive correct advice about value and tax implication of gifts
- understanding that donor information is privileged and should not be used to benefit other organizations
- not accepting compensation on the basis of percentage of contributions

Nonprofit leaders should encourage members of their development staff to join AFP and adhere to its code of ethics.

The American tradition of philanthropy enables the nonprofit sector to make a difference in people's lives, not only in the United States but indeed around the world. This tradition will endure if organizations are transparent in their actions, accountable to the public and their donors, and practice ethical fundraising.

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A Donor Bill of Rights

A Donor Bill of Rights

PHILANTHROPY is based on voluntary action for the common good. It is a tradition of giving and sharing that is primary to the quality of life. To assure that philanthropy merits the respect and trust of the general public, and that donors and prospective donors can have full confidence in the not-for-profit organizations and causes they are asked to support, we declare that all donors have these rights:

I.

To be informed of the organization's mission, of the way the organization intends to use donated resources, and of its capacity to use donations effectively for their intended purposes.

II.

To be informed of the identity of those serving on the organization's governing board, and to expect the board to exercise prudent judgement in its stewardship responsibilities.

III.

To have access to the organization's most recent financial statements.

IV.

To be assured their gifts will be used for the purposes for which they were given.

V.

To receive appropriate acknowledgement and recognition.

VI.

To be assured that information about their donations is handled with respect and with confidentiality to the extent provided by law.

VII.

To expect that all relationships with individuals representing organizations of interest to the donor will be professional in nature.

VIII.

To be informed whether those seeking donations are volunteers, employees of the organization or hired solicitors.

IX.

To have the opportunity for their names to be deleted from mailing lists that an organization may intend to share.

X.

To feel free to ask questions when making a donation and to receive prompt, truthful and forthright answers.

DEVELOPED BY

Association of Fundraising Professionals (AFP)
Association for Healthcare Philanthropy (AHP)
Council for Advancement and Support of Education (CASE)
Giving Institute: Leading Consultants to Non-Profits

ENDORSED BY
(in formation)
Independent Sector
National Catholic Development Conference (NCDC)
National Committee on Planned Giving (NCPG)
Council for Resource Development (CRD)
United Way of America

Source: Courtesy of the Association of Fundraising Professionals, Arlington, Virginia.

Appendix 1–B

A Checklist: Selected Legal Precautions to Protect Your Organization and Distinguish It as a Potential Recipient of Gifts and Grants

This checklist is meant to help you identify and address issues in selected areas of concern. It is not a comprehensive list of all actions an organization must take to ensure compliance with all laws, but rather is an indication of significant legal issues for your organization to address when preparing itself for the scrutiny of potential grantors, board members, and individual donors.

A. Corporate Law Considerations.

1. Articles of Incorporation.
   Corporations, including nonprofit corporations, are only permitted to engage in activities within the scope of what is described in their Articles of Incorporation. The Bylaws cannot expand the scope of activities. Are you acting within these purposes, or should you amend your Articles to accommodate an expansion of your activities?
2. Bylaws.
   Some of the messiest nonprofit court cases have involved internal disputes in nonprofits about alleged non-compliance with Bylaws. Are you following your Bylaws by providing notice, conducting meetings, permitting voting, and electing leaders as stated? Or, should you amend your Bylaws to conform to your actual practice?
3. Corporate Standing and Registered Agents.
   Nonprofit corporations must file corporate reports with their State of incorporation. In addition, they must submit an application to do business in any other State where they have an office, and then file corporate reports thereafter. These report forms are sent to your organization's registered agent. Be sure that the registered agent on file for your organization is still at the listed address and is reliable. Otherwise, your organization might miss the report filing deadline and (worse!) could be sued by process served on your registered agent and lose a lawsuit without ever knowing about it. You can file with the State to change your registered agent.
4. Board Minutes.
   Every nonprofit corporation must keep minutes of its Board meetings. At a minimum, these minutes only have to identify the meeting, its time, the attendees, that a quorum attended, and any decisions made at the meeting. However, you may want to describe activity related to decisions (e.g., "after considerable debate, or following a committee report, the Board voted to approve . . .") to indicate the Board's attention to a particular issue. You do not have to—and really should not—tape record and treat each spoken word at your Board meeting as part of your Board minutes. Your minutes should be approved at the subsequent meeting. If you use an Executive Committee, it's a good idea to report its decisions to the Board and include them in the Board minutes.

