Panel on the Non-Profit Sector recommendations: Effectiveness and Relevance to Good Governance of Nonprofit, Tax-Exempt Arts Organizations

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Abstract

This article discusses the Panel on the Nonprofit Sector recommendations for good governance practice; it provides evidence to show how the Panel's recommendations, which laid the groundwork for federal tax law and IRS requirements and recommendations, serve as an effective guideline for nonprofit, tax exempt [501(c)(3)] arts organizations. The article emphasizes the importance of implementing good governance practices, such as the ones suggested by the Panel, in order to avoid scandals, encourage growth, expedite auditing and tax procedures, and increase contributed revenue and reputation (Garcia n.d.). The article includes background on the formation of the Panel on Nonprofit Sector and explains how the Panel, through its publications, "Strengthening Transparency, Governance, and Accountability of Charitable Organizations" and "Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations", addresses key issues related to good nonprofit governance, including size and composition of the board, mission, law compliance, public disclosure, fundraising, and additional legal and ethical policies related to nonprofit arts organizations.

Keywords: good governance, charitable organizations, nonprofit governance, arts management

Panel on the Non-Profit Sector Recommendations: Effectiveness and Relevance to Good Governance of Nonprofit, Tax-Exempt Arts Organizations

Beginning with the Philanthropic Advisory Service in 1971, various advisory groups created standards and recommendations in response to the legal and ethical controversies surrounding non-profit governance. Some of these standards include the Philanthropic Advisory Service Standards, the Better Business Bureau Wise Giving Alliance Standards, the American Institute of Philanthropy Standards, the Senate Finance Committee Staff Paper, the U.S. Treasury Department's Voluntary Best Practices, the Committee for Purchase Proposed Best Practices, the Panel on the Nonprofit Sector Recommendations and Good Governance Principles, the Draft of the IRS Good Governance Principles, and the IRS LifeCycle Educational Tool Principles. Second only to federal, state, and local law, standards set by these agencies have most heavily influenced governing boards of charitable organizations. The standards provide guidance as to good governance practice; many of the standards assist organizations in complying with federal and state law and/or with IRS annual reporting requirements (Form 990). With these standards, these agencies intend not to restrict charitable organizations, but rather to accomplish a similar mission to the IRS's—"helping [America's taxpayers] understand and meet their responsibilities" (Hopkins 2009). Arts leaders should not feel limited by good governance standards, but must realize that they can greatly benefit from implementing good governance recommendations in their organizations. These standards will not only help them to comply with tax and auditing requirements, but also help them to avoid scandals, encourage organizational growth, and increase reputation and contributed revenue (Garcia n.d.). Unfortunately, there are so many different recommendations for nonprofit good governance practice that it can become extremely difficult to sift through the information and determine which standards to adopt as a guideline. Many organizations and individuals also become frustrated with best practice standards because they believe that advisory groups, on top of federal tax and IRS requirements, infringe upon their freedom to structure the governing board of the charitable organization as they see fit. This is especially true in the nonprofit arts world, where each organization has a unique structure, operating environment, and specific needs that require a level of freedom to manage properly. Some of the standards set by particular groups are not relevant or relatable to the complexity of an arts organization, so it is crucial to identify standards that work best for the organization. Out of the various groups that provide good governance recommendations, the Panel on the Nonprofit Sector provides some of the most relevant, effective, and thorough principles for good governance of a 501(c)(3) arts organization. The Panel's recommendations directly correspond with the IRS's concerns as addressed on the redesigned Form 990 and in its LifeCycle Educational Tool. The Panel gives additional helpful suggestions for good governance outside of IRS requirements, but still provides arts organizations with freedom they need to govern according to organization-specific needs.

