**Statement of Ira M. Millstein**
**Weil, Gotshal & Manges LLP**
**before the**
**Committee on Finance**
**United States Senate**

**June 8, 2005**

Mr. Chairman, Senator Baucus, distinguished members of the Committee, I am pleased to appear before you as the former Chair of a Governance Advisory Panel (the "Panel"), appointed by The Nature Conservancy's ("TNC") Board of Governors. To begin, I would like to compliment both of you, this Committee and its staff, especially Dean Zerbe and Jon Selib, on the thorough and substantive work they have done over the last year or longer.

The TNC Panel I chaired was established in August 2003 to prepare a report concerning issues of governance, transparency, and accountability. These were and are critical issues not only for TNC, but also for all nonprofit organizations. Indeed, studies show that the public trust in nonprofit organizations has eroded since 2001.[1] As for-profit corporations have worked to restore public confidence and increase investment in the wake of several highly public governance failures at major corporations, now nonprofit organizations must work to reassure potential contributors that their money will be well spent in furtherance of their intended missions. Because private donations fund most nonprofits' activities, restoring the public trust is, as the Independent Sector

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[1] The Brookings Institution reported in September 2004 that public confidence in charitable organizations was roughly 10 – 15% lower than it was in the summer of 2001. *See* Paul C. Light, *Fact Sheet on the Continued Crisis in Charitable Confidence*, BROOKINGS INSTITUTION, Sept. 13, 2004 at 1.

explained in its recent report, "essential to a viable nonprofit sector."[2] The question is how. I believe that the answer lies with ensuring that each nonprofit organization has an active and engaged of board of directors.

There are many parallels between the governance of nonprofit and for-profit organizations. In both cases the organizations are tasked with managing other people's money and in both cases they are judged by their success in doing so. Yet, there is a very key difference: in the for-profit context shareholders are able to hold corporate directors and officers accountable, whereas in the nonprofit context there is no mechanism by which the organization can be held accountable when it fails to act in furtherance of its mission.

In her recent article, *Reforming Corporate Governance: What History Can Teach Us*, Georgetown University Law Center Professor Margaret Blair explains that while certain provisions of corporate law make it possible for corporations "to lock in capital, and may occasionally lead to abuses by directors and managers, they do not lock in particular investors, since individual investors can sell their shares to other investors."[3] Investors may also sue a corporation's officers and directors for breaches of their fiduciary duties. The threat of a shareholder action can serve as an important deterrent to corporate mismanagement and abuse. In addition, in theory -- and occasionally in practice -- shareholders may be able to remove directors.

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[2] Panel on the Nonprofit Sector, convened by Independent Sector, INTERIM REPORT PRESENTED TO THE SENATE FINANCE COMMITTEE, March 1, 2005 at 14.

[3] Margaret M. Blair, *Reforming Corporate Governance: What History Can Teach Us*, Vol. 1.1 BERKELEY BUS. L.J. 1, 29 – 30 (2004).

The same mechanisms by which for-profit officers and directors are held accountable for their actions are missing in the nonprofit context. Once a nonprofit organization receives a contribution there is no one to hold the organization accountable for how that money is spent. Indeed, while officers and directors have a fiduciary duty to fulfill the mission of their organization, that mission cannot hold them accountable in the same way that shareholders can in the for-profit world.

Although government does play an important role in policing and monitoring nonprofits' activities, specifically the Internal Revenue Service and various state Attorneys General, no agency or state actor has the capacity to oversee every action taken by every organization.[4] Further, while it may also be possible to create a private right of action for a nonprofit organization's donors or beneficiaries to sue the organization, I believe that doing so would deter too many good people from serving on nonprofit boards.

