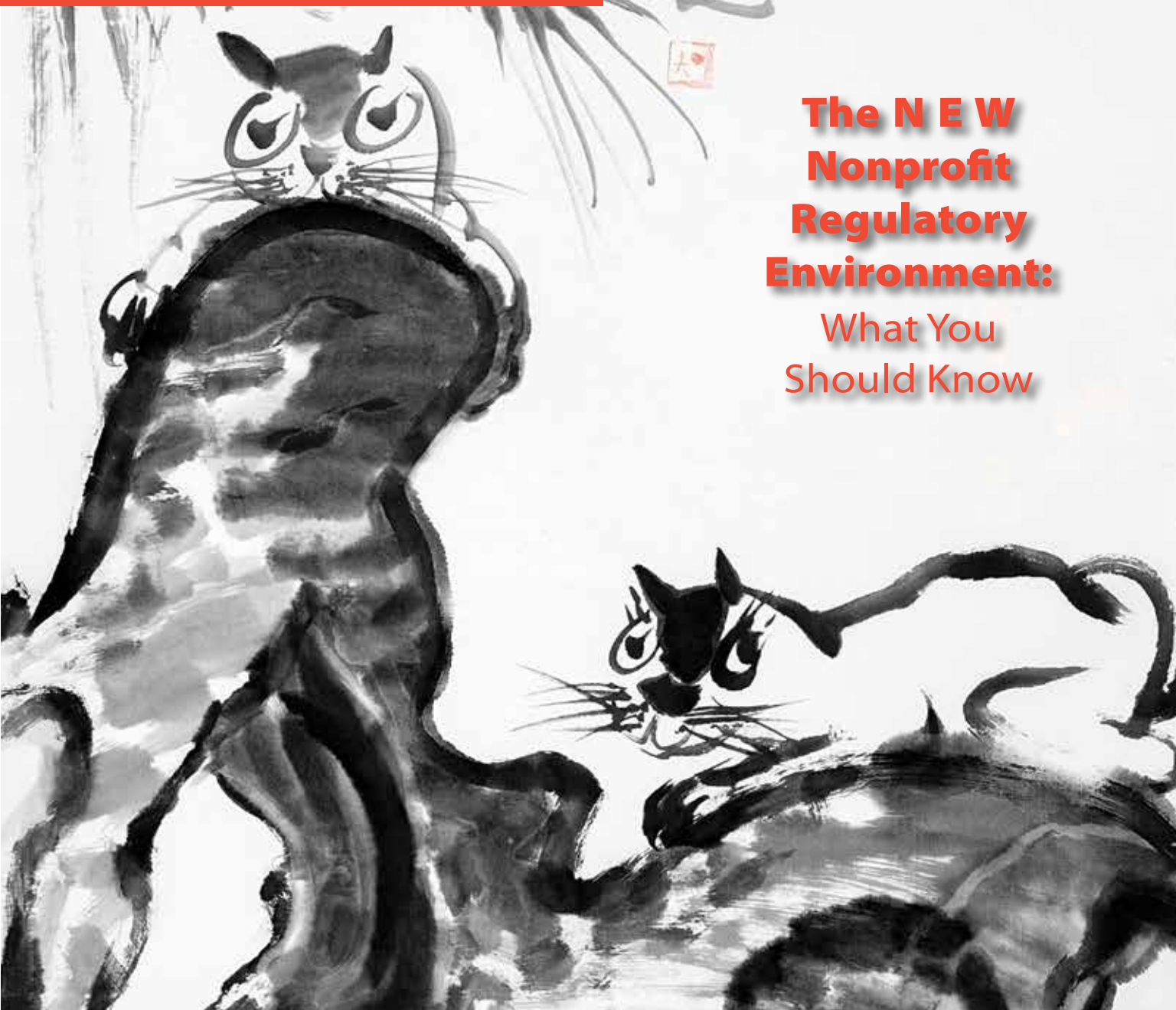


# THE Nonprofit QUARTERLY



## **The N E W Nonprofit Regulatory Environment: What You Should Know**

Pratt *on* Nonprofit Regulation vs. Rights

Lott *on* the Shifting Regulatory Landscape

Gross *on* Major Changes at the IRS



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# Welcome

**D**EAR READERS,  
This edition turns out to have been perfectly timed to coincide with a shift that is occurring in our nonprofit regulatory environment—a shift that Cindy Lott, developer of and lead counsel to the Charities Regulation and Oversight Project for over a decade, first described to us as a dovetailing—with the IRS moving back a bit and the states' regulatory and enforcement mechanisms preparing to become more active both individually and in collaboration. In discussion with the other authors, this description held up, with many complexities embedded in the evolution.

For both the IRS and the states, technology plays a major role in what they will do differently. For the IRS, technology will allow a much more systematic examination of every 990 submitted, removing questions of bias or targeting from reviews, and the flow of new nonprofits may be less impeded as increasing numbers of applicants use the EZ form. In the wake of the Tea Party “brouhaha,” as it has come to be called, there seems to be an overwhelming intention to remove discretion around what kinds of organizations to look at critically in the system. At the same time, all fifty states and the District of Columbia have successfully completed a collaborative suit against a group of cancer charities and are considering how to effect more information sharing and enforcement across state borders, making liberal use of technology. This may involve federal agencies other than the IRS.

The two movements together promise a new landscape—and inasmuch as the states are still evolving their models, it is a great time for nonprofits to get involved and develop a voice about what is and is not important to them. Jon Pratt, director of the Minnesota Council of Nonprofits and *Nonprofit Quarterly* editorial team member, does a great job describing the inherent tensions in this advocacy work: protection of institutions, of free speech, of donors and other stakeholders—all is addressed.

