by WILLIAM S. WHITE, President
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a philanthropic perfect STORM

CHARLES STEWART MOTT FOUNDATION

A Philanthropic Perfect Storm

As I begin my 28th message for a Mott Foundation annual report, organized philanthropy — along with much of the nonprofit world — is struggling for equilibrium in an environment punctuated by questioning, mistrust and increased scrutiny.

The current round of public examination began a year ago when several newspapers wrote stories about compensation practices and alleged acts of self-dealing by a number of private foundations. Since then, the coverage about foundations' missteps, misdeeds, lack of sound governance practices and poor judgment has spread from coast to coast in the media.

Unethical practices and outright illegal activities in the corporate world, the broader nonprofit sector, the media and organized religion have shaped an environment marked by a loss of public trust in our nation's institutions.

Our field quickly found itself in a milieu that spawned a philanthropic perfect storm. Growing questioning and disparaging commentary from philanthropy's observers and critics, as well as those responsible for legislative oversight, contributed to this environment. Examples of abuse have been so damaging that the actions of a few foundations have raised suspicions about the practices of organized philanthropy as a whole.

Unfortunately, many in the field have been generally oblivious — and some might even say dismissive — of this confluence of events. This is surprising, because we have faced this situation before.

Thirty-five years ago, certain governance, investment and financial practices within the field caught the eye of elected officials and resulted in the federal Tax Reform Act of 1969. This law put in place many rules regarding investments, self-dealing, transparency and governance that continue to this day.

Our founder, Charles Stewart Mott — who was a lively 94 years old at the time — testified before the Senate Finance Committee in 1969. He identified the need for practices that since have come to pass, as well as his vision for the role of philanthropy in contemporary society. His written testimony included the following points:

> *"Basically, we feel that the private foundation deserves to be encouraged rather than discouraged, promoted rather than hampered, considered a national asset rather than a reprehensible haven of sharp practice — in short, a very good citizen rather than the villain of the piece.*
>
> *"Perhaps foundations themselves, as a group, should set up a formal association of foundations to adopt voluntary standards of approved purposes,*

methods and practices, to provide a mechanism for self-policing. To be an accredited member of such an association would be conditional upon conformity to universally accepted standards of approved objectives, methods and practice. It seems to me that the encouragement of development of such a framework for establishment and maintenance of standards would be a better approach than governmental restrictions, which could prove detrimental to the public good.

"Maybe what I am trying to say to you as elected representatives of the people of the United States is this: Please don't hamstring us, because it's your race we're running. We are a 'private foundation' only in the source of our funds; in our programs we are as devoted to the public as government itself, and all our activities are completely in the public interest."[1]

So, we have been talking and writing about the need for good management, appropriate governance, transparency and accountability for a long time.

Our first annual report[2] covered 1970 and the message was signed by then-President C.S. Harding Mott, who wrote:

"The new tax law of 1969 governing foundations gave further impetus to changes in our structure and procedure. I observe, however, that it may produce one unforeseen boon. Sometimes activities of foundations in recent years have not been recognized, have been misunderstood or even not appreciated. But the new tax act has focused public attention upon some of the good deeds of foundations and brought them more into the open for all to see."

That annual report marked an early public commitment to nurture a culture of openness, transparency and accountability. Since then, we have been advocating practices that contribute to that culture, not just for the Mott Foundation, but for other philanthropies and nonprofits as well.

Four of my annual messages have focused on these issues. In 1981, I wrote:

"We don't publish our annual report to brag about our programs, although we are proud of many of them. But we do want to let our various publics know more about us and the programs we fund. … We think this may eliminate misconceptions that may exist about us. Although foundation dollars are private, we must remember that a substantial portion of the public believes that foundation dollars are quasi-public and that the people have a right to know where and for what those dollars go. Additionally, distrust of institutions is rampant these days, and foundations are not immune to that distrust."

Those observations are still relevant. However, it is clear that expectations regarding transparency and accountability have increased dramatically. The baseline for what constitutes acceptable, let alone exemplary, practices has evolved through the years. Clearly, what was appropriate a decade ago no longer meets minimum expectations. With the growth and diversity of

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[1]The Council on Foundations adopted its first principles and practices statement in 1980; three years later, endorsement of this statement became a condition of membership. Several regional associations of grantmakers and other philanthropic membership groups have similar requirements.

[2]Prior to publishing our first annual report in 1970, we had published annual reports on our program activities with the Flint Board of Education since 1958.

philanthropy, and the advent of technologies that allow anyone anywhere with a computer to obtain and disseminate information, the situation for the field is more challenging than ever.

