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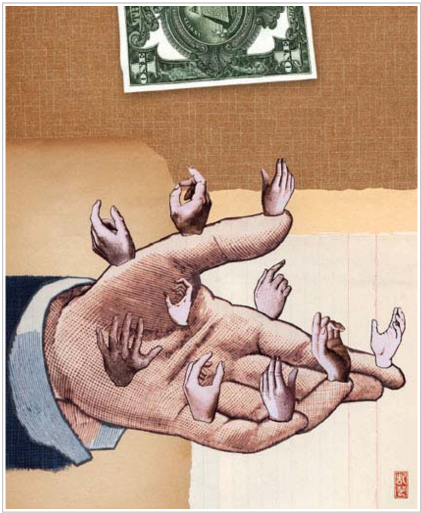
TOP STORIES:TRENDS

SPECIAL REPORT: CHARITY ACCOUNTABILITY

By Kevin Begos



Created to alleviate poverty, the nonprofit Miami-Dade EmpowermentTrust seemed for nearly a decade to be taking aim at South Florida'smost impoverished neighborhoods by creating new businessopportunities and jobs.

As it happened, the organization also had been busy creatingwealth for some of its own. The taxpayer-supported agency hadlavished money on insider deals, lost money on failed loans, andspent hundreds of thousands on celebrity entertainers.Just one wasteful expense involved a tab of more than $87,000to fly hip-hop star Sean "Diddy" Combs from New Jersey toMiami on a charted Gulfstream jet. Diddy's antipoverty missionfor the nonprofit? Hosting an MTV awards ceremony.

Suddenly, in September, it all came out in the open — on thepages of *The Miami Herald,* which detailed questionable practicesgoing back years. The nonprofit couldn't account for millions inexpenses. It had exaggerated the numbers of jobs it had created.Board members and advisers benefited from insider loans. Some$175,000 had been spent on trips, including for singers Shakiraand Eve, and actor Owen Wilson.

But perhaps even more telling than the abuses was the initialresponse to them: the nonprofit declined comment. And no wonder.It didn't have to say anything. Nobody could make it say anything.Indeed, barring some allegation of outright illegality, thoseat the helm of a charity generally can persist in those trademarksof the nonprofit world: silence and denial.

By many measures, thisis the golden age of the charitable-industrial complex: giftsare up. Growth is off the charts.These days, nearly everybodyseems in on a benevolent act orthe catalyst for one — moviestars, rock stars, former presidents,financiers, school teachers,and CEOs. From all appearances,the nonprofit sector has never been so positioned tomake substantial headway against challenges such as disease,poverty, and environmental calamity.

Yet as Americans give away more money than ever before —the total amount of U.S. philanthropy is on track to top $300 billionthis year — an unpleasant question lingers: how much of thatmoney is well-spent, and how much of it is squandered? The uncomfortabletruth: no one knows for sure, and even worse, feware checking.

Whether it's wrongdoing, wasteful spending on administrativeoverhead, rent, or celebrity balls, or questionable proportions ofbenefit to causes and corporations in symbiotic cause marketingrelationships, who can tell? The Internal Revenue Service lacksenough investigators to glimpse more than a minute sample ofnonprofit behavior. Publicly disclosed forms often provide onlya vague and incomplete picture of what's going on. Some statesare even unable to identify legitimate charities; they lack requirementsfor nonprofits to register. Other states lack even a singlefull-time attorney to investigate complaints.

"I always worry about how muchmoney

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CHARITY ACCOUNTABILITY: THE DONOR DRAIN
CHARITY ACCOUNTABILITY: (RED) OR GREEN?

FEATURED VIDEO

CHARITY FRAUD AND REFORM

Five charity reformers participate in a Contribute Roundtable at the National Press Club in Washington, featuring (in order of appearance here): Pablo Eisenberg, a senior fellow at Georgetown University's Public Policy Institute; Dean Zerbe, Senate Finance Committee charity expert; Rick Cohen, former director of the Center for Responsive Philanthropy, and Trent Stamp, president of Charity Navigator. Not all participants appear in this clip.