Lloyd Mayer, professor of law at Notre Dame Law School, writes about the growing cooperation of state nonprofit regulators vis-à-vis oversight. Virginia Gross, member of the Exempt Organizations subcommittee of the IRS Advisory Committee on Tax Exempt and Government Entities (ACT), discusses the current state of IRS regulation of exempt organizations. And Mark Sidel, Professor of Law and Public Affairs at the University of Wisconsin-Madison and consultant on Asia at the International Center for Not-for-Profit Law, looks at the use of regulatory systems around the globe—in some cases to restrain and repress civil society and in other cases to facilitate it.

As our cover suggests, it is all a little like herding cats.

We give a special thanks to Cindy Lott—who helped us to conceptualize this edition—as well as to our brilliant editorial committee, for ensuring that we chose the right mix of voices to describe this relatively fluid situation.



# Battlefield History and Status: *First Amendment Tensions* between *Nonprofits* and *Governments*

by Jon Pratt

*Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances.*

—*First Amendment to the Constitution of the United States of America, 1789*

**T**HE DETERIORATION OF THE INTERNAL REVENUE SERVICE'S AUTHORITY OVER EXEMPT ORGANIZATIONS and the wider implications of *Citizens United v. Federal Election Commission* (2010) need to be understood as part of the ongoing tension between government regulation of the financial and political activities of U.S. organizations and their First Amendment rights of speech and association. Struggles over the regulatory frame surrounding nonprofits represent the next chapter in the evolution of the structural definitions of the nonprofit sector. Nonprofits rely upon government authority to provide their structural integrity—a reliable degree of certainty regarding corporate formation, ownership of property, tax treatment, and contract enforcement; but they struggle to maintain their autonomy and range of movement in the face of various government accountability reforms and political pressures. With the end of World War II and the adoption of the Universal Declaration of Human Rights, a worldwide consensus developed that functioning democracies with market economies benefited from a robust set of nonprofit or nongovernmental organizations to provide opportunities for citizens to do things together that they could not do apart. The growth of organizations in over two hundred countries confirms that there is an almost universal interest in forming associations that are larger than friend and family relationships but smaller than the state.<sup>1</sup> However, there is no consensus on how freely these organizations may operate.