If organized philanthropy is to survive this perfect storm, it must find the integrity, wisdom and discipline to do so under its own power. The philanthropic community needs to speak out against, and address actively, the abuses in our field when they occur. If we fail to do so, legislators and regulatory agencies will chart our future direction and determine how we get there.

Moving Philanthropy Forward

As an industry, we need to take immediate steps to rebuild the credibility and public trust in our sector and in our individual institutions. Let me offer some suggestions, beginning with the field of philanthropy as a whole.

First, we need to get a handle on the extent of the current problems. Toward this end, Mott has provided funding for a study being conducted through a collaboration of the Urban Institute's National Center for Charitable Statistics, the Foundation Center and GuideStar. This study is collecting and analyzing a range of data — including administrative costs, trustee fees and travel expenditures — from the most recent tax returns of 10,000 foundations responsible for approximately 90 percent of U.S. grantmaking. While this study is only the first step, it should provide preliminary data to help the field understand the nature of the challenge it faces.

Second, foundations need to work with legislators to make more financial resources available to analyze information and data from Form 990-PFs (the tax returns filed by private foundations) and from other sources.

The paucity of financial resources available at both the federal and state levels for oversight and monitoring needs to be addressed. The revenue generated by the excise tax, from its very beginning, was intended for use by the IRS for this purpose. However, much of this revenue has been earmarked for the federal government's general fund, leaving the IRS with insufficient resources to monitor the field and enforce existing regulations.

Increasingly, we are seeing a number of state attorneys general placing a greater emphasis on oversight of charitable activities. However, we also recognize that state governments face tight budgets and potential deficits, which reduce financial and personnel resources and make it more difficult for these officials to pursue that part of their mandate.

We believe that oversight efforts need to continue and that illegal activities need to be prosecuted aggressively.

We also need to work with the IRS to obtain significant revisions to the 990-PF to ensure accurate and consistent reporting of the financial data included on the return. In addition, an audit performed by an independent outside firm should be appended to the return, and documentation provided that each member of the foundation's board of trustees has received a copy of the audit. All returns should be filed in a timely manner.

While philanthropy could benefit from a more informed understanding of actual practices within the field, there is limited funding available to support analysis and benchmarking of financial and other types of data. However, resources for this purpose could be raised through a fee associated with the tax returns filed by private foundations and based on a sliding scale determined by asset size. The funds generated could be made available to nonprofit research organizations for this purpose, and the findings used by the field to identify, benchmark and disseminate best practices.

Third, our national infrastructure organizations, representing various subsets of the industry — including the Council on Foundations, Independent Sector, the Forum of Regional Associations of Grantmakers, the Association of Small Foundations and The Philanthropy Roundtable, just to name a few — should collaborate and coordinate efforts to educate their members about governance and compliance issues.

Fourth, regional associations of grantmakers need to educate their members — many of which do not belong to national infrastructure organizations — about solid governance and management practices. In addition, they need to work with state attorneys general to inform these officials about the role of philanthropy in their states and to partner with them in helping correct mismanagement and abuses.

Fifth, both the national organizations and regional associations need to develop and implement procedures to address illegal and unethical practices. Too few of these organizations have statements of principles and practices that members must adhere to as a condition of membership. In many instances, the lack of progress in this arena comes from hesitancy on the part of individual members to support the concept. This reluctance needs to end. If education, quiet persuasion and voluntary compliance do not result in changed behavior, publicly visible sanctioning mechanisms need to be put in place.

We are proud that our regional association, the Council of Michigan Foundations, updated its principles and practices statement in 2003, making adherence a condition of membership. In addition, CMF is in the process of establishing specific policies to respond to self-dealing, conflicts of interest or otherwise alleged mismanagement practices on the part of both members and non-members.

Building Institutional Trust

What can we, as individual foundations, do?

We need to recognize that the actions of one organization reflect on the field as a whole. Because of this, each foundation from its very beginning needs to create an ethos, or culture of ethics, and adhere to the highest standards of behavior, avoiding self-dealing, conflicts of interest or any appearance of the same. A foundation's board of trustees must recognize and embrace the concept that its members are the keepers of that organization's ethics; all standards and expectations for behavior begin there.

Although our Foundation's Trustees serve without pay, those foundations that feel the need to compensate their trustees should do so at modest levels. And, in no instance should a trustee have a business relationship with any consultant or professional service provider working for the foundation. It also should go without saying that the salaries and benefit packages of foundation personnel should be reviewed annually and benchmarked against industry norms to ensure that compensation is competitive, but not excessive.

