

# Panel on the Nonprofit Sector

Convened by INDEPENDENT SECTOR

The Panel on the Nonprofit Sector is an independent effort by charities and foundations to ensure that the nonprofit community remains a vibrant and healthy part of American society. As a result of convening the Panel on the Nonprofit Sector to promote responsible and accountable organizations, Independent Sector is soliciting input on 29 principles for self-regulation. These principles embody the idea that each charity and foundation must set standards and implement practices that manifest its dedication to transparency and governance.

The 29 principles address four areas:

- A. **Principles for facilitating legal compliance** (6). Addressing legal knowledge and compliance, conflict of interest, whistleblowing, governance responsibility, record keeping and transparency.
- B. **Principles for effective governance** (11). The board role, constituting a diverse and relevant board, and governing operating policies.
- C. **Principles for strong financial oversight** (5). For tracking budget performance, maintaining financial records, and the responsible use of funds and reimbursement policies.
- D. **Principles for responsible fundraising practices** (7). For truthful and ethical solicitation of donors, effective training for development personnel and ethical consultant compensation.

For additional information, please visit <http://www.nonprofitpanel.org>.

**Grantmakers in Upstate New York.** Our cultural traditions, religious beliefs, and individual values have resulted in a great diversity of philanthropic entities, all dedicated to advancing the common good. As stewards of these resources in the public trust, we believe those involved in philanthropy have a special charge to practice and promote ethical behavior.

The regional associations of grantmakers and their members in 52 counties of Upstate New York follow the highest standards of professional and ethical behavior.

- We support the work of the Panel on the Nonprofit Sector.
- We celebrate the positive contributions of the charitable sector.
- We examine our practices, ensuring that our values contribute to the community impact of our grantmaking.

**1. A charitable organization should be knowledgeable about and must comply with all applicable laws and regulations and international conventions.**

Obedience to the law is fundamental to being a responsible and accountable nonprofit organization. The governing board is ultimately responsible for overseeing and ensuring that the organization complies with its legal obligations and to detect and remedy 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 secure the necessary legal advice and assistance to structure appropriate monitoring and oversight mechanisms.

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

The duties and requirements for directors of charitable organizations are generally determined by the laws of the state in which the organization was founded or incorporated. Some states also have established requirements for the board of directors of any organization that conducts activities, particularly fundraising, within its borders. Where no specific nonprofit corporation rules have been established, the rules for business corporations generally apply to tax-exempt entities.

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

Establishing and enforcing a conflict of interest policy is an important part of protecting charitable organizations from unethical or illegal practices. The IRS Form 1023, which an organization must file to obtain a determination of federal tax-exemption under section 501(c)(3) of the Internal Revenue Code, now asks the organization to indicate whether it has adopted a conflict of interest policy and, if not, how it will handle conflicts of interest.

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

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

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

A document retention policy is essential to protect the organization's records of its governance and administration, as well as business records that are required to demonstrate legal compliance and to protect against allegations of wrongdoing by the organization or its directors and managers. A document retention 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 handling paper documents, as well as electronic files and email messages.

**6. A charitable organization must make information about its operations, including its board members, finances, programs and activities, and methods used to evaluate the outcomes of work, widely available to the public.**

Donors, volunteers, and staff will have greater confidence in a charitable organization if they can learn easily about how the organization conducts its work and how its programs improve and enrich lives

## **B. PRINCIPLES FOR EFFECTIVE GOVERNANCE**

### **7. The board of a charitable organization must meet regularly enough to conduct its business and fulfill its duties. The board should hold at least three meetings per year.**

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. While most standards of practice for charitable organizations require that the board meet at least three times a year to fulfill its basic governance and oversight responsibilities, each board should determine whether more frequent meetings are necessary depending on the nature of the organization and the number and structure of committees the board has created to assist it in overseeing the organization's business.

### **8. The board of a charitable organization should establish and review periodically its size and structure to ensure effective governance and to meet the organization's goals and objectives. The board should have a minimum of five members.**

A board of directors should have a sufficient number of members to allow for full deliberation of governance matters and for diversity of thinking in areas such as conflicts of interest and self-dealing. *The Panel on the Nonprofit Sector has recommended that Congress amend the federal tax code to require that each organization, with certain exclusions<sup>4</sup>, have a minimum of three members on its governing board to be recognized as tax-exempt under section 501(c)(3) of the code.*

### **9. The board of a charitable organization should include members with the diverse skills, background, expertise, and experience necessary to advance the organization's ability to fulfill its mission. The board should include or have access to some individuals with financial literacy.**

Boards of charitable organizations generally strive to include members with expertise in budget and financial management, investments, personnel, fund raising, public relations and marketing, governance, advocacy and leadership skills, as well as knowledge about and insights into the charitable organization's area of expertise or programs, or a special connection to the organization's constituency.

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

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. Nonetheless, 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 consider changes in management or program activities that might advance the mission and improve the services of the organization.

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

For charitable organizations with paid staff, one of the most important responsibilities of the board of directors 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 chief executive's performance and approve the compensation of the CEO annually and in advance of payment of the new compensation level. 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 the 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.

**12. The board of a charitable organization that has paid staff should ensure that the positions of chief executive officer, board chair, and treasurer are held by separate individuals.**

Concentrating authority for the organization's governance and management practices in one or two individuals 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. 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.

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

A knowledgeable, committed board of directors is the strongest protector of a charitable organization's accountability to the law, its donors, consumers of its products and services, and the public. 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. Too often, they do not have the training or information necessary to understand adequately their fiduciary responsibilities or common practices of boards of charitable organizations.