THE CONTRIBUTE POLL

Should nonprofits be permitted to be involved in partisan politics?

- Yes
- No

actually gets to the peoplewho need it. There just doesn't tseem to be any oversight."

—Philanthropist Lewis Cullman

Not sure

Despite some tough talk by the feds in recent years — and initiativesin which tax authorities are said to be cracking down onnonprofit executive compensation and other abuses — thechances of an IRS audit are so remote that even shaky nonprofitscan go for years without much risk of being caught. Even litigationis difficult: the Supreme Court has ruled there's nothinginherently illegal about a charity that spends just 1 percent of donationson good deeds.

The result? Just about anything goes — an unregulated, unpolicedfree-for-all in which anything might be happening to donordollars, with anything short of blatant allegations of legal wrongdoingunlikely to be exposed, except occasionally by enterprisingreporters or bloggers well after the fact. "These are times that trynonprofit souls," says New York University Professor Paul Light."It used to be that the nonprofit sector had the benefit of thedoubt from donors. But not anymore. Donor confidence is shaky.Americans have come to believe that there is some sort of leakybucket that no matter who they give to, some of the money willbe lost through waste, inefficiency, and high executive salaries."

Consider just a few recent headlines about what's happeningin this emerging Wild West of America's nonprofit industry: inSeptember, the Lucile Packard Foundation for Children's Healthin Palo Alto, Calif., reported that an employee had embezzled$350,000. Then, later that month, the director of the AfricanCommunity Resource Center in Los Angeles was arrested andcharged with embezzlingmore than $1 million. Previously,she had been named"Phenomenal Woman of theMonth" by Oprah Winfrey's OMagazine. And in October,aGoodwill employee was arrested for stealing more than $1,700in donated goods. Finally, in late October, the Associated Pressreported that the director of a Catholic charity, the North ForkParish Outreach Center in Suffolk County, N.Y., used $700,000in charity donations and thrift shop proceeds to finance her gamblinghabit, using much of that money to buy lottery tickets.

Some people tire of being so close to messy nonprofit situations.In October, Dorothy Cann Hamilton, the chairwoman ofthe James Beard Foundation Board, resigned five months beforethe end of her term, much of which was spent in damage controlmode after the former president pled guilty to stealing from thefoundation in 2005. "I have been put to my best and highest use,"Ms. Hamilton told *The New York Times*, referring to her reformefforts. "But it was never intended to be a lifetime appointment."

At risk are more than a few sullied reputations. Nonprofitsgenerate billions in revenue and over 8.3 percent of all wages andsalaries in the United States each year, according to the NationalCenter for Charitable Statistics in Washington. Yet despite aminimal risk of exposure, there is plenty of anxiety within thecharity industry. Part of that is because the growth in charities isoutpacing the growth in donations, according to IndependentSector, a nonprofit trade group that represents nonprofits inWashington. Since 2001, charitable giving has risen 12 percentwhile the number of charitable organizations has risen 23 percent.Adjust the numbers for inflation and the picture looks evenworse. Total giving per charitable organization (in 2006 dollars)fell from approximately $382,000 in 1982 to $277,000 in 2006.Increasingly, donors would rather turn a blind eye, or walk away,rather than fight: donor churn is at an all-time high, with nearlyone in two donors feeling underappreciated or ignored orsimply fed up with bad management — and withdrawing theirsupport within the first year, according to the Urban Institute.

And the trend is on the rise, says Mark Kramer, a senior fellowat Harvard University and founder of FSG Social Impact Advisers,a Boston philanthropy consultancy. Kramer, citing a surveyhe did for the Gates Foundation, says more donors today are becomingincreasingly skeptical of the traditional nonprofit systemand would rather start their own nonprofits than trust their moneyto an existing one. Adds Eric Kessler, principal and managingdirector of Arabella Philanthropic Advisors, an advisory firmbased in Washington, DC: "The same people who feel like they gotburned by Enron are also feeling like they got burned by some ofthese big nonprofits."