Governments generally have an affinity for organizations that promote civic peace—whether through supporting disaster relief, the performing arts, healthcare, or education—but have less patience with those that seek to influence the workings of government, let alone aspire to rule the state. The ability of associations of plain citizens to serve as an intelligent check on the abuses of democratic power assumes a substantial degree of freedom of expression and association. This ability is often unappreciated and periodically suppressed by those in power. Neither Alexis de Tocqueville in *Democracy in America* nor the authors of the *Federalist Papers* felt that these expanding voluntary







associations were a completely positive development for democracy, or that these organizations should have unrestricted freedom. Tocqueville understood that forbidding some types of associations and allowing others would confuse people and inhibit the use of associations but could be justified by the need for order. As he expressed it in *Democracy*:

I certainly do not think that a nation is always in a position to allow its citizens an absolute right of political association, and I even doubt whether there has ever been at any time a nation in which it was wise not to put any limits on the freedom of association.

Tocqueville admitted that there would be a cost to restricting the right of association:

To save a man's life, I can understand cutting off his arm. But I don't want anyone to tell me that he will be as dexterous without it.

In *Federalist 10*, James Madison sought strategies to counteract the inevitable development of factions and special interests dividing the attention and the loyalties of the public. Nevertheless, the First Amendment rights of citizens to peaceably assemble, speak, and petition the government were seen as necessary checks to protect the young democracy against authoritarian regimes.

Periodically in U.S. history, particular types of associations have been defined as threats to the Republic requiring active suppression—including abolitionists, victims of the Palmer raids of 1919–21, labor unions under antiracketeering investigations, Civil Rights and anti-Vietnam war protest groups in the '50s and '60s, and Muslim charities after September 11. Special concerns about the concentrations of power held by large private foundations controlled by wealthy families sparked members of

Congress to enact the Tax Reform Act of 1969, which imposes an excise tax and special restrictions on the use of private foundation funds. The ongoing tension between the economic regulation of nonprofits and the First Amendment rights of people in organizations is now largely overshadowed by the nonprofit sector's high rate of economic activity and the location of the federal regulatory structure of nonprofits in the IRS. Because two defining features of charitable organizations are their freedom from the corporate income tax and their ability to receive tax-deductible contributions, charitable organizations are commonly seen as creatures of tax policy, as opposed to expressions of speech and association. Academic explanations for the existence of nonprofits mirror this focus on the economic aspects of organizations, citing "market failure" as a primary cause: When the marketplace fails to provide certain types of goods or services, the last resort is to form an association or nonprofit organization to provide said goods or services.

That the IRS was designated as the primary federal regulatory agency for nonprofits adds to this economic focus, despite the fact that nonprofit corporations generate just a sliver of tax revenue for the federal government—their regulation is a mismatch of the IRS's expertise and attention. (By contrast, in Great Britain, the Charity Commission, not the Department of Inland Revenue, provides oversight of charitable organizations. Most U.S. states locate this responsibility with their attorneys general.) The primary federal report required of nonprofit organizations, IRS Form 990 (Return of Organization Exempt From Income Tax) is termed an "information return," not a tax return, and has evolved to be both a primary enforcement vehicle and an awkward public disclosure and education tool.

The tax exemption (from corporate income tax, state sales tax, and local property taxes) and eligibility for tax deductible gifts convey a significant economic benefit to the recipient organizations, and are a major explanation for why charitable organizations in English-speaking countries comprise a larger segment of the economy than in other developed countries. The power to tax (or not to tax) is well understood to include the power to regulate, so the U.S. Internal Revenue Code has reserved the best financial incentives for organizations that accept the greatest restrictions (including restrictions and expenditure limits on some types of speech, such as lobbying and electioneering).

In addition to enforcing tax laws and collecting revenue, state and federal governments focus on financial oversight of nonprofits as part of their interest in protecting consumers (to prevent theft and fraud), and the state attorneys general have broad powers to preserve charitable trusts and assets. When specific problems or well-publicized abuses occur, new laws and regulations are proposed, yet legislators unfamiliar with nonprofit organizations can be prone to overreaching and overregulating (with loud calls that "there oughta be a law!")—sometimes triggering constitutional challenges. According to the National Center for Charitable Statistics, the nonprofit sector has 1.5 million organizations with \$358 billion in charitable contributions and \$905 billion in total revenue. The growth in the number and size of U.S. nonprofit organizations threatens to overwhelm the sector's regulatory framework.<sup>2</sup> During this growth, federal and state policy-makers have sought a parallel increase in regulation.

