BBB WISE GIVING ALLIANCE ADOPTS STANDARDS FOR CHARITABLE ACCOUNTABILITY

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In 2001, the BBB Wise Giving Alliance (the "Alliance") was formed as a result of the merger of the National Charities Information Bureau ("NCIB") and the Council of Better Business Bureau's Foundation and its Philanthropic Advisory Service ("CBBB"). Shortly after the merger, the Alliance undertook revision of voluntary standards for charitable solicitations to merge the previously disparate standards of the NCIB and CBBB. As a result of that undertaking, the Alliance recently issued its new *Standards for Charitable Accountability* (the "Standards") which will apply to publicly soliciting organizations that are exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended, and to other organizations conducting charitable solicitations. The Standards are not intended, however, to apply to private foundations, which typically do not solicit contributions from the public.

The Alliance and its local Better Business Bureaus are using the Standards as the basis for their evaluations of national and local charities. To explain how the Alliance and its local bureaus will interpret the Standards, the Alliance has created the *Implementation Guide to the BBB Wise Giving Alliance Standards for Charitable Accountability*[1] (the "Implementation Guide"). Most of the Standards were applied to evaluations conducted by the Alliance and its local bureaus beginning on or after March 3, 2003. However, several Standards that may require time to implement, such as scheduling additional board meetings, instituting new board procedures, adding information to websites, and addressing privacy concerns, will be effective March 3, 2004.[2]

For charities that it has evaluated, the Alliance issues a "Charity Report" which indicates whether or not that charity meets the Standards. These reports are available on the Alliance's website and summarized by the Chronicle of Philanthropy and elsewhere. In the past, charities

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1 The Standards and the Implementation Guide can be found on the Alliance's website at www. give.org.

2 The Implementation Guide specifies which Standards became effective on March 3, 2003 and which will become effective on March 3, 2004.

that met all of the NCIB or CBBB standards were not allowed to publicize their approval by these groups when soliciting funds. Now, if a charity meets the Standards, it will be permitted to use the "Wise Giving Seal" in direct-mail appeals, print and billboard advertisements, annual reports, posters, television public-service announcements and websites. Charities will be required to pay an annual fee for use of the Wise Giving Seal.[3] The seal program is expected to begin in mid-2003 and is intended to provide potential donors with notice that a particular charity meets the Standards.

To promote full disclosure to donors and potential donors, the Standards focus primarily on a charity's governance, effectiveness, finances, fund raising and informational materials. In general, the Standards revise or expand former NCIB and CBBB standards. The Standards also introduce new requirements for fund raising and informational materials that address issues such as the protection of donor privacy and the accuracy of a charity's representations to the public.

This memorandum highlights those Standards that may have significant effects on current governance, financial and solicitation practices of charities.

GOVERNANCE AND OVERSIGHT

To ensure that governing boards of charities are active, independent and free from self-dealing, the Standards require a charity to have:

1. **A board of directors that provides adequate oversight of the charity's operations and its staff.**

2. **A board of directors with a minimum of five voting members.**

3. **A minimum of three evenly spaced meetings per year of the full governing body with a majority in attendance, with face-to-face participation.**

4. **Not more than one or 10% (whichever is greater) directly or indirectly compensated person(s) serving as voting member(s) of the board. Compensated members shall not serve as the board's chair or treasurer.**

5. **No transaction(s) in which any board or staff members have <u>material</u> conflicting interests with the charity resulting from any relationship or business affiliation.**

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[3] Grant Williams, *Charity Watchdog Group Offers Seal of Approval; Revises Standards*, Chronicle of Philanthropy, March 20, 2003 at 53. The annual fee will be calculated according to a sliding scale based on an organization's annual contribution revenue. The Alliance intends to require a charity with $1 million in revenue to pay $1,000; a charity with more than $100 million in revenue will probably pay $15,000.

For charities that maintain board seats for employees of affiliated organizations, Standard 4 imposes greater restrictions than either the NCIB or CBBB standards did on the number of board seats that can be held by paid staff members of affiliated organizations.[4] The Alliance, has determined, however, that voting members of the board who are paid staff members of affiliated organizations are considered to be directly compensated only if generally accepted accounting principles (GAAP) require the affiliated organizations to have "combined" audited financial statements.[5] This interpretation of Standard 4 allows qualifying federated and constituent charities the flexibility to add or maintain board seats for employees of affiliated organizations without violating the 10% limitation. "American Friends of" charities that have employees of the foreign charity occupying a minority position on the U.S. charity's board would also benefit from the Alliance's interpretation of this Standard.