And once a big scandal hits the news, many assume the worst;one bad apple tarnishes the rest. "People don't differentiate fromone charity to another. They think what they're reading and hearingis the tip of the iceberg," says Diana Aviv, president of IndependentSector, who opposes mandatory nonprofit regulation."I'm very worried that the big scandals damage the image of thesector," Aviv says.

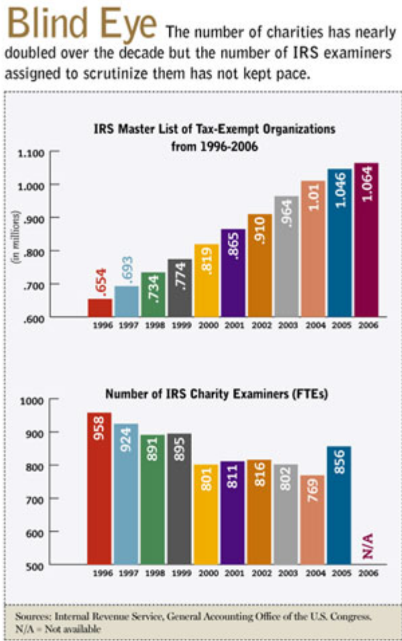
The anxiety is more than palpable. A national survey conductedfor *Contribute* by Harris Interactive poll putssome striking numbers on the extent of the concern and mood forchange. While most of the 3,040 people surveyed between October11 and October 15 feel strongly about the role of philanthropy,large majorities are increasingly skeptical of how nonprofitsspend money — to the point of saying they believe nonprofitsshould be subject to more policing. As many as three-fifths ofthose surveyed said they agree or "agree somewhat" that thereshould be more regulation of nonprofit/charity organizations.More than half — 56 percent — acknowledged being more concernedabout charity misuse of funds or services than they werea decade ago.

While illegality and ethical transgressions make news, nonprofitdollars can be consumed in a variety of never-intendedways, from funding excessive executive salaries to increased expensestied to retaining existing donors and keeping new onesfrom walking out the door.

Sometimes, the money isn't used at all: the 2006 tax return forthe Schwarzman Charitable Foundation — the family foundationheld by hedge fund mogul and Blackstone Group Chairman andCEO Stephen Schwarzman — shows five-figure assets of $63,424but only $991 of that being used for charitable purposes.

Yet for all of the instances of waste and worse that have surfacedin recent years, many politicians respond with little morethan shrugs. "I see very little real interest in aggressively using resourcesto go after the bad guys," says Rick Cohen, former executivedirector for the National Committee for ResponsivePhilanthropy and currently a correspondent for *The NonprofitQuarterly* in Washington. Cohen is hardly exaggerating. The newhead of the

Senate Finance Committee was recently asked aboutcracking down on abusive charities. “That’s not at the top of mylist. I haven’t got time,” Sen. Max Baucus, D-Mont., acknowledgedin an interview published last summer in *The Chronicle for Philanthropy.*



Then, in October, that same publicationreported that the Council on Foundations“is changing its legislative strategy because ithas gotten signals from Democratic leaders thatthey are more interested in efforts to promotephilanthropy, especially during a time of federalbudget constraints, than in regulating it.”

Some donors, meanwhile, practice whatmight be called give-and-forget; they don’t demandclose accountability for how their moneyis being spent. But this, too, is starting tochange. According to Blackbaud’s 2006 *Stateof the Nonprofit Industry Survey*, 31 percent of657 organizations polled by the charity researchfirm said they were getting increaseddemands from donors asking to be updated onhow their contributions were being spent, and42 percent of organizations said they saw anincreased demand from donors asking thatcontributions be restricted to a certain purpose —to the point that 48 percent, or nearlyhalf of those nonprofits surveyed, reported thatthey’re now having trouble raising funds forgeneral operating expenses, such as salaries oroverhead to keep the lights on. In that samesurvey, 58 percent of charities said theirbiggest challenge was recruiting new donors.