**14. Board members should evaluate their own performance as a group and as individuals no less frequently than every three years. The board should establish clear policies and procedures on the length of terms and on the removal of board members.**

Establishing a regular process of evaluating the board's performance is an essential component of ensuring the board's ability to fulfill its responsibilities to the organization, its funders, and the community it serves. Evaluation can help to identify strengths and weaknesses of the board's processes and procedures and provide insights for strengthening orientation and educational programs, the conduct of board and committee meetings, and its interactions with board and staff leadership. Most boards will find it necessary to conduct such a self-assessment on an annual basis to provide the most useful feedback to each member and to address any obstacles to effective performance before they become problems. 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 particular needs.

**15. The board must review organizational and governing instruments no less frequently than every three years.**

Boards of charitable organizations should regularly review their governing instruments, to ensure that the organization is abiding by the rules it set for itself or if changes need to be made to those instruments. Such reviews should be the ongoing work of a board of directors and a special effort should be made at least once every three years to conduct a thorough review of the organization's articles of incorporation, bylaws and other governing instruments, to ensure that they reflect its current practice. The board may choose to delegate this responsibility to a committee, but the full board should consider and act upon the committee's recommendations.

**16. The board should establish or review goals for implementing the organization's mission on an annual basis and evaluate programs, goals, and activities to be sure they are consistent with the mission no less frequently than every three years.**

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 review the strategic goals of the organization on an annual basis, generally as part of the annual budget review process. The annual 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.

**17. Board members are generally expected to serve without compensation, other than reimbursement for expenses incurred to fulfill their board duties. Charitable organizations that provide compensation to board members must make available to anyone, upon request, relevant information that will assist in evaluations of the reasonableness of such compensation.**

Millions of Americans serve each year on the boards of charitable organizations. 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.

### **C. PRINCIPLES FOR STRONG FINANCIAL OVERSIGHT**

**18. 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 and prudently. The full board must review and approve the organization's annual budget and should monitor actual performance against the budget.**

Among the most important responsibilities of the board of directors is ensuring that the organization manages its financial resources effectively to further the charitable mission. The board must set the policies for financial management and review financial practices and reports to ensure that staff or designated volunteers are adhering to those policies. 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 with the necessary time and skills.

**19. A charitable organization must keep complete and accurate financial records and should have a qualified, independent financial expert audit or review them 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 the board to exercise appropriate oversight of the organization's financial resources. Boards of directors that do not have members with financial expertise should retain a qualified paid or volunteer accounting professional to establish whether the organization's 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 financial information available. Charitable organizations must ensure that they have their annual financial statements audited or reviewed as required by law in the states in which they operate or raise funds.

**20. A charitable organization must not provide loans (or the equivalent) to directors 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. 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 offices of the charitable organization, the terms of such loans should be clearly understood and approved by the board.

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

A charitable organization has an obligation to devote its resources to carrying out the charitable purposes for which it was 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 requires effective management and administration.

**22. A charitable organization must establish and implement policies that provide clear guidance on its rules for paying or reimbursing expenses incurred when 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.**

Charitable organizations should establish and implement clear travel policies that reflect the standards of the organization as to what it considers "reasonable" expenditures and that will guide individuals who may

incur travel expenditures while conducting the business of the organization. These policies should include procedures for properly documenting expenses incurred and their organizational purpose. Charitable organizations must not pay for or reimburse travel expenditures (not including de minimis expenses of those attending an activity such as a meal function of the organization) for spouses, dependents, or others who are accompanying individuals conducting business for the organization and who are not themselves conducting business for the organization. If such expenses are paid by the organization, they generally must, by law, be treated as compensation to the individual traveling on behalf of the organization.

## **D. PRINCIPLES FOR RESPONSIBLE FUNDRAISING PRACTICES**

### **23. Solicitation materials and other communications with 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 are therefore important for helping potential contributors differentiate an organization with a solid reputation and history of service to the community from deceptive fundraising efforts launched by individuals using organizations that use similar names and purposes.

### **24. Contributions must be used for the purposes described in the relevant solicitation materials, in the way specifically requested by the donor, or in a manner that reflects the donor's intent.**

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. Donors 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 they expect their contribution to be used.

### **25. Charitable organizations must provide donors with appropriate acknowledgments.**

Providing appropriate acknowledgement and recognition to donors is an important step toward building a donor's confidence in and support for the charitable organization's activities. Organizations should establish procedures for acknowledging all contributions in a timely manner and for providing appropriate receipts for cash contributions if requested.

### **26. Charitable organizations should implement clear policies, based on the organization's exempt purpose, to determine whether accepting a gift is in the best interests of the organization.**

Because of a continuing need for income to operate its programs, a charitable organization can be tempted to accept a generous donation before carefully considering any associated costs or other consequences. A gift acceptance policy provides some protection for the board and staff of the organization, and 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.

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

Individuals who solicit funds on behalf of a charitable organization 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. All those who solicit contributions on the organization's behalf, including volunteers, should be provided with clear materials and instructions on information they should provide to prospective donors, including the name and address of the charitable organization, 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.

### **28. Organizations 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. 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.

**29. A charitable organization must respect the privacy of individual donors and must not sell or otherwise make available the names and contact information of its donors without prior permission, except where disclosure is required by law.**

Preserving the trust and support of donors requires charitable organizations to handle donations and donor information with respect and confidentiality to the extent provided by law. Charitable organizations should provide all donors, at the time of making a contribution, an easy way to indicate that they do not wish their name or contact information to be shared outside the organization. Organizations should also provide information in all solicitation and other promotional materials about how donors and others who receive such materials can request that their names be deleted from similar mailings, faxes, or electronic communications in the future.