



**INDEPENDENT SECTOR**  
A vital voice for us all

STATEMENT FOR THE RECORD  
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HOUSE WAYS AND MEANS COMMITTEE  
SUBCOMMITTEE ON OVERSIGHT  
"HEARING ON TAX EXEMPT ORGANIZATIONS"  
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Chairman Boustany, Representative Lewis, and distinguished Members of the Subcommittee, thank you for the opportunity to share the perspectives of America's charitable sector as the Subcommittee examines oversight of tax exempt organizations.

I serve as the president and chief executive officer of Independent Sector, a national coalition of approximately 600 public charities, foundations, and corporate giving programs that with their affiliates total tens of thousands of charitable organizations across the country. Our nonpartisan coalition leads, strengthens, and mobilizes the nonprofit and philanthropic community in order to fulfill our vision of a just and inclusive society, as well as a healthy democracy of active citizens, effective institutions, and vibrant communities. We work to ensure that America's 1.3 million charitable organizations are able to help people and improve communities across the country and around the world.

### Importance of the Nonprofit Sector

Every day, charitable nonprofit organizations provide educational and economic opportunities for families in need, work to alleviate poverty and suffering at home and abroad, assist victims of disaster, enhance the cultural and spiritual development of individuals and communities, and foster worldwide appreciation for the democratic values of justice and individual liberty that are part of the American character.

Cities, suburbs and rural communities in every corner of the United States are enriched by the work of nonprofit, philanthropic, and religious organizations. The United Way of Southwest Louisiana, for example, has supported the educational and social development of children by providing quality after-school and summer programs for 32,901 children in 2009, and the Second Harvest Food Bank of Greater New Orleans and Acadiana fights hunger in southern Louisiana through food distribution, advocacy, education, and disaster response, serving more than 260,000 people each year.

In response to April 2011 tornadoes that destroyed 600 homes in Georgia, American Red Cross volunteers and staff provided 486 people safe haven in Red Cross shelters, served 49,703 meals, and distributed 10,754 bulk items, including diapers, baby formula, insect repellent, dust masks, and more. On a daily basis, the Points of Light Institute, based in Atlanta, puts people at the center of transforming their communities through enterprises like the Hands on Network, whose 250 volunteer centers in 16 countries around the world partner with more than 70,000 corporate, faith, and nonprofit organizations to deliver approximately 30 million volunteer hours valued at over \$626 million each year.

The charitable nonprofit and philanthropic sector is also a critical component of the nation's economy. Nearly one in 10 workers in the U.S. is employed by a nonprofit organization, and with 13.5 million employees, we employ more people than the finance and real estate sectors combined. Further, we collectively pay nearly \$670 billion annually in wages and benefits – salaries that support middle class families in communities across America – and in 2008, 501(c)(3) organizations paid \$32.4 billion in payroll taxes.<sup>1</sup>

In addition, charitable nonprofit organizations inspired 62.8 million American adults to contribute more than 8 billion hours of volunteer service in 2010, the equivalent of 4 million full-time jobs valued at approximately \$173 billion.<sup>2</sup>

The nonprofit sector's broad community impact and public support is evidenced by the breadth of its funding sources. Millions of Americans make donations each year, collectively providing nearly \$300 billion<sup>3</sup> to support the work of charitable nonprofit organizations. But charitable donations are only part of what is needed to ensure that the sector's programs and services can continue. More than 52 percent of revenue across the sector is derived from fees paid for services, ranging from tuition and patient care charges to event admission fees. An additional one-third of nonprofit sector revenue is generated through partnering with all levels of government to deliver programs and services like after-school care, nutrition assistance, and health care services.<sup>4</sup>

### **Impact of the Economic Downturn**

The struggling economy has made it more difficult for charitable organizations to serve their missions, as America's nonprofits have been hit hard financially in recent years. The Nonprofit Finance Fund, a community development financial agency, surveyed over a thousand nonprofit organizations in April 2010, and found 12 percent operating above a break-even point.<sup>5</sup> Sixty two percent of organizations had enough cash on hand to cover less than three months' worth of expenses, and half of those (31 percent) had enough for less than one month.

