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Lack of Serious Oversight of Charities Undermines Public Trust

By Suzanne Perry

Nearly five years ago, a committee of the House of Representatives held hearings to explore accusations that some veterans charities were spending just a trickle of the money they raised for programs to help veterans or their families.

Lawmakers grilled charity executives and presented data showing that most of the donations they collected to aid veterans of the Afghanistan and Iraq wars had gone instead to professional fundraising firms or to salaries and perks. They expressed outrage and vowed to explore ways to strengthen the regulation of charities—for example, by creating a new federal agency to oversee charities or beefing up the Internal Revenue Service or Federal Trade Commission.

Legislative aides and policy experts suggested other remedies: Charities that receive discounted postal rates could be required to disclose in their mailings what percentage of their donations pays for programs. Or Congress could require charities to meet certain fundraising standards to qualify for tax-exempt status or to get government grants.

And then nothing happened.

That probably pleased some charities and fundraising firms that fear too much government involvement in their activities. But the inaction highlights a problem that other nonprofit experts say threatens to undermine public trust in the charitable world: the lack of serious efforts to bolster the regulatory system that monitors the nation's 1.1 million charities and foundations—a number that has mushroomed by 75 percent since 1995.

The situation has been aggravated by the economic downturn, which has forced some states that are on the front lines of policing charities to cut their budgets for that purpose.

"They're having to do more with less, and they were already doing more with less," says Karl Emerson, former head of Pennsylvania's Bureau of Charitable Organizations.

Exposés and Inquiries

Since Congress concluded its hearings, problems with veterans charities that are spending little on programs, or even allegedly committing outright fraud, have continued unabated. So have reports of other alleged improprieties.

In just the past year, media exposés have highlighted charity telemarketing and direct-mail appeals that have mainly benefited commercial firms, and states have conducted investigations into high-profile charities including Yéle

Haiti, the group set up by the hip-hop artist Wyclef Jean, and the Central Asia Institute, co-founded by Greg Mortenson, co-author of the widely acclaimed book *Three Cups of Tea*.

Nonprofit leaders need to issue a "clarion call," says Cindy Lott, a lawyer who developed and runs Columbia Law School's Charities Regulation and Oversight Project and previously served in the Indiana attorney general's office. "We need good regulation. We need it at the federal level. We need it at the state level."

She says policy makers have tended not to look at the nonprofit world too closely, thinking: "The vast amounts of people who work in the nonprofit sector are doing great work every day, are compensated far less than they could make in the for-profit sector."

But the nonprofit world has become such a big economic engine—employing millions of people and handling billions of dollars—that it needs a strong regulatory regime to "protect the charities that are doing it right," she says."

'An SEC for Nonprofits'

Nonprofit and policy experts have, over the years, proposed many ideas to improve the way that charities are regulated, a task that now generally falls to the Internal Revenue Service, which monitors tax-exempt organizations, and the states, many of which require charities and professional fundraisers to register and provide financial information. (The Federal Trade Commission sometimes works with states to crack down on fraudulent telemarketing campaigns or sham charities.)

Many say the IRS's nonprofit division, which has its hands full dealing with the tens of thousands of applications it gets each year for tax-exempt status and is able to audit only a tiny percentage of charities, needs more money and people—or should perhaps cede regulatory authority to a new body modeled on the FTC or the Securities and Exchange Commission.

"Why can't we have the equivalent of an SEC for nonprofits?" says Janet Greenlee, an associate professor of accounting at the University of Dayton who specializes in nonprofits. "The IRS is in the business of collecting taxes," she says. "Let them devote their time and money to collecting taxes." (The IRS did not respond to questions about the nonprofit division's budget, audit capability, or staff levels.)

But Congress has never shown much interest in tinkering with the current regulatory system, and prospects that it will do so now are slimmer than ever.

Lawmakers—especially those on the Senate Finance Committee, which oversees rules affecting tax-exempt groups—are consumed with cutting the nation's debt and overhauling the tax code, says William Josephson, former head of the New York State Charities Bureau. "It's difficult, in fact impossible, to get anybody to focus on other issues until these really titanic issues are resolved," he says. Nonprofit advocates including Independent Sector, a coalition of nonprofits and foundations, favor giving more money to the IRS, perhaps using revenue from the foundation

investment-income excise tax that was originally designed for that purpose but never used that way. However, they are giving the issue little attention, preoccupied instead by federal budget battles that could limit charitable deductions.

Government Help

Only a few big states, like California and New York, have ever been able to devote major attention to charity supervision, which has prompted some experts to propose that the federal government provide money to help them out. Ms. Lott, who is in regular contact with the offices of attorneys general, says that in the past two years, many of them have lost staff through layoffs or attrition, or have required staff members to take furloughs. And charity regulation has had to compete with other state needs that might be more important to the public, says Mr. Emerson, the former Pennsylvania official. “If you’re talking about laying off police, firefighters, and teachers or cutting down on charity-registration violations, what’s the typical person going to be more upset about?” he says.

Unethical but Legal

One hitch that regulators face when trying to curb abuses is that some practices that may offend donors or seem unethical are not illegal.

For example, the U.S. Supreme Court has ruled several times that in the absence of fraud, states may not restrict charities from spending most of their gifts on fundraising or require solicitors to volunteer how much of the money that’s raised will pay for programs.

Some experts say the U.S. Postal Service could help curb fundraising abuses by restricting the use of the nonprofit postal rate by commercial companies that reap most of their money from direct-mail appeals. But in 2003, the agency moved in the opposite direction, changing a rule to allow for-profit fundraising firms to qualify for the reduced rate when requesting money on behalf of a charity. Some lawmakers have criticized the new approach, but have not taken any action to change it.

Private Efforts

In the absence of government action, some organizations are stepping up private efforts to police bad behavior.

The Direct Marketing Association Nonprofit Federation, a trade group, is investigating charges against one of its members, Quadriga Art, a direct-marketing company that the Senate Finance Committee is questioning because of its ties to a veterans charity that is deeply in debt to the company. (Quadriga says the charity needed to invest heavily to acquire donors and will eventually see a payoff.)

The group is also reviewing its ethics guidelines to see if it should offer more specific advice on what kind of information fundraisers should provide to donors and charities about how donations are being used, says Xenia “Senny” Boone, senior vice president for corporate and social responsibility at the federation.

The BBB Wise Giving Alliance, a charity watchdog, in January will start reviewing direct-mail solicitations and telemarketing scripts from selected charities to see how truthful they are.

“State regulatory authorities can certainly go after an organization if it’s misleading the donating public,” says Bennett Weiner, chief operating officer. But he says his group’s reports can help weed out bad practices in the “gray areas” where regulators may not have enough ammunition to bring a legal case.

Some critics say the nonprofit world needs to do much more to call out bad actors, including expelling them from trade groups.

“The charitable community seems loathe to speak ill of anybody anytime, anywhere,” says Dean Zerbe, a former top aide to Republicans on the Senate Finance Committee.

Diana Aviv, Independent Sector’s chief executive, says she has planned a session at her organization’s annual conference next month on ethics and moral issues, adding that nonprofit leaders need to think about how scandals affect the broader charitable world and use “social pressure” to encourage good behavior.

But she says self-policing only goes so far with organizations that purposely violate the law.

“The chances that they are going to listen to one of us saying 'You shouldn’t do that’ is zero to none,” she says. “What’s likely to happen is they’ll thumb their noses at us and that the only power to stop them is law enforcement.”