

Responsive Philanthropy

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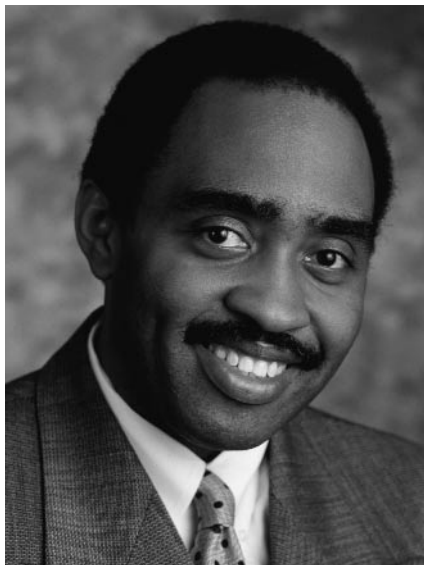
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A Worst-Case Scenario Or the Perfect Storm?

Current Challenges to Foundation Board Governance



By Emmett D. Carson, Ph.D. *

The issue of board governance has become a growing concern to the public, media, government officials and community groups because of a number of well-publicized scandals in both the private and nonprofit sectors. In addition, foundation boards are facing other challenges that together amount to either a worst-case scenario or the perfect storm.

The difference between a worst-case scenario and the perfect storm is whether you survive the experience. Let me describe what I mean. There is a weekly television program called "Worst-Case Scenario." In the show, an impossible situation is created in which survival seems unlikely. The show

illustrates for viewers, step by step, how to live through the experience. Scenarios have included jumping from a burning boat through an oil slick filled with raging flames to surviving a head-on automobile collision.

By comparison, in the movie *The Perfect Storm*, the characters face a storm of epic proportions. Unfortunately, at key steps along the way, the captain and the crew make a series of bad decisions that ultimately result in their demise. When the crew should initially turn back, they sail forward. When they should call for help, their captain destroys the radio. When they should wait in calm seas until the storm has subsided, they decide to try to make it back to port. It wasn't the severity of the storm that did them in. It was their poor decision making. Unlike a no-win situation, in which there is no way to avoid the negative consequences, the difference between the perfect storm and a worst-case scenario is whether you make the right decisions, at the right time, that will allow you to survive the experience. Today, foundation boards are finding themselves in just this situation, and it will

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* With Dr. Carson's generous permission and a minimum of editing, this commentary reflects his complete remarks to the Council on Foundations' board trustee dinner on April 27, 2003, at the Council's annual conference in Dallas. The article makes its first published appearance here in the pages of Responsive Philanthropy.

Foundation Boards Face Higher Expectations

“Challenges to Board Governance” continued from page 1

Individual foundations must act—and expect that the Council will act—in ways that recognize that our most important asset is the public’s trust.

be largely our actions, and not those of others, that will determine the final outcome.

We need to evaluate three things. First, there is the multitude of difficult challenges that foundation boards are facing across the country. Second, we must ask how foundation boards should assess and address these challenges. Third, we must understand what foundation trustees and staff must ask—and expect—of the Council on Foundations in order that our field survives the current storm’s onslaught.

I must confess to some degree of schizophrenia in preparing this analysis. For while I am vice chair of the Council on Foundations, chair its management committee and serve on several nonprofit boards, in my day job I am president and CEO of The Minneapolis Foundation. The Minneapolis Foundation is a community foundation that was started in 1915 and has total assets under management of \$550 million. It is one of the oldest and largest community foundations in the country. The foundation has a governing board of 30 trustees with six standing committees, three supporting organizations with a combined total of 27 trustees, and more than 735 separate charitable funds. I mention all of this to say that I have some small knowledge of foundation governance issues from both sides of the table.

Parts of my analysis may trouble some foundation trustees and staff in our sector. This is not my intention. I have a deep passion and love for our field, for what it has accomplished and for what it can accomplish. My observations reflect the concerns I have about the future of philanthropy at this point in history. As a consequence, I have chosen to try to generate a healthy discussion of some difficult issues facing foundation boards at the risk of possibly making some of my colleagues uncomfortable. For this, I sincerely apologize.