Discussion

The Sarbanes-Oxley Act 0f 2002 was created in response to various cases of financial corruption and unethical business practice in the for-profit business world. As a result, the U.S government began to scrutinize the financial accountability and ethical business practice of organizations, even non-profit organizations, which were not technically required by law to comply with the Sarbanes-Oxley Act. In 2004, The Senate Committee on Finance wrote a discussion draft including "strong governance and best practices" for tax-exempt organizations. This staff paper received criticism because many aspects of it had little relevance to non-profit organizations. Later that same year, the U.S Senate Committee encouraged the Independent

Sector to form the Panel on the Nonprofit Sector, with the goal to improve the oversight and governance of charitable or individual nonprofit organizations and to ensure high standards of ethics and accountability ("Independent Sector | Panel on the Nonprofit Sector" 2006). "Independent Sector | Panel on the Nonprofit Sector" (2006) provides further background on the Panel, stating:

> The Panel on the Nonprofit Sector was an independent effort by charities and foundations to ensure that the nonprofit community remains a vibrant and healthy part of American society.
>
> The Panel issued a report to Congress and the nonprofit sector, "Strengthening Transparency, Governance, and Accountability of Charitable Organizations", in June 2005, and followed up with a supplemental report by the same name in April 2006. In October 2007, the Panel released "Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations."
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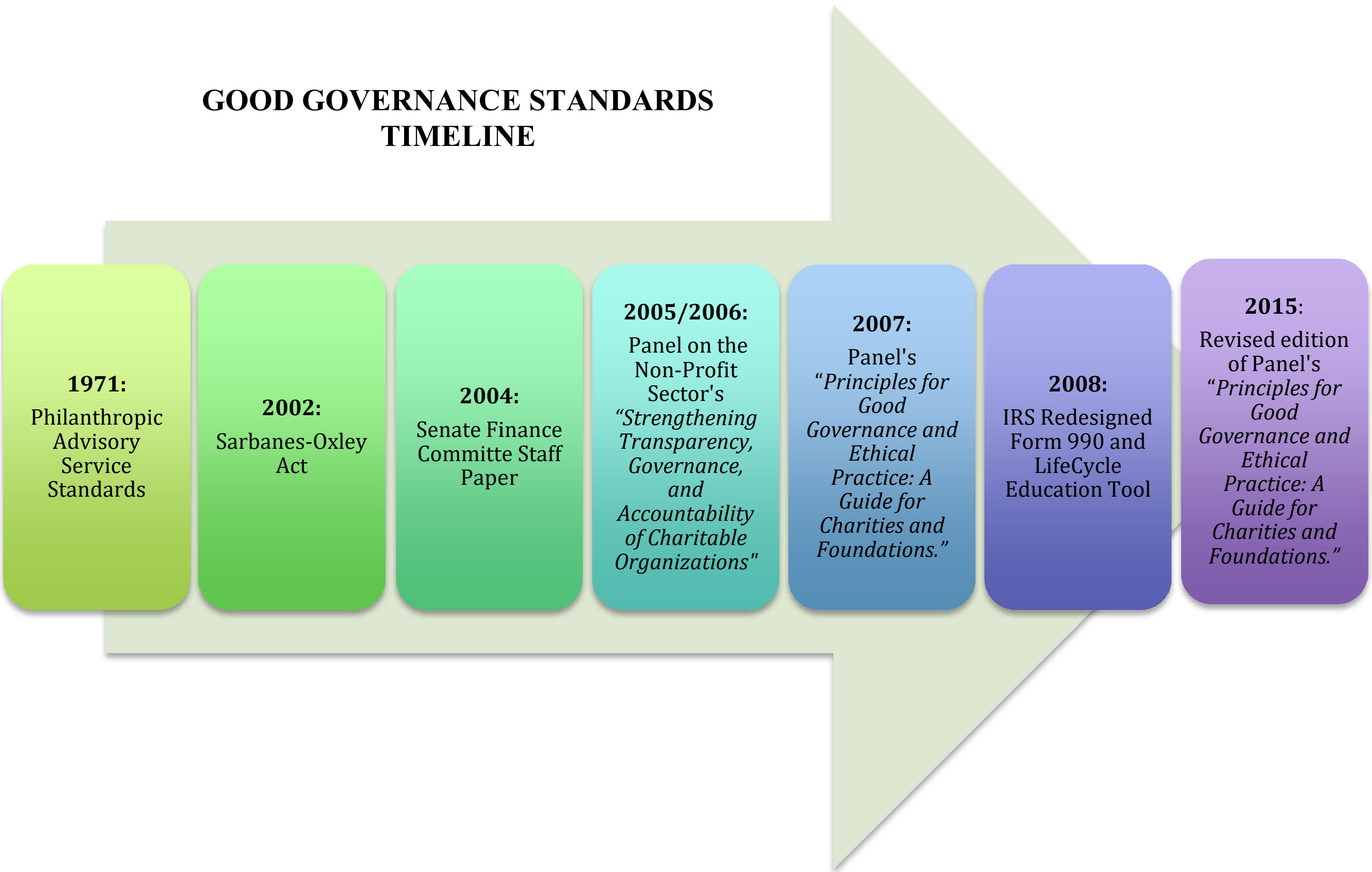
> The Panel on the Nonprofit Sector was comprised of 24 nonprofit and philanthropic leaders whose organizations encompass great diversity in location, mission, perspective, and scope of work. Lorie Slutsky, president of the New York Community Trust, and Cass Wheeler, then-chief executive officer of the American Heart Association, were its co-conveners. Diana Aviv, Independent Sector president and CEO, was the Panel's executive director, and Patricia Read, IS's senior vice president for public policy and government affairs, was project director." ("Independent Sector | Panel on the Nonprofit Sector" 2006)