In addition to Standard 4's limitation on the number of compensated voting board members, Standard 5 prohibits "transaction(s) in which any board or staff members have material conflicting interests with the charity resulting from any relationship or business affiliation." While the Alliance has preserved the former NCIB and CBBB standards,[6] its Implementation Guide provides more clarification as to what situations will result in a finding of a material conflicting interests transaction. Such circumstances include a charity that conducts substantial transaction(s) with a board member or staff-related firm and takes no steps to ensure arm's length transactions; a transaction that is of such a large amount or is in effect over such a long period of time that it is unlikely that the transaction could qualify as arm's length; or where a number of small related transactions have taken place over the past year and, when combined over that period of time, constitute significant related-party activity.[7]

MEASURING EFFECTIVENESS

The Alliance has adopted new requirements in measuring a charity's effectiveness that were not part of either the NCIB or CBBB standards. These Standards require the charity to:

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4 The NCIB standard required that not more than one paid staff person sit on the board (National Charities Information Bureau, Standards in Philanthropy, 1g), while the CBBB standard allowed compensated persons to occupy no more than 20% of the total voting membership of the board (Council of Better Business Bureaus Foundation and its Philanthropic Advisory Service, Standards for Charitable Solicitations, E3).

5 Alliance, Implementation Guide, Standard 4.

6 CBBB, Standards for Charitable Solicitations, E4; NCIB, Standards in Philanthropy, 1g.

7 Alliance, Implementation Guide, Standard 5.

6. **Have a board policy of assessing, no less than every two years, the organization's performance and effectiveness and of determining future actions required to achieve its mission.**

7. **Submit to the organization's governing body, for its approval, a written report that outlines the results of the aforementioned performance and effectiveness assessment and recommendations for future actions.**

To meet Standard 6, a charity should provide the Alliance with a copy of the charity's board policy that clearly states the board's intention to formally evaluate the charity's success and impact in carrying out its mission, goals and objectives. The charity must also be able to confirm that it is actually carrying out its policies for evaluating its performance and effectiveness by indicating whether it has submitted to its board a written report of the most recent assessment.[8] These reports may be prepared by the charity's staff, a subcommittee of the board, an outside committee of volunteer experts, a paid consultant or any combination of these, as directed by the charity's board. To help charities develop their reports, the Implementation Guide lists certain elements that should be included such as the identification of measurable goals and objectives, descriptions of the charity's activities and recommendations for future actions.[9]

FINANCES

To ensure that a charity spends its funds honestly, prudently and in accordance with statements made in fund raising appeals, the Standards require a charity to:

8. **Spend at least 65% of its total expenses on program activities.**

Formula for Standard 8:

$$\frac{\text{Total Program Service Expenses}}{\text{Total Expenses}} \text{ should be at least 65\%}$$

[8] Id., Standard 7.

[9] Alliance, Implementation Guide, Standard 7.

9. Spend no more than 35% of <u>related</u> contributions (*e.g.*, donations, legacies, and other gifts received as a result of fund raising efforts) on fund raising.

Formula for Standard 9:

$$\frac{\text{Total Fund Raising Expenses}}{\text{Total Related Contributions}} \text{ should be no more than 35\%}$$

Note that Standards 8 and 9 have *different* denominators.

10. Avoid accumulating funds that could be used for current program activities. To meet this Standard, the charity's unrestricted net assets available for use should not be more than three times the size of the past year's expenses or three times the size of the current year's budget, whichever is higher.

11. Make available to all, on request, complete annual financial statements prepared in accordance with generally accepted accounting principles.

12. Include in the financial statements a breakdown of expenses (e.g., salaries, travel, postage, etc.) that shows what portion of these expenses was allocated to program, fund raising, and administrative activities.[10]

13. Accurately report the charity's expenses, including any joint cost allocations, in its financial statements.

14. Have a board-approved annual budget for its current fiscal year, outlining projected expenses for major program activities, fund raising, and administration.