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<sup>1</sup> IRS data. <http://www.irs.gov/taxstats/charitablestats/article/0,,id=97176,00.html>

<sup>2</sup> Corporation for National and Community Service, "Volunteering in America," 2011

<sup>3</sup> Giving USA Foundation (2011). Giving USA 2011: The Annual Report on Philanthropy for the Year 2010. Chicago: Giving USA Foundation

<sup>4</sup> National Center for Charitable Statistics (NCCS), The Urban Institute, The Nonprofit Almanac 2011. Sources of Revenue for Reporting Public Charities: NCCS calculations of IRS Statistics of Income Division Exempt Organizations Sample (2007); NCCS Core Files (2009); American Hospital Association (AHA) 2009 survey; and the National Health Accounts, produced by CMS.

<sup>5</sup> Nonprofit Finance Fund, "2011 State of the Sector Survey," 2011

Like our counterparts in other major sectors of the economy, many nonprofit employers have struggled to meet payroll during the past three years, and countless more have been unable to hire additional workers needed to keep pace with an increased demand for services. In 2009 alone, 38 percent of human services nonprofits reported laying off employees, 50 percent froze or reduced salaries, and 23 percent reduced employee benefits.<sup>6</sup>

These financially challenging times have also seen a significant increase in demand for help for those most in need, as documented in numerous recent studies. One such study, conducted by the NonProfit Research Collaborative, found that human services organizations experienced a 78 percent increase in demand for services between 2009 and 2010.<sup>7</sup> Earlier, an annual survey conducted by Catholic Charities found that its agencies had served 9,164,981 people in 2009, an increase of nearly 19 percent increase from 2007.<sup>8</sup>

Many charitable nonprofit organizations have struggled to keep pace with this increased demand in part because they saw revenues fall during the economic downturn. From 2007 through 2009, annual charitable giving declined by almost \$30 billion<sup>9</sup> as Americans struggled to navigate a difficult economy. Federal, state, and local budget cuts have further burdened and diminished the capacity of nonprofits, and this has disproportionately affected people who are least able to help themselves.

There are meaningful ways in which Congress might help charitable organizations secure the support they need to deliver these much needed services. Specifically, we ask that you enact the expired tax extenders without delay. It is difficult to overstate the urgency for our community, and the people we serve, of immediately reinstating the charitable giving incentives in the tax extenders package, which include the IRA charitable rollover as well as enhanced incentives for the donations of food, books, computer equipment, and land conservation easements.

More broadly, as Congress looks toward comprehensive tax reform, we ask you to keep in mind the value of charitable giving to the work of public charities and private foundations, and the important role of tax policy in encouraging that giving. We know that Americans give generously to the causes they care about; we also know that how much and when they give is influenced by incentives in the tax code. There is perhaps no better illustration of this than the fact that more than 22 percent of all annual online charitable donations in the U.S. are made on December 30 and 31,<sup>10</sup> as taxpayers seek to make donations before the deadline to claim a charitable deduction. Millions of lives are improved every day because our tax laws encourage people to give, and I urge you to explore ways to increase the impact of those incentives.

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<sup>6</sup> Elizabeth T. Boris, Erwin de Leon, Katie L. Roeger, and Ileana Nikolova, "Human Service Nonprofits and Government Collaboration: Findings from the 2010 National Survey of Nonprofit Government Contracting and Grants" (Urban Institute, October 2010).

<sup>7</sup> The NonProfit Research Collaborative, *November 2010 Fundraising Survey*, 2010.

<http://www2.guidestar.org/ViewCmsFile.aspx?ContentID=3117>

<sup>8</sup> Catholic Charities USA, 2009 Annual Survey Final Report, 2009.

Center for Applied Research in the Apostolate, Georgetown University, Washington, DC, July 2010.

<http://www.catholiccharitiesusa.org/NetCommunity/Document.Doc?id=2392>

<sup>9</sup> Giving USA 2011, The Annual Report on Philanthropy for the Year 2010

<sup>10</sup> "[Online Giving Study: Donations Driven by Donor Experience, Year-End Gifts and Large-Scale Disasters.](#)" Network for Good and True Sense Marketing, Dec. 2010

As the Committee looks ahead and prepares for tax reform, it may also be instructive to look back to the Tariff Act of 1894, which first exempted from federal income tax organizations operated for charitable purposes, and the Revenue Act of 1917, which first made donations to charitable organizations tax deductible. In both instances, Congress embraced the entire range of social purposes and important causes that citizens – individually or collectively – might choose to pursue through charitable organizations. Whether focused on the arts, social services, scientific research, or spiritual matters, this great American tradition has sparked innovation, saved lives, and enriched our communities. Through the wisdom of these decisions, Congress established century-old policies that have stimulated charitable giving, and made it clear that our government and our society value the contributions made by every charitable organization.

