

TESTIMONY BEFORE THE SENATE FINANCE COMMITTEE
HEARING ON CHARITIES AND CHARITABLE GIVING:
PROPOSALS FOR REFORM
BY THE HONORABLE LEON E. PANETTA

Mr. Chairman; Members of the Committee:

I am pleased to be here in my capacity as a member of the Citizens Advisory Group to the Panel on the Nonprofit Sector. As most of you know, I have been in the public sector and the private sector and I now serve as the director of the Panetta Institute, a nonprofit, non-partisan center for the study of public policy located at California State University, Monterey Bay. When I was in government, I was privileged to serve as a Member in the House of Representatives, and as Director of the U.S. Office of Management and Budget, and as Chief of Staff in the White House.

From those different vantage points I learned a great deal about the role of charities and foundations in this country and came to appreciate, far more than I had before, how essential to our communities and our nation these organizations are to serving the needs of a nation. Whether large or small, these organizations focus on a wide range of services from helping the homeless or bringing opera to the schools, cleaning the oceans or researching a cure for AIDS. Their ability to innovate, collaborate and tailor services to meet an immediate need, test a creative idea or build a museum for the arts is something government officials support and

applaud. Their work in many ways represents the essence of our democracy.

The human as well as financial resources these organizations tap is inspirational. We saw it most recently and most overwhelmingly, following the tsunami crisis when the best of what we are capable of being, came to the fore as millions of individuals and organizations contributed more than a billion dollars to help the victims of this immense tragedy.

Are there abuses in the nonprofit field? Yes, sadly, there are. In the midst of incomprehensible human suffering and need in southeast Asia, there were a few scam artists attempting to siphon off funds for their personal use, funds that would otherwise have gone to help rebuild the devastated communities in Sri Lanka, India and Thailand. There are a few charitable organizations that have not been good stewards of the public trust, that have spent charitable dollars for purposes other than those for which they were contributed.

I join you in saying that these abuses must end. I feel very strongly that charitable institutions must be above reproach because they are so essential to every aspect of community life. The only way to guarantee their continuation is to ensure an even higher level of public confidence and trust in the way they do business. We cannot allow the small number of those who deliberately abuse the public trust to hurt the good name of thousands of organizations that operate in good faith and serve the public good with distinction.

Having spent some time lately reviewing current laws and IRS regulations as well as the Finance Committee's staff discussion paper and the Joint Committee on Taxation's Options paper, I believe that collectively you have done an excellent job of clearly identifying problem areas. I want to commend you for your vigilance and your commitment to protecting what is best about this magnificent voluntary sector. Already your attention to this area has stimulated many to look at their programs and practices with an eye towards improvement.

The fundamental issue you confront today is how do you balance the need for new laws and regulations with the need for stronger enforcement of existing laws with the need for tougher self-regulation.

There may be some new laws or clarifying rules needed in certain areas of charitable activity, but we also need greater attention paid to adequate enforcement of current law. Many of the stories I've seen describe excessive compensation and self-dealing (where insiders benefit not the charitable cause) appear to be violations of existing law. In those instances the problems would not be solved by simply raising the bar but by going after the violators.

The vast majority of abuses are already illegal and the solution lies more in improving—greatly improving—enforcement of the laws and regulations already on the books than in creating more laws and regulations that increase the burdens on the IRS. I say this having served in the public sector and being keenly aware of the shortage of financial resources to achieve this important goal. I begin, therefore, by

encouraging serious consideration of increased funding for the IRS to allow for additional audits, collection of fees and development, and installation of software that will enable mandatory electronic filing of all of the forms in the 990 series, including attachments, and Form 1023, the application for 501(c)(3) status.

I believe that a good blueprint for action is provided in the recommendations included in the Panel on the Nonprofit Sector's Interim Report. As a member of the Citizens Advisory Group, I had the opportunity to review the work of the Panel and the well-considered advice it received from so many fine experts and organizations. I believe it has achieved the important balance between adequate oversight and accountability and the ability of charitable organizations to fulfill their missions.

Among the recommendations that I call to your attention are:

- Requiring audits for organizations with annual revenues over \$2 million; and mandating an independent public accountant's review of financial statements for those with budgets of \$500,000 to \$2 million (p23).
- Defining and clarifying the rules for donor-advised funds (p36).
- Increasing penalties for violations of the self-dealing rules (p40).
- Allowing better cooperation between state and federal regulators (p47)
- Encouraging the IRS to move forward with mandatory electronic filing for the Form 990 series (p 21)

The Panel on the Nonprofit Sector is now preparing its recommendations on other critical issues, and will release a final report in late spring. I encourage you to hear the full scope of its recommendations before you take any formal action.