The Panel based its 33 Good Governance Principles on the need for "a careful balance between the two essential forms of regulation—that is, between prudent legal mandates to ensure that organizations do not abuse the privilege of their exempt status, and, for all other aspects of sound operations, well informed self-governance, and mutual awareness among nonprofit organizations" (Hopkins 2009). The Panel on the Nonprofit Sector Principles provided (and continue to provide) some of the most helpful considerations for effective governance of arts organizations. The 33 Principals cover topics related to four different categories: legal compliance and public disclosure, effective governance, strong financial oversight, and responsible fundraising. The 33 Principles were recently updated to reflect new circumstances in which the charitable sector functions, and new relationships within and between the sectors ("Principles for Good Governance and Ethical Practice" 2015).

The recommendations created by the Panel heavily influenced the IRS's redesigned form 990 and LifeCycle Educational Tool. Without the Panel's work, the U.S. government may still not have had an accurate perception of and reasonable, relevant expectations for governance of nonprofit organizations; non-profit organizations may still not have had proper guidelines for implementing proper governance practice. In its 33 Principles document, which is widely used in today's non-profit world, the Panel addresses many crucial topics that relate directly to the IRS Form 990 requirements and give additional helpful insight for arts leaders. Below, I will discuss in more detail a portion of these topics, including mission and goals, size and composition of the board, transparency and accountability, and additional legal and ethical policies related to nonprofit arts.



Mission and Goals (Principle 19).

A non-profit organization is required by law to have a charitable purpose. In arts organizations, the mission is an organization's *raison d'être,* the "why" that drives all activities as well as artistic and/or educational programming. The IRS places great emphasis on an organization's charitable mission, and Form 990 requires the organization to recite its mission. The IRS asks for a "clearly articulated mission statement" that will "explain and popularize the charity's purpose and serve as a guide to the organization's work". The mission will show "why the charity exists, what it hopes to accomplish, where, and for whom" (Hopkins 2009). Principle 19 in the 2015 edition of *Principles for Good Governance and Ethical Practice: A Guide for Charities*, states that "the board should establish and review regularly the organization's mission and goals and should evaluate, no less frequently than every five years, the organization's programs, goals, and activities, to be sure they advance its mission and make prudent use of its resources" ("Principles for Good Governance and Ethical Practice" 2015). Arts organizations should most definitely implement these guidelines to make sure not only that they meet the IRS's requirements, but, as Principle 19 says, so that they can effectively work toward achieving a common charitable goal that will truly resonate with audiences and constituents.

