

Panel on the Nonprofit Sector

Convened by INDEPENDENT SECTOR

Work Group Recommendations to the Panel on the Nonprofit Sector Posted for Public Comment January 24, 2005

#21: Compliance Requirements for Small Organizations

I. Small Organizations Work Group Recommendations

A. Statement of Problem

Demonstrations of compliance with legal requirements and sector standards for accountability that may be appropriate for large charitable organizations can place significant and sometimes unreasonable time and financial burdens on smaller organizations. Yet smaller organizations are equally concerned about confirming to the public that they adhere to high standards of ethics and accountability. The challenge is to institute compliance measures that are appropriate to the scale of the organization without granting unconditional exemptions.

B. Recommendations

All charitable organizations, regardless of size, should be held to the same standards of accountability and ethical conduct, but methods for demonstrating compliance should be commensurate with the size and scale of the organization.

Legal reporting requirements, such as the filing of annual information returns, should reflect the size and complexity of individual organizations, as the Form 990 and 990-EZ currently do. Any new reporting requirements to be recommended by the Panel or enacted by Congress should provide appropriate modifications for the size and scale of the reporting organization.

Voluntary standards for “best practices” should also provide alternative measures for smaller charitable organizations to demonstrate compliance.

Education and technical assistance must be easily available on an affordable or free basis to ensure that smaller charitable organizations are knowledgeable about and able to comply with legal requirements and with voluntary standards for “best practices.”

Note: These recommendations have not yet been reviewed by the Panel on the Nonprofit Sector. They will be part of the deliberations by the Panel as it prepares its interim report.

C. Rationale

The Work Group believes that all organizations should be expected to operate in the same ethical manner and be worthy stewards of the public resources entrusted to them. Fraud or abuse should not be condoned in any organization, regardless of the financial amounts involved. A breach of the public trust by any organization, large or small, results in damage to the reputation of the entire sector.

There are, however, varying methods that may be used to demonstrate accountability to regulators and the public. In addition, federal and state enforcement abilities are limited, as are educational opportunities and technical assistance, including accounting and legal professional advice, for small organizations that often lack such capacities internally. Thus, the Work Group recommends that small organizations only be legally required to demonstrate their compliance with standards of ethical and accountable operation in ways that are proportionate to their capacity (including human, technical and financial resources) and only if the benefits gained by such demonstration (by regulators, the public and the organization itself) outweigh the costs to the organization.

Further, setting or raising standards alone will be ineffective in increasing the use of best practices (or deterring poor practices) if organizations are ignorant of, or lack the capacity to efficiently comply with, the appropriate standards. For many small organizations, the most effective way to increase best practice utilization is through the provision of education and technical assistance, thereby building the organization's knowledge of and ability to comply with the standards. With appropriate educational and technical assistance, as an organization grows in complexity and resources, its ability to comply with increasingly demanding standards should also grow.

D. Other Considerations

The Work Group feels it is important to raise the issue of costs and benefits in considering new reporting requirements for charitable organizations, suggesting that scarce enforcement resources should be targeted to protecting the bulk of charitable assets. This is not intended to send any signal that small abuses are acceptable since small organizations must be held to the same standards of ethics and accountability as other organizations. The Work Group further noted that it is important to review data on the patterns of risk and abuse relative to organization size. In Phase II of the Panel process, the Work Group will analyze specific proposals and recommendations for developing both legal requirements and voluntary standards to improve the governance and oversight of smaller charitable organizations.

II. Expert Advisory Group Comments

The Expert Advisory Group concurs that small charitable organizations, which comprise the bulk of the charitable nonprofit sector, provide significant benefits in bringing together individuals to address community issues and needs and to develop innovative solutions to broader societal problems. The Expert Advisory Group further concurs that in making its recommendations, the Panel should consider thresholds for legal requirements that reflect the costs of compliance and enforcement relative to the size of the organization and other aspects of an organization's purpose and function. For example, small family foundations serve an important function by involving family members in the philanthropic process, which could be eroded by requiring independent board members.