Thus, a body within the organization must be able to fill the void left by the absence of shareholders -- and that body must be its board of directors. Every nonprofit needs a board that is committed to continuously reviewing, adapting and strengthening its oversight responsibilities to meet the changing needs of the organization. Increasing transparency, adopting conflict of interest policies and whistleblower procedures, and

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[4] *Exempt Organizations: Enforcement Problems, Accomplishments, and Future Direction Hearing Before the Senate Committee On Finance* (statement of Mark W. Everson, IRS Commissioner,) *available at* http://finance.senate.gov/hearings/testimony/2005test/metest040505.pdf (stating that IRS' exempt organization master-file data lists 1.8 million tax-exempt entities, up 300,000 from 2000. Collectively, it is estimated that these organizations file more than 800,000 annual returns).

recruiting individuals with financial or other skills necessary for the organization are all important, but underlying such reforms is a fundamental need to make boards understand their role. Typically, those individuals who serve on nonprofit boards believe in the organization and they want to help fulfill its mission. If they appear to be lax in exercising their fiduciary duties it is not necessarily a result of bad behavior, but rather of lack of understanding of what they are supposed to do. Thus, I recommend that any reform effort -- legislative or self-regulatory -- include a requirement that directors receive training in how to be effective directors.

Each nonprofit organization is unique -- size, composition, and missions vary greatly. However, there are certain key principles which all organizations should be able to follow. For example, smaller boards, meeting in person more frequently (at least quarterly) and utilizing standing committees focused on specific issues relevant to the organization are more effective than overly large boards which meet infrequently, and whose members view their service as honorary or focused on fundraising. Directors need to understand the role they play in the organization, the kinds of issues they should examine, and the kinds of questions they should ask of management. Once these principles are in place, they should be able to do the necessary to ensure transparency, governance and accountability.

My specific comments related to TNC are contained in my April 19, 2005 Progress Report which is attached to this testimony.

Thank you.

**Weil, Gotshal & Manges LLP**
**M E M O R A N D U M**

April 19, 2005

**To:** Board of Governors
The Nature Conservancy

**From:** Ira M. Millstein

**Re:** Progress Report on The Nature Conservancy ("TNC")

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**Summary**

In March 2004, a Governance Advisory Panel (the "Panel"), appointed by TNC's Board of Governors (the "Board"), submitted its final Report (the "Report") containing a number of far-reaching recommendations for improving the organization's governance.

Since that time the Board and Management of TNC have made a significant good faith effort to consider and implement the Panel's recommendations, including modifications when considered appropriate.

The Panel did not suggest that its recommendations were cast in stone; it believed them to be subject to modification based on experience and necessity. Moreover, the Panel recognized that many improvements were underway as the Panel began its work, and that additional progress was made during the months the Panel was preparing its Report.

When the Board asked me in February of this year, about a year after the Report was filed, to review TNC's response to the Panel's recommendations, the most important facts I searched for were whether the Board and Management had been activated and energized to face the difficult issues, and were earnestly continuing the process of improvement. I find that this has happened: the Board and Management have clearly undertaken, and promise to continue to undertake, a good faith continuous review of all of TNC's activities and responsibilities, in order to assure the public of TNC's integrity in carrying out its important mission.

**Introduction**

In June 2003, the Board of TNC resolved "to enlist independent, outside advisors to assist it in achieving the aspiration of making the Conservancy a recognized leader in governance and oversight."[5]

In August 2003, the Board established a Governance Advisory Panel which included myself as Chair, along with Derek C. Bok, Claudine B. Malone, Richard T. Schlosberg III, and Thomas J. Tierney, to prepare a report concerning issues of governance, transparency, and accountability. While the Panel was undertaking its work, the Board and the Management of TNC made many changes and improvements in its policies and practices. At the time the Panel submitted its Report to TNC's Executive Committee and Board on March 19, 2004, TNC's approach to changes was still evolving, and could be thought of as a work in progress. But in my view, governance was improving.

In the Report, the Panel commented on the current environment in which non-profit organizations operate and on TNC's evolving practices in the areas of

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[5] The Nature Conservancy, *Actions Taken by the Board of Governors* (June 13, 2003) <http://nature.org/pressroom/links/art10309.html>.

governance, transparency, and accountability, and made further recommendations in these and other areas.

In February of this year, the Board of Governors asked if I would examine the progress that TNC had made in the intervening year. This Progress Report is a summary of what I found, and where I think TNC is headed. It is organized in three sections, as was the original Report.

