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A wake-up call for philanthropy

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A wake-up call for philanthropy

As this report goes to the printer, the Charity Aid, Recovery and Empowerment (CARE) Act has been approved by the Senate Finance Committee and is expected to be considered in some form — along with House-passed companion legislation — by the U.S. Congress before the end of 2002.

This piece of legislation, as it now stands, contains several important and worthwhile provisions to encourage more private giving for charitable purposes. These include measures to allow non-itemizers to claim deductions for gifts to charity, and charitable rollover provisions for holders of traditional or Roth individual retirement accounts.

However, what you will not find in the Senate bill as it stands today is a provision to reduce the excise tax that private foundations pay on net investment income from a variable rate of either 1 or 2 percent to a flat rate of 1 percent.¹ I understand there were two reasons this provision fell off the table: first, the loss of revenue from a tax reduction, given the current state of the federal deficit, and second, concerns over improper foundation administrative and governance practices. Regardless of the final form the CARE Act (S. 1924) takes, this omission — if linked to perceived improper conduct — should be a wake-up call for philanthropy.

Estimates are that a reduction in the private foundation excise tax could result in an additional \$450 million being made available for charitable purposes. In addition, lowering the tax would simplify what has become a time-consuming and tricky calculation process that causes administrative headaches and can, over the long haul, reduce the amount of money going to charity.

Almost all observers of the foundation world with whom I have talked, including legislators, grantees, foundation executives and foundation critics, agree that the excise tax should be reduced to a flat 1 percent. What should have been a slam-dunk — the inclusion of that provision in the legislation (to date) — simply wasn't.

Based on my conversations on Capitol Hill and elsewhere in Washington, D.C., over the past few months, what is more troubling to me are the questions that have

¹The House-passed bill (H.R. 7) does contain such a provision.

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— when they come to light. Let's not wait for the regulators.

Today's post-Enron environment creates a milieu where the public, media, regulators and legislators demand that institutions of all types adhere not just to the letter, but to the spirit, of the law. We must employ ethical practices and be open and transparent in any business dealings. In other words, they rightly are demanding accountability. If an industry or sector fails to police itself, regulatory agencies and Congress have and will continue to step in and do the job. No part of our society — including philanthropy — should consider itself immune from these repercussions.

Foundation boards of trustees must set the highest standards of behavior and operations for their institutions and staffs. We need to take whatever steps are necessary to correct the perception that foundations are unresponsive. Even more importantly, we need to understand the limits of power and money, particularly when they are undisciplined by the democratic process. We need to listen to diverse voices and apply the levers of caring, humility, collaboration and partnership in our decisionmaking and problem-solving.

Foundations in the United States are a diverse group, and this diversity is one of the field's strengths. Philanthropies provide funding for a wide range of issues and topics, and support nonprofits of all political and philosophical stripes. Observers of the field may not always agree with the organizations or the projects that a foundation funds, neither do they always see the value in focusing on a particular issue. That's fine — openness to disagreement and dialogue is a key component of democracy.

For example, the Mott Foundation funds grassroots organizations as well as universities, and nationally and internationally recognized think tanks. Our grantees span the political spectrum, from conservative to liberal. And we also have a long history of funding the work of many of philanthropy's "watchdog" groups.

Many national associations, affinity groups and regional associations of grantmakers have voluntarily developed and implemented codes of principles and practices, requiring their members to adhere to them as a condition of membership. These statements

been emerging about excessive trustee compensation and staff salaries, cases of self-dealing, and high administrative costs. Some believe these issues are a major reason the excise-tax reduction was not retained in the CARE Act.

Overall, I believe the nonprofit sector — including foundations — has a good record of accomplishment, service and management. That is not to say that abuses haven't occurred, but they have been the exception rather than the norm. However, a few abuses can result in serious damage to the nonprofit sector and to philanthropy as a whole. The field of philanthropy needs to take prompt, forceful steps to address these situations — real or perceived

address basic operational and ethical issues; legal and regulatory compliance and requirements; governance, including board oversight and fiduciary responsibilities; public reporting and disclosure; avoidance or resolution of conflicts of interest; and responsiveness to constituencies.

The Council on Foundations passed its first statement of Principles and Practices for Effective Grantmaking in 1980, and two years later required all members to subscribe to it as a condition of membership. Although this document has served the field well, the council recently revised it to reflect the current environment. Other national membership organizations, such as the Association of Small Foundations and The Philanthropy Roundtable, have similar guidelines. In 1996, the Minnesota Council on Foundations became the first regional association of grantmakers to adopt such a code. Today a number of the 28 regional associations, including our own Council of Michigan Foundations, have such codes in place.

From time to time, these organizations have had frank conversations with foundations that might be violating their public trust. In some cases, this has resulted in the correction of offending behaviors. The time has come where these conversations should become a regular practice.

Adopting practices and principles promulgated by national or regional membership organizations is critical; more importantly, each foundation must embrace ethical and responsible behavior that goes beyond such standards. That responsibility starts with the board of trustees, assisted by its audit committee and other appropriate committees, and then is implemented by the responsible officers.