Regardless of size, foundation boards and staff need to become involved with industry organizations to learn more about best practices and to network with their peers and colleagues. We urge them to participate in conferences, workshops and learning opportunities to stay abreast of the best practices and to identify competent sources of professional services familiar with the tax rules and laws governing philanthropy.

It is also important that each board of trustees establishes an audit committee that meets at least once a year with the foundation's auditor and, at a minimum, reviews financial statements and adequacy of internal controls, ensures compliance with regulatory and tax filing requirements, and discusses board governance and conflict of interest situations. If the size of the board is limited, then the board itself should serve as the audit committee.

Insist on an environment of openness and accountability for your organization. Strive to make information about your operation and decisionmaking processes readily available. Recognize the need to tell your own stories and encourage your grantees to do the same.

While publication of annual reports and guidelines is still important, Web sites offer inexpensive, fast, easily updatable mechanisms to communicate with constituencies. Nearly 4,000 grantmakers, including public charities with grantmaking programs, maintain Web sites, and the Foundation Center (www.fdncenter.org) provides links to all of them.

The Foundation Center, long considered the definitive source of information on philanthropy, initiated the Foundation Folders Program in the late 1996 to develop and host foundation Web sites at no charge. That project continues today, with the center hosting 123 sites at last count.

We urge foundations to go a step further and post their 990-PFs on their Web sites. When we launched a redesigned Web site in 2001, we put a link to our Foundation's most recent 990-PF, as well as a link to the financial information included in our most recent annual report. As part of our ongoing transparency efforts, we are in the process of posting a copy of our 2002 tax return, which runs nearly 700 pages.

Invest in educating your elected officials — local, state and federal — about the projects you fund and the work of your grantees. This can be as simple as a periodic letter and list of grants, or adding elected officials' names to publication distribution lists. When in Washington or your state capital, take the time to visit your elected representatives. One of the best ways to gain experience in this process is to participate in the annual Foundations on the Hill event sponsored by the Council of Foundations and the Forum of Regional Associations of Grantmakers in Washington.

Adopting a New Code of Ethics

Our Foundation has had a formal conflict of interest policy for our staff and Trustees since 1969, and we periodically review and amend it. On an annual basis, each employee and Trustee revisits this document, which details the potential types of conflicts that may confront us in our day-to-day work and decisionmaking processes, and identifies any outside employment or consulting work, or board memberships or affiliations, that could constitute a conflict.

Last year we took yet another step to maintain the highest standards possible. In March 2003, our Board of Trustees adopted a formal Code of Ethics.

Because successful policy depends on implementation, we have long had practices and procedures to ensure ethical conduct. The Foundation's standards of conduct, reviewed annually and modified from time to time, are contained in our Trustees' handbook and in our employees' manual. The guidelines address both conflicts of interest — where a Trustee or a staff member has, or appears to have, a financial interest in a Foundation decision — and conflicts of loyalties, where a Trustee or staff member has an affiliation with, but no financial interest in, a grant applicant or other third party that may suggest influence.

While the guidelines are considered most often in the grantmaking process, they also apply to all investment and business decisions and related matters. Enforcement of the guidelines is also buttressed by our strict adherence to both the spirit and letter of the laws and regulations that govern private foundations, including the rules on self-dealing, and laws and regulations of general application.

While we have put a lot of thought and attention into these efforts, we recognize that there are always ways to improve. We do not think our Foundation is perfect.

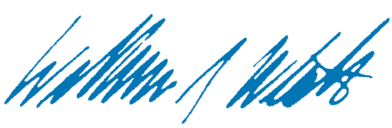
Escaping the Storm

Industry observers, regulators, legislators and professionals in the field will agree, I believe, that there is no single step, no individual or isolated solution to address governance and compensation abuses effectively. Pluralism in philosophy, funding interests and operating styles has always been — and should remain — one of the strengths of philanthropy. Culture changes in individual foundations, commitment to plain and open talk about goals and practices, and an increased sensitivity to how individual and industry practices are perceived all could help position the field to survive the storm.

Despite the differences in size, donor intent, grantmaking interests and operational practices, we are bound together by the common thread of the craft of grantmaking, a concept first described by Jim Joseph, a former president of the Council on Foundations.

Like any craft, it is composed of an inherent set of skills. But it also is an attitude comprised of humility, creativity, informed risk-taking, common sense, a deep-seated sense of accountability, and the pursuit and practice of the highest ethical standards.

As stewards of organizations that were created with private money, but committed to serving the public good, we must embrace these practices. Failure to do so will condemn this field to flounder in not only today's perfect storm, but also turbulence that may come our way in the future.



William S. White
President

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