Indeed, says Bill Levis of the Urban Institute’s Center for CharitableStatistics, donor retention is becoming an enormous problemfor the industry at large. Blackbaud studies of nonprofitperformance show that over the past five years, there’s been agradual but steady decline in the number of nonprofit donors —particularly in the number of new ones.

Some funders are simply walking away from conventional givingchannels and building their own. In 2002, a group of philanthropistsfrustrated with the U.S. health care system founded theBravewell Collaborative, an operating foundation, to promote integrative medicine — and turn the traditional philanthropicmodel on its head. “The general feeling among philanthropists isthat they’ve been burned,” says Bravewell founding memberChristy Mack. “We don’t just write the check and say ‘Good luck,hope you use it the way we want.’” Instead, the collaborative overseesand runs a clinical network and a fellowship program, workingclosely with clinics and physicians to make sure the programon the ground matches the program on paper. New York philanthropistLewis Cullman, who sits on the boards of New Leadersfor New Schools, Chess in the Schools, and the Municipal Art Societyof New York, shares Mack’s skepticism. “I always worryabout how much money actually gets to the people that need it.There just doesn’t seem to be any oversight.”

That kind of crisis of donor confidence is definitely not a messagethat many nonprofits want to hear. Just ask Paul Light, theprofessor of public service at NYU’s Wagner School of Public Service.Five years ago, Light started a project monitoring the public’sconfidence in charities. In 2006, he found that 71 percent ofAmericans say charitable organizations waste “a great deal” or “afair amount” of money, up from 66 percent in 2005 and 60 percentin 2003. In the for-profit business world, that kind of wastewould draw plenty of scrutiny, and probably lead to firingsa-plenty and intense scrutiny by investors and executives. In thenonprofit world? Light says it’s information “that nobody wantsto hear.” His study ended this year for lack of funding (eventhough it only cost about $15,000 to run). “They just reallyweren’t interested in learning more,” he says of leaders in the charitysector. Whether indifferent or simply tired of hearing the obvious,says Light, “even people who have a great deal ofconfidence in the sector believe we don’t spend money wisely.”

Yet like any industry, the independent sector also has expendedsome serious time and energy on organized resistance tochange. When members of Congress threatened to consider a newset of Sarbanes-Oxley–like requirements for nonprofits two yearsago, the nonprofit world’s lobbyists in Washington resisted andcame up with voluntary standards themselves, the better to staveoff regulation. On October 18, the leading charity lobby, IndependentSector, put forth a 33-point plan outlining various ways thecharity industry might better police itself, including a suggestionthat it embrace a voluntary code of ethics. But even IndependentSector’s President Aviv concedes that the call for self-regulationisn't endorsed by many charity-watchers and donors.

Doug White, an NYU instructor and a consultant for suchgroups as the Smithsonian Institution and Greenpeace, says: "There should be some legislation that should be scalpeloriented,but the lion's share of the work has to be done by thecharities themselves. They have to be self-motivated [to do theright thing]." After all, says White, "the question, 'do you lie todonors?' will never be on the Form 990...Some of the importantreforms will have to be driven by the sector itself," White told a*Contribute* roundtable on charity reform in Washington on Oct.22. Trent Stamp, president ofCharity Navigator, disagrees. "It's time," Stamp says, "to quit foolingaround and go to an SEC for nonprofits." Considering the sizeof the industry, its workforce, its involvement in tasks once thedomain of government, its impact on the national economy, andon society overall, Stamp adds, "it's time to regulate it for the bigbusiness that it is." But congressional insider Dean Zerbe, a charityexpert on the staff of the Senate Finance Committee, says sucha measure would only pass Congress if charities supported it — anunlikely prospect.