B. Tax Considerations.

5. Form 1023 Tax Exemption Application.
   To obtain 501(c)(3) status, your organization filed Form 1023. In it, you described the intended activities, and based upon that description, the status was granted. If you have begun activities other than what was described, you have to disclose that on your Form 990 return, and if the changes are outside of the type of activities described in Form 1023, might have to obtain subsequent IRS approval of the new activities.

Source: © 2006. Peter C. Wolk, Esquire.

6. IRS 501(c)(3) Recognition Letter: Advance Rulings; Definitive Rulings.
   Please be sure that you have either a Definitive Ruling from the IRS, or an Advance Ruling whose date has not expired. Virtually all 501(c)(3) public charities begin with advance rulings but if they fail to file Form 8734 within the deadline after their Advance Ruling period expires, they can be reclassified by the IRS as 501(c)(3) private foundations.
7. Donor Substantiation/Quid Pro Quo.
   When we receive financial support, we have to comply with the tax rules on charitable substantiation, as follows. If a 501(c)(3) donor receives any goods or services in exchange for a donation over $75, the charity must tell the donor *in writing* in advance what portion of the donation is tax deductible. (E.g, Invitation to a Fundraising Dinner: "Amounts in excess of $60, the fair market value of this evening's dinner, are tax deductible.") With any charitable donation of $250 or more, the donor must have written substantiation or is prohibited from taking a charitable deduction for the donation. (A canceled check is not a sufficient receipt.)
8. Auctions and Raffles.
   The price paid at an auction must be over the Fair Market Value (FMV) of the item in order to be considered a contribution. If the price is under the FMV, nothing is deductible. If the contribution is for more than $75 and is greater then the FMV, then a disclosure statement is necessary. The purchase of raffle or lottery tickets is not deductible regardless of whether or not you win because the entire price of the ticket is considered a payment for services received—the opportunity to win a prize.
9. Lobbying.
   Your 501(c)(3) organization is permitted to lobby to an "insubstantial" degree. If you engage in lobbying, you should: (a) have a policy identifying who is authorized to speak on behalf of the organization and who decides which positions the organization will take; and (b) consider making the 501(h) Election (IRS Form 5768) so that only your lobbying expenditures, and not your volunteers' lobbying efforts, will be counted toward the "insubstantial" limit.
10. Campaign Activity.
    Your 501(c)(3) organization is <u>prohibited</u> from taking positions for or against any candidates for public office. You should have a policy to that effect, and advise your organizational leaders. Violation could cost your organization its 501(c)(3) its tax exemption.
11. State Tax Exemptions.
    Just as individuals pay State income taxes (in most States), so do corporations. But unlike commercial corporations, charitable organizations can obtain exemption from paying income tax and from paying sales tax on their purchases. You should obtain a copy of your States' tax exemption application and pursue both exemptions.
12. Private Inurement: Doing Business With Directors.
    You must treat doing business with directors as conflicts of interest. You must remove the conflicted Director from the balance of discussion and any voting on the issue. If Directors knowingly give another Director (or another organizational insider, such as a current or former leader) more in value than what the organization is receiving (e.g., spend more to buy computers from a Director's company than are available from other retailers or sources) the Board members conferring, and the Director receiving, the undue benefit can be held personally liable by the IRS under the Intermediate Sanctions law. Be sure to comparison shop and document your spending decisions before doing business with a Director.
13. Unrelated Business Income Taxation ("UBIT").
    For many groups, their financial future—and therefore their existence—is linked to their ability to diversify their funding sources. Your organization may be engaged in limited, substantial, or no revenue generation, but would benefit from such additional revenue. Knowing the law related to taxation of funds generated from activities unrelated to your mission can help you to either restructure your activities or to find exceptions that will allow your group to avoid taxation (and therefore save up to 35%; i.e., 35 cents from every dollar earned!). You may also find opportunities to license your name to generate untaxed royalty revenue (i.e., T-shirts, educational products, credit cards). You can pursue activities that are taxable, and just plan to pay taxes on that revenue (e.g., revenue from advertising on a website); you will have more revenue than when you started. However, such unrelated business activity can not be more than an insubstantial part of your group's work (or your group will change from nonprofit to for-profit, or have to move the unrelated activity into a for-profit subsidiary).
14. Form 990.
    Every 501(c)(3) nonprofit organization with more than $25,000 in income has to complete and file form 990 with the IRS. In it, among the most important points, the organization discloses: a) details about its financial activity; b) its fundraising costs (in ratio to the amounts spent on its mission and program); c) a description of the costs and outcomes of your programmatic efforts; d) compensation of the Directors, officers, and key employees. Beginning in 2008, even those groups that do not normally have $25,000 in income will be asked by the IRS to complete and submit what is being called a "990 Postcard Return." This is being used to identify which 501(c)(3) groups are still in existence (albeit with income normally less than $25,000) versus those that are no longer in existence at all. If your group does not receive such a form from the IRS, you will be able to retrieve it from the IRS website (www.irs.gov) for submission to the IRS.