I found that TNC had made substantial progress in implementing many of the initiatives which it had undertaken in the second half of 2003 and the beginning of 2004. In some instances – particularly with respect to the organization of the Board itself – it appears that TNC came to believe that Panel recommendations did not result in TNC's best use of its Board. The Board assessed the situation and developed an alternative approach for reorganizing the Board, which is being acted upon this month.

With respect to improving transparency and accountability in its programs, I believe that TNC has successfully implemented many of the initiatives which were contemplated by the Panel's Report or which were independently underway at the time. In some instances, however, TNC has adopted policy initiatives, but is still in the process of implementing systems which would allow it to track its progress in meeting these objectives.

I wish to thank my partners David B. Hird and Robert C. Odle, Jr. for their assistance in preparing this Progress Report.

## I. The Board

As noted in the Report, there has been a dramatic shift in recent years in public expectations concerning the responsibilities of governing boards of non-profit organizations such as TNC. In order to meet these expectations, the governing boards of these organizations have had to adopt structures that are similar to those employed by for-profit corporations. Generally, the non-profit sector, like the commercial sector, has come to recognize that smaller boards – which meet more frequently and have standing committees focused on particular issues relevant to the organization – are more effective than overly large boards which meet infrequently, often by telephone, and whose members sometimes regard board service as an honorary function.

As part of its work, the Panel made preliminary recommendations to the Board about its structure and organization on January 28, 2004 and refined those recommendations through iterative discussions with the Board between that date and the March 19, 2004 date of its final Report.

One of the challenges at the time was to develop an approach which would marry the institutional history of TNC's Board of Governors with a modern perspective on board structure. Historically, like many other large, non-profit organizations, TNC had a large Board of approximately 40 members. Many of the Governors had long personal histories of involvement in TNC programs and strong commitments to TNC's mission. TNC rightfully sought to encourage the continued involvement of these individuals. At the same time, a 40-member Board could not govern effectively, no matter how qualified the members were; there were simply too many of them to operate as a modern, hands-on board.

In its Report, the Panel tried to address this problem by proposing the creation of an 11-member Executive Committee, which would function as a "board within a board." The Panel's concept was that the Executive Committee would be the true governing board. The Panel's proposal also included the creation of six standing committees: Audit, Strategy, Governance, Conservation Project Review, Finance, and Marketing and Philanthropy, making use of the members of the larger board. The chairs of each of the standing committees would have been members of the Executive Committee, along with the Chair, two Vice Chairs, Secretary/Treasurer, and the President, for a total of 11 members. Thus, a larger board would remain, but the "work" would be accomplished by an Executive Committee and active functioning committees.

TNC's Board attempted to follow the Panel's recommendation, but came to believe that the plan could not work in practice as it had been envisioned in theory. The whole Board – then about 35 members – believed that it should function as a governing, not an advisory, body, and that the Executive Committee should act in an emergency role when the whole Board could not be quickly convened. At the same time, the concept of six standing committees appeared to be unwieldy, and in addition, Board members believed that some of those functions were better handled by the Board as a whole or by management and staff.

As the larger Board came to believe that the Panel-recommended structure would not work for TNC, it began to consider modifications to the structure that we had recommended.

At the present time, a resolution is being prepared to submit to the Board of Governors at its meeting later this month, to alter its structure in order to enable it to govern more effectively. The key component of this proposal is for the Board to reduce its authorized maximum size from 41 to 21 members (including the President).[6]

Reducing the board membership from 36 (its current actual size) to 21 members will be an important step in restructuring the board to better discharge its responsibilities. Although, generally, "best practices" suggest that boards of both commercial and non-profit organizations should range in size between 9 and 15 members, there is little empirical proof of an ideal number. It is anticipated that the size of the Board will continue to shrink as members retire or resign. In fact, I am told that three Board members will complete their terms by early 2006, two in September of 2005, and one in January of 2006, thus probably bringing the number of Board members to 18.[7]

I recognize that ultimately the Board will adjust its size to fit its needs (e.g., enough members to fill out more active committees, representation from TNC's various constituencies, fundraising, and the like), and yet not be unwieldy or overly large. Experience going forward will determine the appropriate size from time to time, as needs vary.

At the same time as it is shrinking its size, TNC's Board of Governors is in the process of adopting a resolution to specify more particularly the responsibilities of the Board and the duties of Board members in governing the organization.

