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Charities in line for more oversight
Congress prepares to set rules aimed at cleaning up sector

By Joanne Kelley, Rocky Mountain News
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Denver's largest charitable foundation until recently leased a jet from a company with close ties to the organization's chairman.

The Daniels Fund whisked its board members around the country on the plane for four years and stopped the practice only after discovering that the arrangement may have run afoul of the law. The nonprofit group disclosed the matter in its most recently filed tax form.

The revelation comes as Congress prepares to clamp down on questionable practices in the largely unregulated nonprofit sector.

"There's been a major change since Congress began to shine a light on how foundations were actually spending their money," said Rick Cohen, executive director of the National Committee for Responsive Philanthropy, a watchdog group in Washington.

Some high-profile scandals in other cities, including reports of lavish travel expenses by nonprofit board members and misuse of funds by others, have captured the attention of lawmakers in recent years.

And nonprofits fear a crackdown similar to the sweeping reforms imposed on publicly traded corporations after the spectacular collapses of Enron Corp. and WorldCom Inc.

Overhauling policies

In a recent survey of the nation's nonprofit organizations, almost half the respondents said they have voluntarily tried to comply with at least some of the Sarbanes-Oxley requirements imposed on the corporate sector. The law aims to make executives and board members more accountable for their company's financial statements and dealings.

The Colorado Trust, a Denver foundation with about $400 million in assets, has overhauled its governance policies to adhere to the Sarbanes-Oxley rules.

"We moved to adopt them as best we could, even though the legislation does not apply to nonprofits - with a couple of exceptions," said John Moran, president of the foundation.

Regardless, new laws governing a wide range of nonprofit practices are on the way. Specifically, proposals would clamp down on the sort of arrangement disclosed by the Daniels Fund. Proposals also could include everything from limits on how much nonprofits can pay trustees to closing loopholes that allow some types of nonprofits to spend little money on charitable activities.

Senate Finance Committee Chairman Chuck Grassley, an Iowa Republican, has been leading the charge to clean up the fast-growing nonprofit sector by imposing stiffer rules and penalties.

"It's obvious from the abuses we see that there's been no check on charities," Grassley said at a hearing last summer. "Big money, tax- free and no oversight have created a cesspool in too many cases."

In return for tax-exempt status, the Internal Revenue Service requires nonprofits to file annual tax returns. But there are few other regulations governing the sector. Even the tax filings get little scrutiny because the IRS lacks the staff to look at even 1 percent of the forms, a staff aide to the Senate Finance Committee said.

In Colorado alone, the number of nonprofits has jumped to an estimated 17,000, up from 10,500 a decade earlier.

It's unlikely that the Daniels Fund disclosure - or any other disclosure by other nonprofits - would ever be noticed by the IRS unless the government agency chose to audit the foundation's return.

"Unfortunately, these things are never really catching the eye of the IRS," the committee aide said. "Tax-exempt organizations have been the forgotten stepchild."

'Nuance' in the rules

At the Daniels Fund, CEO Hank Brown said the plane-leasing practice had been in place when he joined the $1 billion foundation bankrolled by late cable pioneer Bill Daniels.

Brown's main concern had been whether they were paying prevailing market rates to fly to meetings in New York and small airports such as those in Sheridan, Wyo. and Roswell, N.M.

While a review showed that the foundation paid about half the typical rate for renting a private jet, according to Brown, the foundation said in its filing that it determined "such arrangements, even at below-market rates, may in fact constitute acts of self-dealing."

A Daniels Fund spokesman said board Chairman John Saeman thought he was "just doing a favor" by letting the foundation lease the plane at below-market rates. The spokesman said attorneys have told the foundation that "it was not a clear incident of self-dealing" because there is no relevant case law on the exact circumstances.

A former head of the IRS tax-exempt division said that any costs associated with such a transaction fall under the heading of self-dealing, which can carry penalties.

"It doesn't matter if it's substantially below cost," explained Marcus Owens, who spent a decade at the helm of the IRS division and is now an attorney in the Washington office of Caplin & Drysdale law firm.

Saeman, a part owner in the company that owned the plane, agreed to reimburse to the foundation all of the lease fees, which the tax filing said amounted to $21,517.

"The fact that you could run into a problem even when you were paying less than half than what the normal rate was a nuance that I don't think our folks had thought of," Brown said.

Indeed, foundations and other types of nonprofits elsewhere have drawn scrutiny for spending far bigger sums in questionable ways.

Among the findings in an extensive series by The Boston Globe: The W.K. Kellogg Foundation spent more than $800,000 on first-class airfare and lodging so its trustees could travel overseas for 10 days to check out the foundation's charitable projects for the poor. In another instance, The Nature Conservancy sold discounted plots of ecologically sensitive land to its trustees, who then took tax write--offs on their purchases, according to an investigation by The Washington Post.

Looking at accountability

In perhaps the most widely publicized case of nonprofit abuse, a top United Way executive went to prison for embezzling money from the umbrella group for the charity network.Closer to home, the University of Colorado Foundation has come under scrutiny for the way it has spent scholarship funds and other money. The fund-raising arm of the university is embroiled in a controversy about whether it should open its records to public scrutiny.

"Nonprofits should be accountable in every possible way - for their financial information, for their programs, for the way they govern their organizations," said Sharon Heinlen, a professor in the master's of nonprofit management program at Regis University.

Heinlen said the topic of accountability and governance has become a hot one among her students, many of whom work by day at nonprofits around the Denver area.

Accountants say they have seen a boost in business from nonprofits who want to know what they should be doing in the wake of the Sarbanes-Oxley reforms.

"Given the heightened public awareness, we have been fielding more inquiries," said Peggy Topel, audit partner at Gordon, Hughes & Banks, a Denver-area accounting firm.

Topel said many nonprofits have formed audit or finance committees to help steer board decisions.

The Daniels Fund is among the large groups in Denver that say they already have incorporated most of the changes that might be in the offing.

"We've been through all the things that Congress is looking at," Brown said. "That doesn't mean they won't pass something else."

Some nonprofit advocates worry that smaller agencies could be overly burdened by extra rules. More than 80 percent of nonprofits have an annual budget of less than $500,000.

"If you bombard all these groups, it may be more of a disincentive for folks to be engaged and involved," said Audrey Alvarado, executive director of the National Association of Nonprofit Organizations, a Washington trade group.

Charitable recommendations

With legislation in the works, a nonprofit industry panel wants to shape new laws by telling Congress what it would like to see happen in several areas. A sampling:

Stricter financial reporting requirements

• Suspend tax-exempt status of charities that fail to file annual IRS Form 990s two years in a row

• Penalties for misrepresentations by preparers of nonprofit tax returns, similar to those imposed on accountants handling personal and corporate returns

• Require that charitable organizations conduct an independent audit of their finances if they must file a Form 990 return with the IRS each year and have total annual revenues of $2 million or more

More accountability in the boardroom

• Increase excise taxes imposed on foundation managers and board members who knowingly partici- pate in self-dealing transactions

• Encourage charities and founda- tions to adopt and disclose conflict- of-interest policies. (The panel stopped short of recommending that Congress require such policies.)

Stronger rules and enforcement

• Boost IRS resources for oversight and enforcement of rules governing charitable organizations

• Allow state attorneys general overseeing charities to share information with the IRS

Source: Panel on the Nonprofit Sector, March 1 interim report