What are key issues individual foundations should pay attention to? Let me suggest the following, which I consider to constitute the basics of foundation management and operation.²

First, educate trustees about their responsibility as keepers of your foundation's ethics.

Make sure your board has the necessary tools within its governing documents, including board and committee charters/responsibility statements, and a structure to accomplish that task. Each foundation should adopt a formal conflict of interest policy and disclosure process. If a conflict of interest occurs, handle it promptly and openly. It is also important to have written codes of behavior for your trustees and staff that address organizational effectiveness and integrity, and recognize the need to provide quality service to grantees, and to respect the value and contributions of other constituents.

Second, if a foundation is paying trustees, it should be benchmarking the fees against those paid at comparable foundations. Foundations are in the business of strengthening charitable activities. Furthermore, there is a tradition in parts of the nonprofit sector that trusteeship is a privilege and duty and therefore should not be compensated. At times, compensation may be appropriate, but the level should reflect

²Incidentally, I have spoken on the topic of foundation management practices several times in recent years. Online links to several of these speeches can be found at www.mott.org/publications/websites/annual2001/annualmessage.asp.

the traditions of service and charity. We should never forget that we too are a part of the nonprofit sector.

Third, the same holds true for staff salaries and benefit packages. Designing compensation packages to attract and retain first-rate talent is a challenging task, and one influenced by many variables including geographic location, the labor market and the skill set required to do the job. Foundations should make use of benchmarks, including data from studies published by the Council on Foundations and other sources, to ensure that our compensation practices are competitive without being excessive.

Fourth, foundations need to adopt policies that support openness and transparency, as well as funding efforts to increase the availability of information about foundations, other nonprofit organizations and the sector as a whole.

While there are basic legal requirements for providing information on a foundation's 990-PF, or tax return, we need to go beyond those requirements in helping the public understand our mission and our work.

Twenty-five years ago, publication of an annual report was the gold standard of accountability. Today, foundations need to step beyond a print annual report to explain — proactively — their guidelines, decisionmaking processes, grants funded and project outcomes using a variety of media including Internet-based technologies.

We need to support efforts that increase the availability of information about nonprofit organizations and the sector as a whole. People want to know more about the finances, salaries and administrative costs for nonprofit organizations, including foundations, as they evaluate and make decisions about what charities to support. They want assurances that their gifts to charity are being used for the purposes they intended.

Increasingly, online information sources provided by the Foundation Center (www.fdncenter.org) and Guidestar (www.guidestar.com) serve a valuable purpose by making the recent tax returns of nonprofit organizations, including those of foundations, readily available.

In addition, more of the revenues generated by the federal excise tax should be devoted to making timely and accurate information about nonprofits available to the public.³ According to one source, in 1999 the budget of the tax-exempt division of the IRS was \$59 million, but the excise tax actually generated \$499 million.

Fifth, we need to be vigilant about our fiduciary responsibilities as managers of assets that are essentially a public trust.

Payout rates for private foundations almost inevitably enter into the discussion about managing private foundation assets. Today, that rate is set at 5 percent, which includes grant payments, foundation-administered projects, excise tax and administrative expenses. The latter need to be reviewed constantly to make sure they are not excessive.

³When the excise tax on foundations was passed as part of 1969 tax legislation, the revenue was earmarked for oversight of the nonprofit sector.

Differing opinions also abound among intelligent, thoughtful people about the level of the payout rate and what it should include. A number of studies have been completed in recent years examining this issue, including one commissioned by the Council of Michigan Foundations. That study, *Sustainable Payout Rates for Foundations*,⁴ conducted by Cambridge Associates, Inc. of Boston, concluded that a payout rate higher than 5 percent would erode foundations' endowments — and thus their grantmaking — over the long term.

Of course, there is nothing to preclude a foundation from granting more than 5 percent and foundation boards can make that decision on an individual basis. But we should not forget donor intent, i.e., the fact that many philanthropists establish foundations with the desire to make their resources available for the long term and with a degree of flexibility for the unknown.

I believe the philanthropic table of the 21st century has room for many styles and values, whether it is the short-term spend-down of all resources to solve a specific problem, or increasing payout rates on a short-term basis, or using payout and investment strategies to sustain a portfolio's philanthropic potency over the long run. Pluralism and diversity are strengths of the field, and it would be unfortunate to see them disappear.

Sixth, be prepared to go beyond the minimum requirements of the law in your financial and management practices. Make sure you would be comfortable having any aspect of your practices reported on in the national, local or trade media.

I am not suggesting that the Mott Foundation is a paragon of perfection, or that we can't find room for improvement. Our own practices are constantly evolving and being refined as we learn from our experiences and occasional mistakes.

At the end of the day, we need to focus on the basics of our business. It behooves grantmakers to set a good example of ethical conduct for nonprofits in both the United States and in foreign countries, where many of us work. We must be sure that our everyday actions pass this litmus test — whether they benefit or detract from our reason for existence — which is to provide resources for charitable purposes.

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⁴Visit www.cmif.org to view the complete study, which was funded by a number of Michigan foundations, including the Mott Foundation.

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