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[6] The proposal also calls for reducing the size of the Executive Committee.

[7] TNC has also a practice of limiting the number of chapter trustees who may serve on the Board of Governors so that not more than 50% of the board members at any given time may also be chapter trustees. As I understand it, TNC expects that this 50% limitation on the percentage of board members who also serve as chapter trustees will continue to apply to the proposed 21-member board, so that no more than ten members of the Board of Governors will be chapter trustees.

The proposal before the Board would also substantially change the Board's committee structure. Three standing committees would remain: Audit, Finance, and Governance and Nominating. The functions of two standing committees – Strategy, and Marketing and Philanthropy – would be reinvested in the Board as whole. This is a fair choice for the Board to make, since at a smaller size, it can take up serious matters such as these.

The sixth of the original six standing committees was the Conservation Project Review Committee, which has jurisdiction to review specific conservation projects. In its Report, the Panel considered it important to have a separate board-level committee to serve this function. Although TNC has addressed this function at the management level through the creation of the Risk Assessment Committee, I continue to believe, as did the Panel, that it is important that a standing committee at the board level have oversight over specific conservation projects.

To that end, the proposal that the Board has developed would transfer the functions of the Conservation Project Review Committee to a new standing subcommittee of the Audit Committee, to be called the Conservation Practices Subcommittee. This, to me, is a satisfactory resolution.

Although TNC believes the Panel's proposed board structure did not work as planned, it is encouraging that the Board is taking steps to develop an alternative structure to improve its ability to govern consistent with the spirit of the recommendations. No specific structure is a panacea; what is most important is that a board understand its responsibilities and develop policies and practices to discharge them.

And the Board, after some experience and much consideration, has selected reforms it considers better suited to TNC.

## II. The Field

A section of the Report was devoted to the respective roles of the TNC's Board of Governors and TNC's various advisory boards of trustees in its State chapters.

The Report recognized that while the chapter boards did not have legal authority, the volunteer boards played an important role in TNC's history and development, and continue to provide valuable human resources in setting and achieving goals on a local level, promoting local conservation projects, and fundraising. Thus, TNC draws much of its strength from active and involved chapter boards.

While the Report recognized the importance of the various chapter boards of trustees to the future of the organization, the Report also acknowledged that it was critical for the effective governance of the organization as a whole that the different roles of the Board of Governors and the various boards of trustees be clearly defined and that TNC maintain a centralized management structure to allow for transparency and accountability.

To these ends, the Report recommended that TNC:

- Establish uniform governance standards for each chapter board;
- Clarify the decision-making roles and responsibilities among the Board of Governors, local chapter boards, and senior staff, especially with respect to strategic decisions; and
- Enhance transparency and communications among the Board of Governors, chapter trustees and staff.

Since the Report was issued, TNC adopted a policy in September 2004 concerning the "Roles and Minimum Standard for Governing The Nature Conservancy," setting forth the functions of both the Board of Governors and the individual boards of trustees. This policy specified that the Board of Governors maintained legal and fiduciary responsibility for governance of TNC and that those responsibilities could not be delegated to the individual chapter boards. The policy also set forth the specific responsibilities of the individual chapter boards, which include:

- Reviewing and recommending for approval the chapter's annual operating plan and budget;
- Reviewing and recommending for approval major conservation projects and activities;
- Reviewing, recommending for approval, and providing guidance for the chapter's government relations agenda;
- Reviewing results of the internal audit of each chapter's operations and working with chapter staff to ensure recommendations are addressed;
- Working with chapter staff to ensure that chapter activities are consistent with the chapter's strategic plan and financially feasible within the chapter's budget and financial resources; and
- Working with chapter staff to ensure long-term effectiveness of conservation projects, through appropriate stewardship and measurement of results.

These functions are consistent with an advisory role, which is more appropriate for the local chapter boards than the governance role, which should be exercised only by the Board of Governors.

Moreover, the list of responsibilities identified makes it clear that the chapter boards advise and assist the staff of the chapter, rather than supervise them. Although the chair for each chapter board will participate on an advisory basis in decisions relating to the employment, annual evaluation, and termination of the chapter director, ultimate authority to hire and fire chapter directors will remain a staff function.