Even with improved regulations and the significant infusion of funds, there is a limit to what can be achieved through new legislation and improved enforcement.

Without the collective will within the voluntary sector to uphold good standards of ethical practice, we will not achieve the outcome we all wish for.

I have had the opportunity to meet many leaders of charitable endeavors. Their purpose is to make life better in some way and they try their best to live up to their obligations. Too many of them don't know as much as they would like about board governance, management of organizations, audit processes, self dealing and so on. For them a good program of education would do wonders. I hope that this Committee will favorably consider putting some meaningful resources behind a nationwide education system undertaken by the charitable sector itself. But I also encourage the sector itself to invest in this effort. A comprehensive education initiative will take both public and charitable sectors coming together to achieve these outcomes.

Let me offer some thoughts that go beyond where the Panel is at this time. I fervently believe the best way to prevent abuse and raise the standards of the charitable sector is for the sector to demand of itself greater accountability. And I understand that this is beginning to happen. Numerous organizations have held conferences, workshops, seminars and other training sessions on the fiduciary responsibilities of Boards of Directors, Chief Executive Officers and others. Many of the sector's leaders have begun to better educate themselves and their directors

about the law and filing requirements. And there are a host of organizations—national, regional and local—devoted to standard setting and improving the practices of their affiliates and those associated with them. I am aware that some fields of practice require compliance and meeting of certain standards in order for the organization and professionals to operate. Other standards are entirely voluntary.

It is a good start, but it is far from sufficient. Self-regulation, to be credible and effective, must have a structure, must demand high standards, and must have the authority to investigate allegations of wrongdoing and enforce penalties. Without such a structure, self-regulation is just an aspiration.

It is my view that the charitable sector needs a formal structure, a National Council on Nonprofit Accreditation, that brings together all of the accrediting bodies of the sub-sectors under one umbrella. They ought to have common standards regarding governance, transparency and accountability, allowing for the diverse needs of small, intermediate and large organizations. Although the charitable purposes of public interest groups, family service agencies, health systems and research centers are significantly different, there are standards of operation that they must surely share.

A National Council of some sort could write clear guidelines requiring that any nonprofit institution seeking accreditation from any cooperating accrediting body must meet the guidelines for board composition, audits, public disclosure of

financial information, and compliance with all laws and regulations governing exempt organizations. These guidelines would be in addition to the sub-sector requirements for curriculum development, physician certification or whatever is relevant in each sub-sector to obtain accreditation today. Violations of governance and ethical standards would be cause for suspension and finally revocation of accreditation, just as failure to meet academic, health or safety standards.

An additional function of a National Council on Nonprofit Accreditation would be education and training. I have been truly surprised to find that many, many people working in charitable organizations or serving on boards or as trustees do not know the laws and regulations that apply to their tax-exempt status, IRS filings, fiduciary responsibilities and public disclosure requirements. While not denying that there is abuse of tax laws that is knowing and purposeful, there are a great many errors of omission and commission that are due to ignorance of the law or its application to the specific organization. Examples are failure to file a Form 990, failure to receipt gifts over \$250 or providing excess benefits to executives or trustees.

At the end of the day, relying on this type of self-regulation has three main advantages: It lightens the burden on the IRS and other regulatory agencies, all of whom are already struggling to meet their responsibilities with limited resources; it preserves the independence of the sector, which has been crucial to its ability to address the needs and aspirations of Americans; and it places the responsibility where it should be—on the organizations across the country that know that they

will maintain the support of the public only if they operate according to the highest possible ethical standards.

The charitable sector is indispensable to American life as we know it. Americans value volunteer service to their communities and they trust and rely on nonprofit institutions that serve them. We send our children to religious schools or community centers to learn the values in which we believe. People from all over the world come to the United States for higher educations in some of the finest colleges and universities ever established. It is impossible to enumerate the myriad services charitable organizations make available to families that would be unable to afford them in the private marketplace—from shelters for the homeless to job training, cancer screenings to literacy programs.

The charitable sector serves the public good. But it must do more. It must serve well and to do that there must be more accountability and transparency. The trust placed in these organizations is more important than the dollars contributed to them. The good work needs funds; the donors need trust. They are inseparable.

So I urge you to please keep the pressure on. Demand better enforcement of current laws from the IRS and give them the means to do it. Demand passage of new laws and promulgation of new regulations to curb abuse and increase penalties, but do so cautiously and only where absolutely necessary.

And finally, demand that the charitable sector do a better job of self-regulation.

Those of us involved in the sector will make demands on ourselves as well: for higher standards of ethics and governance, for better training of professionals and volunteers about their duties and responsibilities, and for holding organizations accountable for meeting those standards.

Together we have an obligation to give the public the trust they need to ensure that they give to the nation.