15. Federal Tax Guidelines on Corporate Sponsorships.
Today, corporate contributions are an important source of funds. Typically, the corporate donor wants recognition of its donation. But there are rules about what and how the nonprofit can provide the recognition.

1. Corporation	supports ($$$) the Nonprofit organization	= OKAY
2. Nonprofit	acknowledges the Corporation's support by mentioning the donor's logo, locations, telephone numbers, and value-neutral descriptions of the donor's product/services	= OKAY it remains a nontaxable donation
3. Nonprofit	makes statements of comparison (e.g., this cola is the best"), price information (e.g., computers from our sponsor cost only $599), endorsement nonprofit's ("our favorite"), inducement or a call to ("buy one today!") taxable as advertising revenue	= NOT OKAY If the nonprofit does this, the actions are are considered advertising and the sponsorship amount becomes taxable.

(a) Other examples:

1. A 501(c)(3) organization organizes a marathon and walkathon at which it serves drinks and other refreshments provided by a national corporation. It recognizes the assistance of the corporation by listing the name of the corporation in promotional fliers, in newspaper advertisements, on T-shirts worn by participants, and by acknowledging prizes provided by the sponsor. The organization even changes the name of its event to include the name of the sponsor. These activities are acknowledgments of the sponsorship and not advertising.
2. A local record shop supports your nonprofit organization's educational event in the park. You broadcast during the event: *This program has been underwritten by the Record Shop, where you can find all of your great hit music. The Record Shop is located at 123 Main Street. Give them a call today at 555-1234.* Because of encouraging people to call the Shop, the donation received from the record shop has to be treated as advertising and is taxable!

C. Other State and Federal Statutory Requirements.

16. Charitable Registrations.
As you may well know (and as noted in Appendix A in this book), over 40 States require nonprofits to register before seeking donations from citizens, corporations, and/or foundations in their State. A complete list of these requirements is kept quite current at www.nasconet.org.
17. Sarbanes-Oxley (SOX) Requirements.
This is a federal law that applies mainly to for-profit, publicly-traded organizations. Two provisions apply also to nonprofits. Your organization is expected to have a policy and procedures about:

a) Document/Records Retention and Destruction; and
b) Whistleblowers (to investigate complaints by—and prevent retaliation against—whistleblowers).

18. Sarbanes-Oxley (SOX): Suggested Actions.
Additional SOX requirements are being voluntarily adopted by nonprofits, making them the new de facto standards by which funders are evaluating grant applicants:

a) Have a Board audit committee:
   1) Choose the auditor.
   2) Have at least one member who is financially literate.
   3) Meet directly with the auditor, including at least once without the Executive Director.
   4) Have members who are not compensated by the organization in any capacity.

b) Use auditors who:
   1) Provide no, or limited consulting services to the organization.
   2) Meet with the audit committee for at least one meeting about the audit without the Executive Director present.
   3) Rotate the auditing partner every five–ten years.

c) Have a conflict of interest policy;
d) Prohibit loans or credit to any Directors, Officers, or organizational Executives;
e) Have adequate insurance and bonding for risks and to trigger volunteer immunity statutes;
f) Carefully develop corporate minutes;

g) Have the CEO and CFO certify:

1) That the financial statements accurately depict the financial condition of the organization.
2) That there are adequate internal controls regarding the handling of funds.

19. State Ethics Laws:
(1) California has gone beyond the Sarbanes-Oxley law and enacted a State law called The California Nonprofit Integrity Act of 2004, that:

a) Requires groups with over $2M in gross revenues to:

1) Have and publicly-disclose a financial audit;
2) Have compensation of CEO and CFO approved by the Board or an authorized committee as just and reasonable.

b) Requires there to be an audit committee:

1) Whose chair is not a member of the finance committee, and 50% of whose members are not on the finance committee.
2) That excludes staff and anyone with material interest in the organization to serve on the audit committee.
3) Whose members, if paid, are paid no more than the amounts received by Directors for service on the Board.
4) That recommends and negotiates the compensation of the independent auditor.
5) That confers with the auditor and determines whether to accept the audit.
6) Approves performance of any non-audit services provided by the audit firm.

c) California is seeking to apply the Nonprofit Integrity Act to all charitable organizations conducting activities, qualified to do business, or holding property in California, but it does not apply to educational institutions, hospitals, cemeteries, and religious organizations.