The policy did not address certain issues relating to the composition of trustee boards, such as trustee selection, trustee term limits, the size of trustee boards, board officers and terms, committee structures and charters, attendance and participation requirements, and the number of meetings per year. TNC is in the process of developing model Operating Principles to be adopted by each of the boards of trustees as a framework for addressing these issues, which should be completed by late spring.[8]

The current draft of the Operating Principles specifies that the trustees operate as "volunteer advisors" to the Board of Governors, and that the Board of Governors has the power to remove any trustee. To put these statements into the Operating Principles adopted by each chapter board is an important step in clarifying the roles of the Board of Governors and the chapter boards.

TNC has also recently produced an orientation document explaining the process by which TNC identifies and sets priorities for its conservation work and describes the development and implementation of a conservation project that advances those priorities. Called "How The Nature Conservancy Works: Anatomy of a Nature Conservancy Conservation Project," the document specifies the steps TNC takes in planning and

[8] The current draft proposes to limit a trustee to serving three successive three-year terms.

setting conservation priorities, developing conservation strategies, taking action and measuring the success of individual projects. Project authority has been delegated by the Board of Governors to the President with certain financial limits; however, the Board of Governors retains the authority to approve projects requiring significant financial investment or those which pose unique risks or challenges.

TNC's President has re-delegated project authority to the Chief Conservation Officer ("CCO"), who reviews each project requiring CCO approval based on criteria relating to the conservation worthiness of the project, the certainty of obtaining financial resources needed to complete the project, staff capacity, long term commitments and other considerations. Projects are initially reviewed by the appropriate state or country director. Projects that exceed certain dollar amounts or transcend state or country boundaries are reviewed by one of TNC's eight regional directors. If issues of conflict of interest are raised, projects are further reviewed by TNC's Conflict of Interest Committee, and if a project raises an issue of legal compliance or reputational risk, the project is reviewed by TNC's Risk Assessment Committee.

Successful implementation of these procedures will promote transparency and accountability by enabling more effective centralized oversight of project decision-making.

## III. Programs, Transparency and Accountability

At the request of the Board, the Panel examined TNC's programs and practices with respect to transparency and accountability. At the same time this review was underway, TNC on its own initiative made many significant changes to allow for greater transparency and accountability in the management of its programs and how it decides to enter into various transactions. Therefore, when the Panel issued its Report, it recognized TNC's initiatives in developing such programs and practices. The Panel also recommended additional steps in these areas.

In the intervening year, I believe TNC has made good and substantial progress with respect to improving accountability and transparency. In several instances, TNC has implemented practices and procedures which allow it to effectively monitor how its efforts in these areas have fared. In other instances, however, TNC has not yet fully implemented systems which properly track its efforts to promote greater accountability. Every indication is that, although more work remains to be done by TNC, the organization remains committed to improving its systems, processes and procedures to ensure that its programs meet the goals of transparency and accountability.

Viewed as a work in progress, TNC's efforts in these areas show significant advancement, but, as noted above, there is still more to be done.

a. *Valuations and Appraisals for Land Donations and Conservation Easements*

This is an area in which TNC had been subjected to the most extensive criticism; it is also an area in which TNC has made significant progress in implementing practices to improve accountability and transparency.

In its Report, the Panel recommended that TNC put in place careful, systemic, and strict procedures to ensure compliance with the spirit and letter of the rules with respect to charitable donations of land and property interests.

On March 12, 2004, TNC adopted its "Revised Policy and Standard Operating Procedure for IRS Forms 8282 and 8283." The Standard Operating Procedure requires donors to submit the following information at the time a gift is made to TNC: (a) a completed Form 8283, (b) an appraisal report, and (c) a signed certification from the appraiser stating, among other things, that: (1) he or she is a certified appraiser in the State in which the property is located; (2) his or her appraisal report conforms to the specified professional standards for appraisers; (3) he or she applied generally-accepted appraisal standards, including those established for gifts under section 170(h) of the Internal Revenue Code; (4) the appraisal has taken into account any increase to other real property owned by the donor as a result of the gift; and (5) the donor is covered by TNC's conflict-of-interest policy. For gifts of "qualified conservation contributions," such as easements, a supplemental statement is required setting forth the conservation purposes furthered by the gift and the fair market value of the property before and after the gift of the easement.