Size and Composition of Board (Principles 10, 11, and 12).

The Panel on Nonprofit Sector provides useful information pertaining to board size and board composition in an arts organization. The Panel suggests that the organization "should have enough members to allow for full deliberation and diversity of thinking on governance and other organizational matters" and that board size may depend upon factors like age of the organization, nature, geographic scope, and funding needs. They suggest that, generally, having at least five board members is appropriate, except for very small organizations. The IRS Annual Information Return (Form 990) requires that an organization report the number of board members entitled to vote as well as the number of independent members, and the IRS Good Governance Principles point out the disadvantages of boards that are disproportionately small and disproportionately large. The Panel suggests, in Principle 12, that a "substantial majority" (usually at least two-thirds of members), be independent; they define independent members as those who should not "(1) be compensated by the organization as employees or independent contractors; (2) have their compensation determined by individuals who are compensated by the organization; (3) receive, directly or indirectly, material financial benefits from the organization except as a member of the charitable class served by the organization; or (4) be related to anyone described above (as a spouse, sibling, parent or child), or reside with any person so described) ("Principles for Good Governance and Ethical Practice" 2015). This independent majority in the board can be very difficult to ensure, especially in very small, family-run arts organizations. However, it is necessary for arts leaders to be aware of these guidelines and to realize that they may be held under scrutiny if non-independent members make up the majority of their organization's board. No two arts organizations are exactly the same, so arts leaders must use these guidelines to find the right fit for their organization's needs and to ensure that their organization remains accountable.

Transparency and Accountability

A non-profit is held in trust by its board of directors on behalf of the community. A non-profit arts organization must remain fully transparent to demonstrate its accountability to its stakeholders and to the IRS. The IRS and federal tax law place great emphasis on transparency and accountability by requiring an organization to report whether or not it makes certain organizational documents (both required and not required by law) publicly available in Form 990 and by suggesting disclosure of full and accurate information about an organization's mission in the IRS Life Cycle Educational Tool Principles document (Hopkins 2009).

Public Disclosure (Principle 7). The Panel on Non-Profit Sector's Principle 7 focuses specifically on demonstrating transparency in the form of public disclosure. The Panel encourages organizations to "make information about its governance, finances, programs, and activities widely available to the public" ("Principles for Good Governance and Ethical Practice" 2015), which the IRS focuses on when reviewing organizations. They also suggest including information on evaluation methods and results of these evaluations. Disclosing this recommended information to the public in the organization's annual report and on the organization's website would be advisable for a non-profit arts organization so that it may increase the IRS's and the community's trust in the organization.

Legal and Ethical Issues: Conflict of Interest, Whistleblower, and Document Retention/Destruction Policies (Principles 3, 4, and 5). Legal and ethical issues sit at the forefront of IRS concerns, especially after the creation of the Sarbanes-Oxley Act. Compliance with federal law, state law, local law, and the organization's code of ethics are commonly addressed by organizations, but some prevalent concerns for non-profit organizations that boards may not typically think to implement in their articles of incorporation are the existence of (1) a conflict of interest policy, (2) a whistleblower policy, and (3) a document retention and destruction policy. Form 990 requires an organization to answer several questions concerning the conflict of interest policy and requires the reporting of whistleblower and document retention/destruction policies (Hopkins 2009). Both the IRS LifeCycle Educational Tool Principles (2008) and the Panel Principles (2007/2015) suggest that an organization adopt and implement all three of these policies. The Panel's Principles 3-5 say that a charitable organization should establish and implement policies and procedures to (1) "ensure that all conflicts of interest (real and potential), or the appearance thereof, within the organization and the governing board are appropriately managed through disclosure, recusal, or other means", to (2) "enable individuals to come forward with information on illegal practices or violations of organizational policies" with confidentiality and without retaliation for individuals who make a good faith report, and to (3) "protect and preserve the organization's important data, documents, and business records" ("Principles for Good Governance and Ethical Practice" 2015). The whistleblower policy was one topic that underwent some changes for the revised 2015 edition of the Principles. In the updated edition, the Principle 4 explanation now notes, in regard to the whistleblower policy, that, "some offenses require immediate reporting while others may warrant investigation first, and encourages an organization to have a clear process to decide whether, how, and when to report. Human resources violations should only be subject to whistleblower policies and protections when other human resources processes fail to appropriately handle the violations. The *Principles* encourage wide distribution of the whistleblower policy" ("Principles for Good Governance and Ethical Practice" 2015).