### **Good Governance: Importance and Background**

Charitable nonprofit organizations understand that continued support from Americans who give of their time and money depends upon the high level of public trust in our sector, and that erosion of that trust will ultimately harm those we serve. We are therefore deeply committed to ensuring that public charities and private foundations are governed effectively and transparently, maintain maximum accountability, demonstrate the highest levels of ethical conduct, and fully comply with the law.

Independent Sector has long been at the forefront of efforts to promote good governance and ethical practice among tax-exempt charitable organizations. In October 2004, we convened the Panel on the Nonprofit Sector with the written encouragement of Congressional leaders of both parties. The Panel undertook a comprehensive review of governance and other aspects of charitable sector practice in order to develop recommendations for action by Congress, the IRS, and the sector itself that would help charitable organizations maintain the highest possible standards of ethical conduct.

The 24-member Panel conducted extensive outreach to solicit input and comments from the broader charitable community. This outreach included the creation of six committees<sup>11</sup> that met regularly; phone calls with thousands of participants; two public comment periods; and 15 field hearings that gave more than 2,500 people in communities ranging from Des Moines to Dallas the opportunity to provide input on the Panel's work. The Panel ultimately issued a *Final Report to Congress and the Nonprofit Sector* in June 2005, which contained an integrated package of more than 120 recommendations for improvements within the sector, more effective government oversight, and changes in the law.

The Panel's Advisory Committee on Self-Regulation was charged with examining the state of self-regulation in the nonprofit community and recommending improvements. In its earliest deliberations, the Committee agreed that self-regulation was necessary for our community to encourage strong governance, financial oversight, and accountability. A number of the Panel's final recommendations, as well as the subsequent *Principles for Good Governance and Ethical Practice*,

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<sup>11</sup> Expert Advisory Group, Governance and Fiduciary Responsibilities Work Group, Government Oversight and Self-Regulation Work Group, Legal Framework Work Group, Transparency and Financial Accountability Work Group, and Small Organizations Work Group.

focused on steps exempt organizations could take to improve their own accountability, transparency, and ethical standards.

These Panel recommendations for improved self-regulation included:

- Board review of the Form 990 prior to filing, as well as periodic board review of governing instruments, financial transactions and compensation policies;
- Board approval of CEO compensation;
- Disclosure of donor advised funds owned;
- Adoption of policies governing travel reimbursement, and a prohibition on reimbursement for spouses, dependents, or others travelling with a board member;
- Adoption of conflict of interest policies and whistleblower protections; and
- Discouraging the compensation of board members.

Many of the Panel's legislative and regulatory recommendations were incorporated into the Pension Protection Act of 2006, widely considered to be the most comprehensive reform of the charitable sector since the 1969 Tax Reform Act. Among the key Panel recommendations adopted by Congress were:

- Doubling the excise taxes for charities, social welfare organizations, private foundations, and exempt organization managers found to be participating in abusive tax shelters;
- Requiring exempt organizations with annual gross receipts less than \$25,000 to file an annual notice with the IRS containing basic contact and financial information;
- Clarifying that assets in donor advised funds may not be used in ways that confer substantial benefits on donor/advisors;
- Removing barriers that prevent information sharing between state charity officials and the IRS; and
- Improving the appraisal process to ensure more accurate deductions for donated property.

Additionally, Panel recommendations were an important part of the nonprofit community's input into the major redesign of the Form 990 subsequently undertaken by the IRS. The IRS worked closely with Independent Sector and conducted extensive outreach to members of the charitable community during the redesign process. Panel recommendations that were ultimately adopted by the IRS or incorporated in the Form 990 redesign included:

- The mandatory revocation of exempt status for organizations that fail to file an appropriate Form 990 for three consecutive years;
- Expanded Form 990 compensation reporting, to include listing names and reporting compensation for the organization's five most highly compensated employees;
- Requiring additional information, including a summary and statement of purpose on the first page, disclosure of which voting board members are independent, and disclosing the total amount of donor advised funds; and
- Asking whether an organization has a written conflict of interest policy.