Since March of last year, TNC has effectively implemented this program. It has developed a set of forms, including notice letters and certifications, which are routinely used in these transactions. Also, TNC adopted a strict and more elaborate procedure that its employees not offer tax advice to potential donors. This procedure elaborates upon a previous procedure that was adopted by TNC in 1995. In addition, TNC conducted training programs to implement that procedure.

As the Panel recognized in its Report, relying on appraiser certifications, while helpful, is not enough. Accordingly, the Panel recommended that TNC undertake a "desk review" of all aspects of a proposed transaction, including the donor's appraisal, and that TNC demonstrate that it is willing to "walk away" from an otherwise advantageous transaction if all aspects do not meet TNC's standards (e.g., when a donor wishes to claim a tax deduction on an appraisal value that is not justified). These recommendations are similar to those of the Independent Sector's Interim Report,[9] presented to the Senate Finance Committee on March 1, 2005 ("Interim Report"), which recommends that non-profit organizations undertake close examination of the appropriate valuation and disposition of non-cash contributions.

TNC has also demonstrated an institutional willingness to look closely at transactions. TNC's Standard Operating Procedure with respect to IRS Forms 8282 and 8283 provides that "the Conservancy will not participate in transactions in which the appearance of the transaction is suspect or unreasonable or does not conform to" TNC policy. Not only have staffers performed "desk reviews" of some individual projects, but a system has been put in place to refer potentially unreasonable transactions to a senior management-level Risk Assessment Committee for review. In at least one instance, TNC rejected a proposed gift because of concerns about the validity of the appraisal.

However, the practice of conducting a "desk review" has not been fully institutionalized. While several staffers have conducted "desk reviews" with respect to particular transactions, they are not formally required for all donations in the manner that the appraiser certification is required. In short, "desk reviews" are performed on an ad hoc basis and no standard forms are used to record whether "desk reviews" have been performed. TNC should take further steps to make sure that the "desk review" is a routine

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[9] Panel on the Non-profit Sector (convened by Independent Sector), *Interim Report Presented to the Senate Finance Committee* (March 1, 2005) <http://www.non-profitpanel.org/interim/PanelReport.pdf>.

component in considering any transaction, and the results of such "desk reviews" should be routinely documented.

b. *Monitoring and Enforcement of Easements*

In the Report, the Panel recommended that TNC regularly monitor compliance with easements, require property owners to disclose plans for changes in easements, and take rigorous enforcement action where landowners act inconsistently with the terms of easements. Specially, the Panel recommended that TNC's General Counsel and Compliance Director take steps to implement enforcement programs.

TNC has made important first steps in implementing such programs. TNC formed a Conservation Easement Working Group comprised of senior TNC managers from all parts of the organization. On April 29, 2004, the Working Group issued a report discussing all issues relating to easements and it contained a series of important recommendations, including: (1) the standardization of decision-making with respect to the appropriate location, terms, and conditions of easements; (2) the use of conservation science for easement location and design; (3) the adoption of a process for decision-making with respect to complex easement projects; (4) the development of standard practices for informing prospective donors of the terms and conditions for accepting easements; (5) the strengthening of policies with respect to the valuation of conservation easements; and (6) the adoption of procedures to ensure consistent monitoring of conservation easements.

As a result of the work of the Conservation Easement Working Group, TNC developed institutional guidelines with respect to the types of easements which are acceptable and which are not, and formalized the process for making decisions about easements. In reviewing proposed easements, TNC uses the same standard operating procedures as it does for appraisal and valuation issues, which were discussed in the preceding subsection of this Progress Report. Finally, TNC implemented training programs to make staffers more familiar with the organization's policies and practices in this field.

