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Now's the Time to Push for Changes in How Foundations Operate

By Pablo Eisenberg

The downturn in the economy and the budget troubles of nonprofit groups have made it painfully clear that many of the problems that have long plagued the foundation world have not yet been solved.

In these troubled times, it is important for nonprofit groups, enlightened foundation executives, and members of the Obama administration and the public to push for needed changes in a more comprehensive manner.

To improve foundation responsiveness to today's needs will take legislative and regulatory changes, as well as efforts by foundations themselves to improve their performance. Here's a list of what I believe should be on the agenda, starting with those that should be imposed by government and state officials:

- Increase the minimum amount foundations must distribute annually. Federal rules that require foundations to give 5 percent of their net investment returns have not been changed for almost two decades, despite the enormous increase in foundation assets. Moreover, foundations are allowed to include all administrative and operating costs, including trustee fees, as part of the distribution calculation, thereby substantially reducing the actual amount provided to charities. As a result, taxpayers are cheated by foundation donors who have received enormous tax benefits for their contributions.

  Congress should require foundations to give at least 6 percent of their assets to charities annually in the form of grants. That change could add at least $8-billion a year to the coffers of nonprofit groups.

- Abolish or tightly limit trustee fees for foundation board members.

  Foundations probably spend $300-million on fees to their trustees each year. That means money that could go into grants is instead put into the hands of people who, for the most part, are among the wealthiest people in the country. Those fees should be abolished or, at a minimum, limited to payments that allow low-income or working-class trustees to devote their time to foundation business.

- Eliminate the loophole in federal regulations that permit foundation officials to realize a financial gain from their insider roles.

  Internal Revenue Service rules prohibit "self-dealing," but nevertheless permit trustees and foundation managers to receive compensation not just for their board and managerial duties, but...
also for providing legal, accounting, and other professional services to the foundation that are "reasonable, necessary and not excessive." Many abuses result from the fact that all kinds of self-gain are not prohibited. Legal, accounting, consulting, and investment services, as well as many of the other services handled by foundation trustees, should be provided by outsiders.

- Limit the maximum size of foundations. The growth of mega-foundations like the Bill & Melinda Gates Foundation pose a danger to democracy. With trillions of dollars projected to be transferred from superwealthy Americans to foundations and charities in the next three decades, many new foundations could have assets larger than the budgets of all but the biggest countries in the world and might be run by two or three family members. Huge amounts of money — billions of dollars — will be distributed without any public discussion or political process, and without any public accountability.

A legislative limit — say $15 billion — should be placed on the size of new large foundations, while existing giants like Gates would be given 15 to 20 years to reduce their size or spin off a portion of their assets into one or more new foundations.

- Require family foundations to shut down within a specific period of time if they do not add outsiders to their boards.

Family foundations should be required to develop boards with at least five members, a majority composed of people who are not family members, or their retainers and advisers. Foundations that refuse to expand their boards would be required to close within 15 to 20 years of their creation.

Small boards are not sufficiently broad to bring adequate perspectives and points of view to the grant-making process. Nor generally are boards composed solely of family members; such boards often are insular and their grant making focuses primarily on family interests.

- Prohibit foundation executives from sitting on corporate boards. Serving as a corporate board member takes a lot of time and effort, energy that should be devoted to the full-time work of running a foundation. In some cases, corporate products and policies may be closely aligned with a foundation's priorities, thereby creating a conflict of interest. In others, corporate practices may conflict with foundation investment policies.

Foundation executives already earn substantial salaries; they do not need to augment their earnings with corporate trustee fees.

- Require all private foundations to pay a flat excise fee of 1 percent on their net investment returns. A uniform rate should be levied on the investment returns of private foundations, instead of the complex variable rate they now pay. The money produced by this tax should be dedicated to the Internal Revenue Service’s efforts to provide oversight of nonprofit organizations and to enforce laws that govern such groups.

- Give the IRS and state attorneys general adequate resources to effectively oversee both foundations and charitable organizations.

The IRS has had neither the will nor the resources to do a competent job of regulating foundations, not to mention other nonprofit groups. Congress not only should provide additional resources so that the tax-exempt division of the IRS can properly do its job, but also should make it clear that the agency is expected to enforce accountability and ethical practices.
Congress should also allocate a substantial sum of money to the states so that their nonprofit regulatory offices, starved for money, can competently complement the federal government in regulating foundations and nonprofit groups. All barriers to the sharing of information between the IRS and the state attorneys general should be eliminated.

- Make federal data about all foundations and their grant making available to the public at no charge.

Grant seekers and others who want information about grant makers now have to pay fees to get it.

To remedy this, the IRS should make all data about foundations available free through GuideStar and other online sites.

- Prohibit foundations from forbidding grantees to lobby. The law permits nonprofit groups to undertake a limited amount of lobbying. Some foundations, however, still include in their grant agreements a requirement that grantees not use any of their general-support money for lobbying. This is against the spirit of federal law that permits charities to lobby.