The IRS's solicitation of input from the tax exempt sector on the Form 990 redesign did not end with the release of the new form for tax year 2008, which had been designed with substantial

input from the charitable community. Indeed, as the IRS has continued working to improve the Form 990, the agency has continued to seek outside input. During a public comment period last summer on several issues of concern that had come to the attention of the agency, Independent Sector conducted an online forum to gather input from exempt organizations, and we ultimately submitted a number of specific recommendations to the IRS, including:

- Revising Part VIII of the Form 990 to better capture the full extent of government revenue received by nonprofit organizations by clarifying that government pay-for-service contracts also qualify as government contributions, and by including lines to record revenue received from Medicaid and Medicare payments;
- Adding lines to the Form 990 to inquire whether audited financial statements are made available to the public, and whether the audit includes an unqualified, qualified, adverse, or disclaimer of opinion; and
- Expanding mandatory electronic filing of the Form 990 to include more organizations.

With respect to the last recommendation, currently only about 30 percent of charitable organizations take advantage of the option to file the Form 990 electronically. While we support expanding the scope of organizations that are required to file electronically, we also believe that more can and should be done to encourage electronic filing. To that end, a group of charitable organizations, led by the National Center for Charitable Statistics at the Urban Institute and joined by Independent Sector, has initiated an effort to better understand and overcome the barriers to filing electronically, and to look for ways to encourage or incentivize additional electronic filing. We believe that increased electronic filing will improve the quality and accuracy of the data available to the public and for IRS and state regulatory purposes. This will further promote accountability and transparency by exempt organizations, and in the long run save donors, nonprofits and the government time and money.

We also see great value in encouraging the IRS to continue to review Form 990 requirements to determine whether particular items are necessary and add value, and look forward to similar initiatives with regard to the Form 990PF, which private foundations must file.

As a publicly accessible document, the Form 990 has become an increasingly important tool for volunteers and donors to determine the accountability and transparency of charitable organizations they may wish to support. Indeed, the form is also used by organizations that assess and rank public charities based on their governance policies, stewardship of assets and ethical practices. It is therefore not surprising that we are keenly interested in not only ensuring that the form collects the most useful information possible, but also that the process for compliance by exempt organizations and subsequent use of collected data by the government and the American public is as effective and efficient as possible.

The charitable sector's deep commitment to accountability, transparency and good governance stems from an understanding that doing so enhances our effectiveness and ultimately improves our ability to better serve individuals, families and communities. In that spirit, Independent Sector, in partnership with GuideStar and BBB Wise Giving Alliance, has led the development of Charting Impact, an important tool that encourages nonprofit organizations to engage in reflection, learning, and communication about what matters the most – results.

## The Current Environment: Government Oversight of Exempt Organization Governance

The IRS has already begun to use data from the revised Form 990 to develop risk models and guide the development of its annual work plans. One example that may be of particular interest to the Subcommittee is a recent effort to test the proposition that good governance leads to better tax law compliance. The IRS designed a “governance check sheet” that reflects the 26 governance questions on the Form 990. According to IRS officials, this check sheet has been completed by IRS agents at the end of every 501(c)(3) public charity examination since October 2009 – more than 1,300 exams.

At the fifth annual *Issues in Nonprofit Governance* conference, held last month and cosponsored by Independent Sector, the IRS, and Georgetown University, IRS Exempt Organizations Division Director Lois Lemer reported that a preliminary analysis of the data shows a statistically significant positive correlation between a number of governance practices and tax compliance. Specifically, they reported finding that tax compliance is higher among organizations that:

- Have a written mission statement;
- Always use comparability data when making compensation decisions;
- Have procedures in place for the proper use of charitable assets; and
- Distribute their Form 990 for review by the entire board of directors prior to filing.

Conversely, the analysis showed that organizations in which control is concentrated in one individual or a small, select group of individuals are less likely to be compliant. The IRS also found no correlation between tax compliance and certain other governance practices, including the adoption of conflict of interest policies or whether voting board members have a family and/or outside business relationship with any other director, officer, trustee or key employee of the organization. (It is important to note that while these specific practices may not have been found to impact an organization’s tax compliance, they are still vital governance tools that promote greater transparency, accountability and ethical conduct, and we continue to urge their adoption by charitable exempt organizations.)