TNC has not yet fully implemented an institutional program for monitoring easements. As of February 22, 2005, TNC made available to users an upgraded version of its Conservation Land System database, which included enhancements to capture monitoring information about conservation easements. The default tab on the system would call for monitoring every 12 months, and would indicate the compliance status of the easement. TNC has indicated that it considers the development of these programs to be important and plans to have its information system appropriately upgraded by the end of June 2005.

c. *Conflicts-of-Interest*

On March 12, 2004, TNC adopted a revised conflict-of-interest policy and standard operating procedure. The Panel noted this accomplishment in its Report and commended TNC for doing so. The Panel believed, as did the authors of the Independent Sector Report, that it is important for modern non-profit organizations to adopt and enforce a conflict-of-interest policy.

The Panel made a recommendation that the definition of a "major donor" as used in the policy be modified to include a donor who contributed $100,000 or more in cash or assets over a prior five-year period,[10] and TNC adopted that recommendation. Since the time of the Panel's Report, TNC has also institutionalized procedures to review matters involving allegations of conflicts-of-interest and has conducted training programs with respect to those procedures.

The Panel further recommended that the Audit Committee of TNC's Board of Governors be actively involved in overseeing implementation of TNC's conflict-of-interest policy. During the last year, TNC's Audit Committee has been actively involved in addressing conflict-of-interest issues, has made adjustments to certain transactions to eliminate potential conflicts-of-interest, and has provided oversight of the organization's processes for handling conflicts-of-interest. In Fiscal Year 2004, the TNC conflicts committee addressed and successfully resolved 143 cases involving actual or potential conflicts-of-interest.

d. *Transactions with Governmental Entities: the "No Net Profit Policy"*

For many years, TNC has had a "No Net Profit Policy" in connection with its transactions with governmental entities. Often TNC would acquire conservation properties which were transferred to governmental entities authorized to preserve them. In some instances, TNC would act at the behest of governmental entities which could not act as quickly as TNC in acquiring the property. In connection with these transactions, TNC established a policy of recovering only its costs from the governmental entity and not making a profit; hence the "No Net Profit Policy."

[10] The original definition of a "major donor" was limited to an individual who contributed at least $100,000 in cash or assets in a single transaction.

In its Report, the Panel noted that it was important for TNC's reputation not only that it continue to comply with the "No Net Profit Policy," but also that it document its compliance with the policy in a transparent manner. Finally, the Panel recommended that relevant data about government transactions be fully described in TNC's Form 990 which is filed annually with the IRS so that compliance with the "No Net Profit Policy" can be assured.

Since the Report was filed, TNC has restated this policy as its "Recovery of Costs in Government Real Estate Transfers" Policy. TNC has also adopted a new and detailed Standard Operating Procedure, which provides guidance for project managers on how to calculate TNC's cost basis with respect to property sold or otherwise transferred to governmental agencies. Project managers are then instructed not to recover more than TNC's cost basis from the government agency. Finally, project managers prepare documentation to substantiate the calculation of cost basis and sale price, and when this is complete, it is placed in the project file.

e. *Compatible Human Use*

Prior to the issuance of the Panel's Report, TNC adopted policies to address issues relating to compatible human use of its conservation properties. In its Report, the Panel stressed the importance for TNC to demonstrate that it is following a policy of only allowing those human uses that are compatible with TNC's conservation goals. The Panel further suggested that the policy (with examples) be included in TNC's Form 990. The Policy is now found at statement 29 of the 2003 Form 990.

TNC successfully continues to implement its compatible human use policy. Review begins with TNC's scientific staff, which evaluates the proposed human use to determine whether it is consistent with TNC's programmatic goals. Subsequent reviews are conducted by business and legal staff and sign-off is required by the Conservation Region Director. TNC has upgraded its computer systems to address compatible human use and has developed a form to record information relating to proposed human uses.

Compatible human use is authorized: (a) as a strategy to reduce or eliminate threats to conservation targets; (b) to mimic or restore essential ecological processes; (c) to meet other programmatic goals; and (d) where it is consistent with TNC values. TNC will not allow any new oil, gas, or hard rock mining activities to be initiated on its properties unless they are already required by existing contracts or other legal obligations to third parties.

f. *Executive Compensation*

The Panel recommended that TNC maintain a consistent policy of paying executives compensation comparable with the compensation paid by other similar non-profit organizations. The Panel further recommended that the Governance Committee of the Board play an active and independent role in reviewing the performance of and setting the compensation for senior staff. The Panel suggested that the Governance Committee directly retain a compensation consultant and that the compensation of the President and senior staff be disclosed on TNC's Form 990.