(2) Other Ethics Laws: While New York's Attorney General, now Governor, Elliott Spitzer attempted (so far unsuccessfully) to have nonprofit integrity legislation enacted. In addition, the U.S. Senate Finance Committee members have held hearings and produced draft legislation—with the IRS—on nonprofit integrity. Proposed bills are expected.

→ To exceed expectations, voluntarily comply with the California law.

(3) Other Nonprofit Governance Initiatives: Independent Sector established a Panel that has studied and made recommendations about procedures and additional requirements for charitable organizations. These recommendations can be obtained by going to www.independentsector.org.

D. Employment Considerations.

20. Employment Policies/Manual.
Perhaps the greatest source of liability for nonprofits is in the area of employment. You should be sure to have an employment manual that identifies those who are employed at-will, and that has policies with respect to their benefits, rights, and obligations.
21. Classifying Employees as Exempt/Non-Exempt.
If your employee is not an executive, administrative, professional, computer, or outside sales person as defined by the Fair Labor Standards Act, they are covered by (non-exempt from) the requirement that you pay overtime (time and a half) for more than 40 hours worked in any work week. If you think an IRS audit sounds bad, you don't want to go through a wage and hour audit, particularly if you do not have records showing that your non-exempt employees worked no more than 40 hours per week (or were paid overtime for doing so). If a covered employee works over 40 hours in a week, giving comp time the following week does not remove the employer's obligation to pay overtime pay.
22. Training about acceptable and unlawful application, screening, interviewing, hiring, promoting, terminating questions, criteria, and procedures.
23. Sexual Harassment avoidance training.
24. Classifying Workers as Independent Contractors Instead of Employees.
An employer has less financial paperwork to do if a worker is as an independent contractor instead of an employee, but not everyone qualifies as an independent contractor. Instead of withholding and making monthly or quarterly payments to the IRS, you only file one form (Form 1099) once at the end of the year, with a cover report form to the IRS. However, the IRS has rules on its website about when we can treat someone as an independent contractor. If we control aspects of where, when, and how workers do their work, they are likely to be employees and the employer must engage in the withholding, payments, and periodic reports to the IRS.
25. Insurance.
There are two main kinds of elective insurance for nonprofits: Comprehensive General Liability (CGL) Insurance and Directors and Officers (D&O) Insurance, which typically includes Employment Practices Insurance. Be sure your insurance agent is briefed on the scope of your operations (e.g., do you need publication insurance?) and that your staff and Board have worked together to secure the advisable insurance coverage that you can afford.

E. Operational Considerations.

26. Conflict of Interest Policy.
    As noted above, your organization should have a conflict of interest policy that: (a) identifies conflicts of interest; (b) requires organizational leaders (Directors and key employees) to disclose if a conflict arises; (c) requires the Board (for Director conflicts) or the Executive Director (for employee conflicts) to determine how much the conflicted person can participate in the consideration and decision-making about the issue.
27. Intellectual Property Policy.
    Your employee handbook should explain that creations (e.g, articles, artwork, designs, web content) done by your employees within the scope of their duties are considered works for hire and owned by your organization. For those done outside the scope of their duties, you should have a policy and procedure for your employees (and volunteers) to assign their rights to your organization.
28. Financial Controls. Have you put into place arrangements for:
    a. The Board to review and approve the budget;
    b. Bonding (insurance against employee theft of organizational funds);
    c. Limits and procedures on check- and contract-signing authority; and,
    d. Handling of restricted funds.
29. Publications and Branding. Has your organization taken action to:
    a. Get assurances that authors' work is original and not infringing others' copyrights;
    b. Assert copyright protection over your organization's works; and,
    c. Secure ownership via trademark registration of the name(s) and logos by which your organization and its goods and services are known to others.
30. Internet Activities. Have you made provisions for:
    a. Copyright notices of the material on your website;
    b. User Agreements and disclaimers to avoid liability;
    c. Sufficient security to protect the privacy of your users/members' information and any transactional (i.e., internet sales activity) information.