Lois Lemer further reported that the IRS intends to verify these initial findings with a statistically representative sample of exempt organizations, which will provide a better understanding of the most useful governance questions to include on the Form 990, while also supporting continued compliance by exempt organizations.

## The Current Environment: Sector Commitment to Good Governance

The majority of America’s 1.3 million charitable organizations are, and always have been, responsible, ethical and accountable in the conduct of their programs and the management of their assets.<sup>12</sup> The public entrusted us with more than \$290 billion in direct charitable contributions in

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<sup>12</sup> In a study of malfeasance by charitable fiduciaries, it was found that between 1995 and 2002, fiduciaries at only 152 organizations – out of a possible 1.4 million – were accused of civil or criminal wrongdoing. Marion R. Fremont-Smith and Andras Kosaras, *Wrongdoing by Officers and Directors Charities: A Survey by Press Reports, 1995-2002*

2010,<sup>13</sup> with individuals giving over \$234 billion while the nation's private foundations and corporate giving programs provided \$56 billion to support charitable endeavors.<sup>14</sup>

We are always mindful of the need to earn and protect the public trust, and to that end, the Panel on the Nonprofit Sector also issued *The Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations*, which outlined 33 principles for self-regulation, grouped into four categories:

- Legal compliance and public disclosure;
- Effective governance;
- Strong financial oversight; and
- Responsible fundraising practices.

To date, more than 184,000 copies of the Principles have been downloaded from the Independent Sector website by charitable organizations and the experts who advise them, and in 2011, Independent Sector launched an online Resource Center for Good Governance and Ethical Practice. Built around the Principles, our online resource center includes a comprehensive collection of tools for charitable and philanthropic organizations to help them enhance the accountability and transparency of their operations and ensure that they operate ethically.

Nonprofit charitable organizations have used the Principles to guide their strategic planning, develop key internal governance policies, institute new procedures, adjust board roles and responsibilities, and hire additional staff. In a recent Independent Sector survey of organizations who reported using the Principles, many noted their value as a tool to engage and educate board members on matters of compliance and transparency, thereby instilling confidence in and commitment to the organization's operations.

We have also learned that nonprofit organizations are using the Principles to develop and instill key core values throughout their organizations and associated members. The Y, for example, has developed for its national network of 20,000 full-time employees and 500,000 volunteers five best practices, focused on the philanthropic and strategic leadership of the board, strengthening board structure and composition, evaluating board effectiveness, meeting regulatory and legal compliance standards, and providing strong financial oversight. Similarly, the Land Trust Alliance has used the Principles to establish standards and an accreditation program for its 1,700 member affiliates.

Taken together, the actions outlined throughout my testimony – legislative, regulatory and voluntary – have strengthened governance and improved the oversight of exempt organizations. And perhaps most importantly they have helped our sector to maintain the public trust. Indeed, at a time when public trust in government and for-profit institutions has reached an all-time low, among people who give to and volunteer in the nonprofit sector – people who should know best

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<sup>13</sup> The Center on Philanthropy at Indiana University, *Giving USA 2011: The Annual Report on Philanthropy for the Year 2010*, Giving USA Foundation, 2011. <http://www.givingusareports.org/free.php>

<sup>14</sup> Ibid

– the perception that the sector is honest and ethical increased seven percentage points between 2006 and 2011.<sup>15</sup>

The progress we have seen, and the resulting continued public support for our sector, reflects a deep mutual commitment – on the part of Congress, the IRS, state charity oversight officials, and charitable nonprofit organizations – to accountability, transparency, and good governance. The progress also underscores our collective determination to preserve an environment in which lawful, ethical, and accountable nonprofit organizations can continue to serve and enrich our communities.

As the Subcommittee works to provide oversight of America's tax-exempt organizations, we look forward to an open dialogue with you, and also to serving as a resource for the Members and staff of the Subcommittee. We will also continue working to educate lawmakers and their staff about the contributions nonprofit organizations make to communities every day, and the impact of proposed policies on our ability to continue making those contributions.

Mr. Boustany and Mr. Lewis, I once again thank you for the opportunity to share these perspectives with you today, and I look forward to answering any questions the Subcommittee may have.

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<sup>15</sup> Harris Interactive, Donor Pulse poll. 2011.