Because information about the compensation of executives of other non-profit organizations is publicly available, information was assembled by TNC's Human Resources Department – without the involvement of TNC's President and other executives – and transmitted to the Board of Governors. The Board used this information to make its decisions. Compensation information about senior staff may be found in statement 20 of TNC's 2003 Form 990.

g. *Lobbying*

The Panel's Report noted that the Board of Governors approved a ceiling on lobbying expenditures of 2% of its charitable budget. The Panel considered this ceiling to be consistent with the letter and spirit of IRS policies.

A year later, the 2% ceiling remains in place and TNC lobbying expenditures do not approach this limit nor have they in past years. TNC continues to follow this policy. Also, over the past year and a half, TNC has conducted a series of training programs taught by an outside legal counsel expert in this area of the law to ensure that TNC staff are aware of the legal limitations and TNC's own policies and procedures.

Expenses incurred by TNC in responding to the Senate Finance Committee's request for information about TNC have not been treated as lobbying expenditures by the organization because TNC is of the view that those expenses were incurred pursuant to a specific letter(s) from the Committee requesting such information and therefore do not constitute lobbying. On the other hand, the costs associated with TNC's work on possible legislation growing out of the response to the Senate Finance Committee inquiry have been characterized by TNC as lobbying, and have been and will continue to be allocated to the organization's lobbying expenditures and subject to the cap set by the organization.

h. *Compliance*

The Panel recommended that TNC hire a permanent Compliance Director who would be recruited from outside TNC in order to obtain a fresh perspective on compliance issues. The Panel also indicated that the Compliance Director's office should have adequate staff support.

Although it appears that several applicants from outside TNC applied for the position, it was disappointing to learn that TNC chose an internal candidate. On the other hand, virtually all senior managers within the organization have now received ethics and compliance training, and have signed a written certification documenting their adherence to TNC's policies and procedures and conflict-of-interest policy. This training and certification is now mandatory for all TNC senior managers, and beginning July 1 will be mandatory for all staff, Board of Governors members, and trustees on an annual basis. TNC also adopted in January 2004 and has effectively implemented a whistleblower policy, which is administered by the Compliance Director, the General Counsel and the Director of Human Resources. TNC has also conducted a review of its policies, procedures and practices using Sarbanes-Oxley requirements and has made a number of changes to respond to those requirements. Finally, TNC has hired additional staff in its internal audit department and has increased the rotation schedule for conducting audits of its programs.

At this point, the Compliance Director has no substantial staff support other than an administrative assistant. TNC believes, however, that adequate staffing for the compliance program is being provided from other offices throughout the organization. This arrangement should be monitored carefully by the Board. Consistent with the

Panel's recommendation, the Compliance Director reports directly to the Board. Should a vacancy develop in this position at some point in the future, I believe an effort should be made to recruit an outside candidate.

i. *Reputation and Transparency*

The Panel recommended that TNC disclose as much information as practicable on its Form 990, that TNC disclose its newly adopted practices and policies on the Form 990, and that the Form 990 include a report from the Conservation Project Review Committee. The Independent Sector Interim Report recommends that Form 990s be signed by the CEOs and CFOs of non-profit organizations.[11]

TNC has not yet issued its Form 990 for 2004. The 2003 Form was signed by TNC's CFO. TNC's 2003 Form 990 included a number of changes to increase disclosure, including a narrative describing the policy changes made by the organization (statement 29); a list of a sub-awardees; a detailed, 18 page statement of the organization's mission, strategy and values, and programmatic accomplishments (statement 10); and a specific delineation of the TNC President's compensation. TNC intends to make additional changes to and disclosures in its annual Form 990 submission to achieve greater transparency.

[11] The Independent Sector Report further recommends that each such organization establish policies and procedures to encourage individuals to come forward with credible information on illegal practices or violations of adopted policies of the organization, and to protect such individuals from retaliation. TNC adopted such a policy in January 2004.