Trouble Around Every Corner

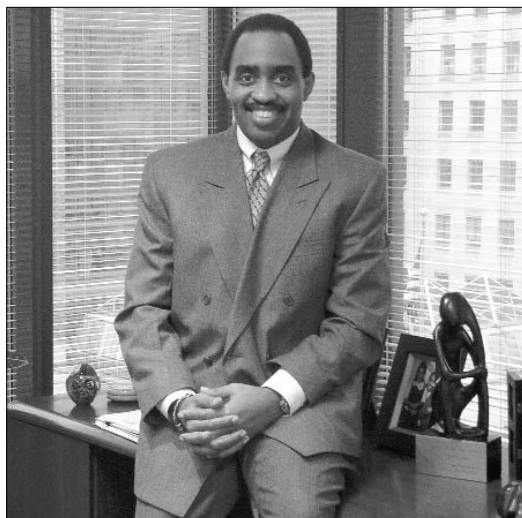
It goes without saying that the issue of board governance is receiving its highest level of public scrutiny in decades. The accounting scandals in the private sector that engulfed Enron, WorldCom

and Tyco, among others, have brought new attention to issues of corporate board governance. The widespread public concern resulting from fraud and ethical lapses by major corporations led to the passage of the Sarbanes-Oxley legislation, in which Congress mandated new norms and standards for corporate governance. While the legislation focuses exclusively on corporations, its impact has been so profound that foundation and nonprofit boards across the United States are reassessing their governance practices based on this legislation.

Even before the Sarbanes-Oxley legislation, questions were being raised about the governance practices of foundations and nonprofit organizations after the charitable response to the 9/11 tragedy.¹ New York’s attorney general has recently issued a white paper that recommends new legislation directed at nonprofit organizations based, in part, on the Sarbanes-Oxley law. He proposes that officers of nonprofit corporations certify the accuracy of the organization’s financial statements and annual report. Minnesota’s attorney general has also issued a white paper on his views about the best practices for governing boards of nonprofit organizations. We should expect and prepare for other states to take similar actions.

Added to this climate of changing expectations for board governance, the deteriorating investment environment over the last three years has caused foundation assets to plummet. The decrease in assets is requiring foundations to reassess their grantmaking priorities and to lay off staff. While foundations have struggled to maintain their giving levels in the face of a falling market, a report by the Foundation Center indicates that two-fifths of foundations surveyed expected their giving to decline in 2003, and this sentiment was greater among larger foundations.² Similarly, a survey by *The Chronicle of Philanthropy* found that the assets of six of the 10 largest foundations declined for a combined loss of \$10.6 billion and that more than 100 private foundations had planned to cut or freeze their grantmaking.³ One foundation that has been very forthcoming about its budget chal-

Photo of Dr. Carson by Becky Borsheim. Courtesy of The Minneapolis Foundation.



Foundation boards must actively explain to legislators and the media that the role of foundations is not, and should not be, to fill funding gaps created by the government.

lenges is the Hewlett-Packard Foundation, which has seen its portfolio decline from a high of \$13 billion in 1999 to \$4.8 billion in 2002. The foundation has laid off 60 of its 160 staff members, including 39 program staff positions, and has eliminated several grantmaking areas where it was the acknowledged leader.⁴

As if things weren't bad enough, the weak economy is also creating other problems. The poor national economy coupled with widespread budget deficits at the national, state and local levels has meant that there are increased social needs in the areas of job training, housing, health care and more. Many states, including my home state of Minnesota, are exacerbating the challenges faced by the poor and unemployed by proposing budget cuts that will drastically reduce or eliminate the very services that poor people rely on at the time when they need them most.⁵ The budget shortfalls also mean fewer resources for arts and cultural organizations, as well as transportation issues that affect growth and urban sprawl. All of this means that rather than being able to rely on state and local governments as partners in providing services, these entities are contributing to the problems. And adding insult to injury, some elected officials are erroneously suggesting to the public that the greater social needs resulting from reduced government funding can be replaced with giving from foundations and nonprofit organizations.

How Should Foundations Respond?

It is imperative that in determining how we respond to these multiple crises, foundation boards recognize the unique role that foundations play in American society and judge our individual and collective actions by whether they will

improve or erode the public trust. Foundations are unique institutions in that they hold resources in the public trust for the purpose of improving our society. As a result, foundation governance practices must now be completely transparent and beyond reproach.

Foundation board positions are no longer ceremonial. Board members must be fully engaged in the oversight of their foundations' operations and must actively seek to improve their skills. It is essential that foundations do everything they can to guard against both real and perceived abuses. In particular, foundation boards must provide careful oversight and documentation that compensation and benefits paid to foundation trustees and executives are fair and equitable; that foundation endowments are well managed; that the ratio of operating expenses to grants is reasonable; that conflict-of-interest policies have been developed and are adhered to; and that grant requests are fairly reviewed and judged against the same standards. Our field needs better tools and comparative data to help us meet these minimum standards.