Additional Relevant Topics: Audit Committees and Fundraising (Principles 21, and 27-33).

The Panel on the Nonprofit Sector addresses some topics that the IRS now places emphasis on when examining organizations. Two of these important topics are audit committees and fundraising practices. For Form 990, the organization must report whether or not it has an audit committee that assumes responsibility for oversight of an audit, review, or compilation of financial statements and selection of an independent accountant. The Panel recommends in Principle 21, "A charitable organization must keep complete, current, and accurate financial records and ensure strong financial controls are in place. Its board should receive and review timely reports of the organization's financial activities and should have a *qualified, independent financial expert audit* or review these statements annually in a manner appropriate to the organization's size and scale of operations" ("Principles for Good Governance and Ethical Practice" 2015)." All arts organizations must have an independent auditor and review financial statements annually if they wish to demonstrate their financial accountability.

The IRS also focuses on fundraising policies, and the Panel thoroughly summarizes general requirements for fundraising in the arts (such as "no compensation based on a commission", "specific acknowledgements of charitable contributions", staying true to the "donor's intent" and conducting "accurate and truthful" practices). The Panel made some recent updates to its fundraising recommendations in the newest edition of the Principles to incorporate new references to online platforms, mobile giving, social media, and crowdsourcing. The updated fundraising principles "emphasize the importance of ensuring that prospective donors receiving such online communications know how to contact the organization for more information. They raise the caution of online fundraising channels providing easy opportunities for fraudulent solicitations, and urge organizations to take steps to counter these. Principles emphasize the importance of providing training and supervision for fundraisers, the handling of donor data, and how to take control of the organization's brand if online platforms are raising funds for the particular organization without their permission." The principles also discuss the fine line between transparency (following disclosure requirements) and respecting the privacy of the donor by not selling or making available names and contact information of donors without their consent. Senator Grassley says, "The sharing of best practices makes sense in any field. That's especially true in philanthropy, where good governance makes it easier for charities to continue their work. Donors want to give to organizations that have transparency, strong financial management, and get the most value from every dollar donated. Independent Sector gives organizations a guidepost for doing things right" ("Principles for Good Governance and Ethical Practice" 2015).

Photo by: Independent Sector

Conclusion

Each advisory group has helped to provide further insight into effectively governing non-profit arts organizations. The Panel on the Nonprofit Sector principles, which serve as a compilation of past knowledge and experience of non-profit organizations, offer the most universal and most note-worthy recommendations. The Panel thoroughly covers each facet of good governance practice in accordance with federal tax law and IRS concerns (which is crucial for successfully completing the annual Form 990 and maintaining tax exempt status). *"Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations"* has been praised by many, including Will Miller, president of the Wallace Foundation, who says:

> Independent Sector has done an important service in convening a group of sector leaders to develop a set of Principles for Good Governance and Ethical Practice in the nonprofit sector, updated to reflect the new challenges we face in a digital age. The effectiveness of the nonprofit sector, crucial to our national health, ultimately depends on public trust. These principles remind us of the importance of sustaining that trust – and offer useful guidance on what it means to be trustworthy ("Principles for Good Governance and Ethical Practice" 2015).

The language and content incorporated into the Panel's principles, in general, is educational and informative, allowing for the customization that arts organizations need to figure out what best suits their size, scope, and purpose; the principles allow non-profit arts organizations, which are very diverse in nature, the freedom they need to most effectively self-govern and ultimately fulfill their charitable mission.

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