To be sure, some even think the problem is too much regulation.In early October, mass-mailing and marketing specialistsAmerican Target Advertising sent a protest to the National Associationof State Charity Officials, charging that its yearly conference"will fail to address violations of law by the sector thatmost consistently violates charitable solicitationlaw: state charitable solicitation officials themselves."The long letter charged that individualregulation by states costs charities millions inwasted revenue, and claimed that many states areignoring established Supreme Court decisionswhen they penalize charities.

At the state and local level, barriers to tougherscrutiny and rule-making include more than politicalindifference or unpopularity of going afterseemingly good causes. It can be a matter of limitedresources and other priorities. Jack Siegel, a consultant andformer tax lawyer who writes a blog on charities, says it can be "justa practical problem — our state budget is a complete disaster, masstransit is on the verge of collapse and everybody's screaming aboutthe education system. To think that the Illinois attorney generalis going to get ten more people in that office (to investigate charities)I think is sort of fanciful."

Regulation and policing of nonprofits is a hodgepodge acrossthe country, at times almost nonexistent. Among the most activestates is California, where Attorney General Edmond G."Jerry" Brown, Jr., the former governor who took office this year,extracted a settlement in July from Noah's Wish, a charity thatsolicited $8 million to rescue animal victims of Hurricane Katrinabut spent only $1.4 million of it on them. He confiscatedthe $4 million remaining in Noah's Wish coffers to redistributeto the intended beneficiaries, demanded that the charity providegovernance training to its board, and barred the presidentfrom serving any charity in any capacity for five years. In June,he enjoined Sensory Integration International, a nonprofit thatpurported to treat autistic children, from conducting any businessactivities whatsoever until a trial could determine whetherone of its officers was commingling charity assets with personalassets and self-dealing at the expense ofthe charity.

But Brown is an exception. Charitiesbased in Florida (a state that ranks fourthin the nation in the number of nonprofitorganizations registered with the IRS and14th among states in terms of the amountof money given to charities) raised $19.5billion in 2006. Yet the the state doesn'thave a single full-time auditor, investigator,or prosecuting attorney devoted solely tomonitoring their books.

The situation couldn't be more differentin Pennsylvania, which lags Floridaboth in the number of charities basedwithin its borders and the amount of moneythey raise — but has recently expandedits charity investigation staff to five investigators,four auditors, and a full-timeprosecuting attorney.

As in any boom, huge sums fuel temptation —a vulnerability that nonprofit insidershave cautioned about for years but tolittle effect. J.J. McNab, a financial consultantand author of *Tools and Techniques ofCharitable Planning*,put it succinctly beforeCongress in 2004: "Bad players havediscovered that they can use small, hungry,or newly formed tax-exempt organizationsto conceal everything from Ponzi andaffinity scams to high-end corporate fraudand terrorism funding...(and) even good charities are findingthemselves sorely tempted to, if not sell their souls, at least rentthem out to the highest bidder."

But reliable, complete information about charities and nonprofitsis hard to come by. Consider that the chief method ofgaining a glimpse of a nonprofit's inner workings, the IRSForm 990, deals only in broad financial categories. "For betteror worse, the tax form is the nonprofit disclosure instrument,"says Peter Swords, an expert onnonprofit tax reporting and the formerhead of the New York Nonprofit CoordinatingCommittee. "It is to nonprofitswhat the SEC regime is to regulatedcompanies, and it is something thatought to be taken very seriously."

Yet hundreds of thousands — or millions —of dollars can be listed as expensesor salaries, with little sense ofwhether they were legitimate. Indeed,deciphering a 990 would challenge anace detective — and probably has. Yetshould a donor have to moonlight as anaccountant or detective just to makesure his or her money is properly spent? "It can be easier to understandhow much a *Fortune* 500 executive is paid than howmuch a charity is paying executives due to the shell games thatgo on," Sen. Charles Grassley, R-Iowa, wrote to the TreasuryDepartment, complaining about the current 990 form.