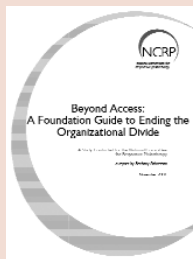
For some foundations, it will be difficult to adjust to the new public norms for transparency and accountability. As we saw in the corporate arena, however, it requires only a few high-profile actors to bring unwanted public scrutiny and increased legislative oversight. Doing the job right is different from doing the job well. Fundamentally, foundations exist to improve the quality of life in their communities. It is not enough for foundation boards to say they are following all of the best practices of board governance but doing little that they think has the potential to improve some aspect of our society significantly. Foundation boards should resist efforts to have their institutions replace government support for basic social services at the expense of funding experimentation and innovation, because it suggests that philanthropic dollars are interchangeable with public tax dollars. If such a linkage is made by our actions, why should private individuals rather than elected representatives of government dispense such funds? Foundation boards must actively explain to legislators and the media that the role of foundations is not, and should not be, to fill funding gaps created by the government.

The increased social needs facing our communities provide a unique opportunity for foundations to show our true worth to the public. Now is the time for foundation boards to insist that staff consider and bring forward innovative solutions. Now is the time for foundations to experiment

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with new approaches. And now is the time for each foundation to take risks consistent with its mission and values. Smaller foundation endowments along with reduced egos may make it easier for foundations to collaborate than in the past. It is important, however, that the success of such collaborations be judged not by how many funding partners are involved or the total amount of funds contributed to a common cause but rather by the value of what might be accomplished. Joint projects that rely on the least-common-denominator approach are not as useful as projects and initiatives that have the promise of changing how an issue is viewed or handled.

The times demand that foundations not only meet the highest standards of ethics and accountability but also show how we make a tangible difference in the lives of people. Unfortunately, notwithstanding that foundations often state that we provide the risk capital for innovation, not enough of us can point to consistent, ongoing examples in our grantmaking portfolios where we have taken risks. I use the word *risk* in this context to mean, Who is the foundation willing to offend to try something different?—for example, its existing grantees, other funders or popular public opinion. Foundations must show the public, in every way, that the trust they place in foundations is justified and that foundations are engaged in the prudent risk taking the public expects.

Foundation boards set the expectations for staff about what kinds of risks are acceptable. One tool that foundation boards should consider developing is a risk-allocation model for their

grantmaking portfolios in the same way that they use an asset-allocation model for their investment portfolios. For each grantmaking area, foundation boards should specify what degree of risk is acceptable and determine what that risk looks like. In the same way that foundation boards determine the degree of diversification and risk within investment asset classes, boards can specify what percentage of each grantmaking area should be high risk, moderate risk and low risk. High-risk grants carry the greater likelihood of failure and controversy. Such grants are likely to represent no more than 25 percent of the typical foundation's grantmaking—they should, however, have the potential to make a significant difference if they are successful. High-risk grantmaking doesn't require large grants.

At a time of increased needs and limited resources, it is equally important that foundation boards show that they are responsive to the needs of diverse communities. We should be concerned with statistics generated by the Council on Foundations that have consistently shown that 90 percent of the governing boards of foundations are white and that 79 percent of foundation professional staff are white.⁶ Such statistics might suggest to policymakers, the media and the broader public that foundations may not equally serve all segments of the community and that there may be bias in our grantmaking practices. Foundation boards carry the responsibility to demonstrate through their words and actions that they take such concerns seriously and have initiated good-faith efforts to address issues of diversity, consistent with their foundation's structure and grant-

In some cases, reasonable government oversight could be beneficial and might help to clarify otherwise gray areas of accountability.

In the wake of recent foundation board governance scandals, Reps. Roy Blunt, R-Mo. (left), and Harold Ford Jr., D-Tenn., are proposing to end foundations' current widespread practice of counting their own administrative costs toward their charitable spending requirement.



making priorities. In this regard, the Council on Foundations has been very helpful in developing useful materials and guidance for its members on diversity issues.

A Changing Role For the Council on Foundations

As individual foundation boards examine what they can do to follow the best practices in the governance area as well as look for ways to ensure that their grantmaking exceeds the public's expectations, we must also assess whether the Council on Foundations must act differently as our advocate and principal spokesperson.