Several of these Standards are more restrictive than either the NCIB or CBBB standards. But a charity that does not meet one or more of the financial measures stated in Standards 8, 9

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10 Such a report should clearly show what portion of the charity's expenses is allocated to program service, fund raising and administrative activities. However, if a charity conducts only one major program activity, the organization's IRS Form 990 would contain the information needed to meet this Standard (Alliance, Implementation Guide, Standard 12).

and 10 may provide evidence to demonstrate that its use of funds is still "reasonable." Certain factors that are likely to result in a finding of reasonable expenditures include higher fund raising and administrative costs of newly created organizations, donor restrictions on the use of funds, exceptional bequests, a stigma associated with a cause, and environmental or political events beyond an organization's control.[11]

While Standard 11 requires that a charity's annual financial statements be presented according to GAAP, it is more flexible than the prior CBBB and NCIB standards. Specifically, how charities must present their financial information will depend on their annual gross income. Charities with a total annual gross income exceeding $250,000 should submit to the Alliance financial statements audited in accordance with GAAP. But charities with an annual gross income of less than $250,000 can submit a review by a certified public accountant. Furthermore, for charities whose annual gross income is less than $100,000, an internally produced, complete financial statement is sufficient.[12]

FUND RAISING AND INFORMATIONAL MATERIALS

The Standards include several new requirements to increase protection of donor privacy and encourage accurate representations in solicitations to the public. To meet these Standards, a charity must:

15. Have solicitations and informational materials, distributed by any means, that are accurate, truthful and not misleading, both in whole and in part.

16. Have an annual report available to all, on request, that includes:

- **a. the organization's mission statement,**
- **b. a summary of the past year's program service accomplishments,**
- **c. a roster of the officers and members of the board of directors,**
- **d. financial information that includes (i) total income in the past fiscal year, (ii) expenses in the same program, fund raising and administrative categories as in the financial statements, and (iii) ending net assets.**

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11 Alliance, Implementation Guide, Standards 8, 9 and 10.

12 Id., Standard 11. Many state charitable solicitation laws and regulations require the submission of audited financial statements. For example, Standard 11 is generally consistent with New York State requirements regarding the filing of audited financial statements by charities that solicit in New York State.

17. **Include on any charity websites that solicit contributions the same information that is recommended for annual reports, as well as the mailing address of the charity and electronic access to its most recent IRS Form 990.**

18. **Address privacy concerns of donors by:**

a. **providing in written appeals, at least annually, a means (e.g., such as a check-off box) for both new and continuing donors to inform the charity if they do not want their name and address shared outside the organization, and**

b. **providing a clear, prominent and easily accessible privacy policy on any of its websites that tells visitors (i) what information, if any, is being collected about them by the charity and how this information will be used, (ii) how to contact the charity to review personal information collected and request corrections, (iii) how to inform the charity (e.g., a check-off box) that the visitor does not wish his/her personal information to be shared outside the organization, and (iv) what security measures the charity has in place to protect personal information.**

19. **Clearly disclose how the charity benefits from the sale of products or services (i.e., cause-related marketing) that state or imply that a charity will benefit from a consumer sale or transaction. Such promotions should disclose, at the point of solicitation:**

a. **the actual or anticipated portion of the purchase price that will benefit the charity (e.g., 5 cents will be contributed to abc charity for every xyz company product sold),**

b. **the duration of the campaign (e.g., the month of October),**

c. **any maximum or guaranteed minimum contribution amount (e.g., up to a maximum of $200,000).**

20. **Respond promptly to and act on complaints brought to its attention by the BBB Wise Giving Alliance and/or local Better Business Bureaus about fund raising practices, privacy policy violations and/or other issues.**

Given the explicit information required by Standard 19, promotional materials merely stating that a charity will receive "proceeds," "profits," "net proceeds" or some other general financial benefit as a result of the sale will not meet the Standard.[13]

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If you have any questions regarding the Standards or would like additional information, please contact Victoria B. Bjorklund (212-455-2875, vbjorklund@stblaw.com), David A. Shevlin (212-455-3682, dshevlin@stblaw.com) or any other member of the Firm's Exempt Organizations Department.

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13 Alliance, Implementation Guide, Standard 19.