When the IRS released a proposed redesign of the form thissummer, it got thousands of comments from the nonprofit sector,and backed off some of the changes. Many objected to theidea that a generic form can truly reflect whether an organizationis efficient or not. "We had stars in our eyes starting out,"says Steven T. Miller, commissioner of the Tax Exempt andGovernment Entities Division of the IRS, the arm that overseescharities and sought to put more regulatory teeth in the form."We thought it would be great if Joe Blow could compare organizationsby looking at the 990 (and) we tried to improve theform to do that, but we have not been successful," Miller toldnonprofit leaders at the Independent Sector's annual conventionOct. 23 in Los Angeles. "I don't know if we'll ever be ableto get there. It's a pity."

So is all the stench and smoke surrounding charities a signof doom for the sector? Is all the talk advocating reform — self-regulationor otherwise, just that — talk? Hopeless?

Hardly, says Marion Fremont-Smith, a senior research fellowat the Hauser Center for Nonprofit Organizations at HarvardUniversity, whose experience with nonprofit organizations beganin the 1960s, when she served as assistant attorney general anddirector of the Division of Public Charities in Massachusetts.She thinks the debate over Form 990 has been “very productive,”considering there might not have been one at all.

And while Supreme Court rulings limit the ability to challengeeven seemingly excessive fundraising costs, states haveother powers. “The power of the states to [oversee] charitiesis broader,” she says, noting that attorneys general have nearexclusivestanding to bring suit for abuse of the old commonlaw concept of “charitable duties” — which include the avoidanceof personal gain at the expense of a charity and gamblingwith a charity’s money.

Yet the most surprising force for reform is coming from anunexpected source: bloggers, activist donors, and young entrepreneurswho are willing to spend extratime monitoring charitable organizations.An example is Perla Ni, a former publisherof the *Stanford Social Innovation Review*,who, aiming to guide donors the way Zagatguides diners, earlier this year launchedsf.greatnonprofits.org to open a few windows.At Stanford, she realized how littlewas known about the nonprofits her publicationregularly wrote about. Who were thegood ones? Who used money wisely? SaysNi: “There’s nothing like transparency andempowering volunteers and clients to havea voice to improve accountability.” Othersuch efforts include London’s IntelligentGiving group and Web site. Founded in 2004 by journalist PeterHeywood, its mission is “to help you give happily and withconfidence.” Heywood notes that he wants “to find a way of helpingpeople less fortunate than me, but I’ve discovered this isn’tas easy as it sounds, largely because it’s tough to work out whichcharities to give money to.” Adam Rothman, a feature editor ofthe London-based site, recently took a British charity, theWooden Spoon Society, to task for spending too much on overheadand not enough on the needy children it serves. “This isa truly dismal performance that lets the whole (charity) sidedown,” Rothman wrote in a recent posting.

To be sure, says Charity Navigator’s Stamp, today’s youngeractivists are mostly looking to find better ways to help society,and a partnership announced in September between theCase Foundation, the Gates Foundation, and MTV—calledThink.MTV.com—“aims to be the definitive online resourceand rallying point for young change makers...where everyonefrom sunny day volunteers to die hard activists can Get Educated,Get Connected, Get Heard, Get Active, and Get Rewarded,”noted a press release.

Stamp says that what major charities should note is that theyweren’t chosen to implement the project. He says that if the charitysector keeps acting as if high-profile scandals are just business-as-usual, younger donors may be far more likely to tune outcompletely — as both donors to traditional nonprofits and as theiremployees. “For the first time in several generations,” Stamp says,“young people have money. It’s one thing to be disenfranchisedand poor. It’s something else to be all those things and have a nicefat checkbook.”

With additional reporting by Marcia Stepanek, TracieMcMillan, Julie Connolly, and Matthew McCann Fenton inNew York.

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