Historically, foundations have been fortunate to operate with only a minimum level of government oversight and regulation. This is due, in large part, to the high ethical standards that have been promoted by the Council on Foundations and have been embraced by most foundations, and the resulting trust that has been cultivated among government officials and others in the ability of foundations to police themselves. To the extent that the public and government officials become aware of egregious examples of bad behavior by foundations, it is very likely that, as with the private sector, they will demand greater oversight of foundation activity. And they should. In this regard, the Council's primary responsibility must always be to ensure that foundations act ethically, consistent with their higher purpose, as perceived by the broader public and elected officials.

The rise and fall of the once-influential American Institute of Certified Public Accountants is a good example of what can happen when a membership organization fails to understand and adjust to the rising bar of public expectations and accountability.⁷ Before the Sarbanes-Oxley Act, the Institute enjoyed the right to set the regulatory standards for the entire accounting profession.

During the height of public concerns about corporate accounting, however, the Institute remained steadfast against any efforts to reform accounting-industry practices. In particular, the Institute fought against changing the rules that accountants should not perform both accounting and consulting services for the same clients. Rather than the Institute's viewing its most important role as protecting the ongoing integrity of the accounting profession, it acted as if its primary role were to protect the interests and actions of its individual members above the public interest. In making this strategic error, the Institute lost the public trust as well as its privilege to self-regulate its industry with a minimum of government oversight and regulations.

There is a powerful lesson in this for the Council on Foundations and its sister institution, Independent Sector. It is not enough to have standards of behavior if we are unwilling to criticize or sanction members and nonmembers alike who abuse those standards. Certainly, it is never easy for a membership organization to criticize its members, and an appropriate balance must be struck between being an aggressive watchdog and a passive lapdog. However, failure to confront members who violate the established norms of best practices may threaten the rights and privileges enjoyed by all foundations.

It is important that trustees not only maintain the ethical integrity of the foundations that they govern but also insist that the Council on Foundations see its primary responsibility as maintaining the integrity of the field of philanthropy rather than the reputation of an individual member or nonmember. This is a message that foundation trustees have yet to deliver. Similarly, it is important that the Council encourage its members to devote some portion of their grantmaking to providing the social-risk capital that provides the rationale for our existence. The special award

that the Council has established to highlight the public policy efforts of foundations is a good beginning, and more must be done.

If I haven't been provocative enough, let me conclude with one final observation. Additional government regulation should not always be viewed as a negative development to be avoided. For an industry that relies on the strategies of partnering with government to provide services, of influencing government to engage or not engage in particular activities, and of encouraging government to adopt programs that have been successfully piloted by foundations, philanthropy's fear of any added government oversight or regulation seems somewhat counterproductive. We should be open to the possibility that, in some cases, reasonable government oversight could be beneficial and might help to clarify otherwise gray areas of accountability and minimally acceptable best practices. It also might help to standardize practices across states rather than leaving it to each state's attorney general to devise different rules and regulations with different interpretations. We should be equally prepared to think through how government might assist and strengthen our field in addition to thinking through strategies to ensure that government intervention does not unduly harm our field.

Conclusion

These are indeed challenging times for foundation boards. However, there is an enormous need, and opportunity, to improve people's quality of life consistent with each foundation's mission, grant-making priorities and the best practices of board governance. To achieve this promise, we must

learn to accept risk and public scrutiny as routine elements of our work and not inconveniences to be ignored or avoided. Individual foundations must act—and expect that the Council will act—in ways that recognize that our most important asset is the public's trust. If we do so, our field will survive the current storm and emerge from the worst-case scenario healthy and intact. ○

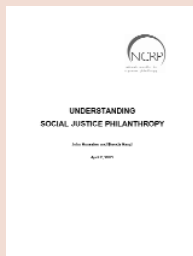
Dr. Emmett D. Carson is president and CEO of The Minneapolis Foundation (www.mplsfoundation.org), one of the oldest and largest community foundations in the country. He is also vice chair of the board of directors of the Council on Foundations (www.cof.org).

Endnotes

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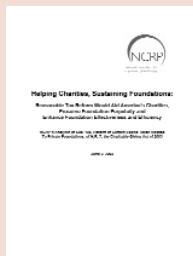
Failure to confront [those] who violate the established norms of best practices may threaten the rights and privileges enjoyed by all foundations.

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