Foundations typically reject any effort to add new regulations, and suggest that they can regulate themselves.

Rarely has action followed the rhetoric. Now may be the time for foundations to overcome their inertia. Here are some ideas foundations should pursue to demonstrate they understand the need to change:

- Provide 50 percent of all grants in the form of general operating support and earmark another 25 percent for public-policy and advocacy activities.

The overwhelming majority of nonprofit organizations say that general-support money is their highest priority and what enables them to retain top staff members and become strong organizations.

In many cases, advocacy provides more bang for the buck than direct services and other programs.

Advocacy efforts help charities meet the needs of their clients and constituencies and is an important tool for nonprofit groups that seek to keep both government institutions and businesses publicly accountable.

- Make grants throughout the year, not just at a few specific times. Foundations routinely grant money only two to four times a year, generally approving money only when their boards meet. That timetable, however, often doesn’t meet the needs of nonprofit groups. Why should the procedures of grant makers trump the requirements of nonprofit groups that do the actual work? Such rolling deadlines have already been adopted by several foundations.

- Make the foundation’s mission a key element in deciding how to invest the foundation’s assets. The $600-billion or more that foundations hold in their investments could make a huge difference in setting corporate priorities.

At least 10 percent of a foundation’s assets should be dedicated to mission-related investments.

- Provide sabbaticals to program officers. Only the rare foundation routinely provides sabbaticals for its program officers. Not only are sabbaticals an effective way to regenerate
staff energies, enthusiasm, and loyalty, they could also be an opportunity for program officers to experience life among nonprofit groups, even their grantees. Too often, foundation executives have lost touch with what it means to work at a nonprofit group, and some have never even worked for a charity.

In addition to such conventional sabbaticals, foundations might find it useful to include a three-month residence at a nonprofit group as a requirement for a new program officer’s first year in office.

- Operate frequent training sessions for foundation executives. The Council on Foundations used to hold one or two annual training sessions for new program officers. Those sessions focused much, if not most, of their attention on the relationship of foundations to grantees. Nonprofit executives played a prominent role, both in formal speeches and by participating in discussions.

  There were healthy and productive exchanges, sometimes sharp, between foundation representatives and nonprofit officials. Both sides received a good education.

  In recent years such training sessions have been few and far between, rarely geared to spirited discussions with people from outside the foundation world.

- Create an ombudsman organization for foundations. There is no place today where grantees or would-be grantees can go to complain about the way they have been treated by foundations. Nor is there an institution to which foundation personnel can voice concerns about grantees, colleagues, and foundation practices.

  The creation of an independent ombudsman organization financed by foundations but governed by a board composed of foundation representatives, nonprofit executives, and academics could serve as such a place. Partly a center to receive, investigate, and resolve complaints and problems, partly an institute to tackle ethical issues in philanthropy, and partly an organization to start an effort by foundations and nonprofit groups to improve their relationships, the ombudsman could serve as a means to reduce tensions between donors and grant recipients and to improve practices on both sides.

- Build career ladders for young people interested in devoting most of their lives to philanthropy. Many of the best young people are leaving the foundation world, discouraged about their prospects for a foundation career, troubled by the indifferent treatment they have received by their bosses, and dismayed by the lack of change in the way foundations conduct their business.

  Currently, few program officers stand a chance of heading a small or mid-sized foundation let alone a large institution, regardless of their merits. The selection process for such positions through search firms almost guarantees that only certified, well known, and safe candidates will be chosen.

  To offset this process, a national clearinghouse for both open foundation positions and potential candidates should be established, making it possible for program officers, especially young ones, to know what is available.

  Outstanding program officers should be encouraged by their
bosses to apply for these positions. For their part, foundation boards should periodically review with their CEO’s how their foundations have done in recruiting and promoting young program personnel.

- Schedule regular staff meetings with nonprofit representatives. Too many foundations don’t meet regularly with either grantees or other nonprofit representatives. Such meetings would educate foundation staff members about developments and problems both locally and nationally. This discourse would be helpful in setting foundation priorities, and it would give the public a better idea of foundations’ programs and activities.

An open meeting once a year could be one way for foundations to reach out to the people they service, and in the process receive useful ideas and recommendations for change.

- Foundations should respond to all proposals they received.

Many nonprofit groups never receive a response to a proposal they have submitted to a foundation. A prompt response to a proposal should be the minimum reply by a foundation, either declining the request or explaining the process for consideration. In cases in which the proposal is turned down, a reason should be given for the decision.

With the advent of a new presidential administration and the collapse of the nation’s financial institutions, now is a good time to think about the future of foundations. Taxpayers subsidize a substantial part of foundations’ efforts. They should get their money's worth.

_Pablo Eisenberg, a regular contributor to these pages, is a senior fellow at the Georgetown Public Policy Institute. His e-mail address is pseisenberg@verizon.net_