The structural beginnings of the nonprofit sector are usually traced back to England's Charitable Uses Act of 1601, the full name of which is "An Acte to redress the Mis-employment of Landes,

Goodes, and Stockes of Money heretofore given to Charitable Uses.” The British Parliament passed this law to codify what already existed in common law to prevent charitable assets from being taxed into nonexistence, and legislatures have been adding provisions ever since. In the United States, the adoption of the federal income tax and the desire for a charitable deduction propelled the formalizing of tax-exempt organizations—incorporated and chartered by state government, and made exempt first by the federal government.

The modern dimensions of the non-profit sector have been shaped by five changes to the Internal Revenue Code governing exempt organizations:

- The Revenue Act of 1950 subjected otherwise tax-exempt organizations to the regular corporate tax rate for Unrelated Business Income Tax (UBIT). Concerns about unfair competition from nonprofit organizations owning for-profit enterprises, including New York University’s macaroni company, Mueller Pasta Co., prompted Congress to carve out economic activities by nonprofits that would no longer be exempt (and would be reported on IRS Form 990T).
- The Tax Reform Act of 1969 defined private foundations as a new subset of charitable organizations, with greater restrictions—out of concerns that large foundations lacked accountability: some were benefiting their donors and could sway elections and public debate. The 1969 law included an excise tax on private foundations’ investment earnings, set out “prohibited transactions” with insiders, severely limited grants to individuals, restricted grants for voter registration to grantee organizations active in five states, and prohibited expenditures or grants specifically for lobbying.

- The Tax Reform Act of 1976 clarified lobbying by charitable organizations, defining, specifically, allowable amounts for grassroots and direct lobbying, and creating a special option allowing organizations to spend up to 20 percent of the first \$500,000 in expenditures on lobbying activities. (This amount has not been adjusted for inflation since then; if it had, it would have reached \$2.1 million by 2016.)
- The Intermediate Sanctions legislation of 1996 prohibited excess benefits from being granted to individuals who control tax-exempt organizations. Previously, the IRS’s only penalty for violations was total revocation of exempt status—and, despite publicized abuses, organizations were rarely punished. The 1996 legislation included potential fines against board members and nonprofit managers for excessive compensation violations.

- The American Jobs Creation Act of 2004 included legislation to limit the deduction for vehicles contributed to charity (in response to evidence that taxpayers were overstating the value of their contributions)—projected to save \$3.4 billion.

Simultaneous with increased federal legislation, forty-six states and the District of Columbia have adopted systems requiring charities to register their fundraising activities and file reports on their financial activity, out of a desire to prevent fraudulent charities from victimizing innocent donors.<sup>3</sup> As a result, the regulatory framework that specifically governs nonprofits is half state and half federal—with miscellaneous city and county regulations—in addition to the full range of employment, land use, environmental, postal, and credit regulations that govern every employer, property owner, mailer, and financial entity in the United States.

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The tension between government regulation and organizational speech has played out through a series of Supreme Court cases establishing a moving boundary between permissible regulation and protected speech. Five notable cases help set the limits of government authority over organizations:

- At the height of the civil rights movement's struggle for voting rights in the South, Alabama ordered the National Association for the Advancement of Colored People (NAACP) to disclose the names of all its members in the state. In *NAACP v. Alabama* (1958), the Supreme Court found that the state of Alabama violated the First and Fourteenth Amendment rights of NAACP members, because "freedom to engage in association for the advancement of beliefs and ideas is an inseparable aspect of the 'liberty' assured by the Due Process Clause of the Fourteenth Amendment, which embraces freedom of speech," and that it was "immaterial whether the beliefs sought to be advanced by association pertain to political, economic, religious or cultural matters, and state action which may have the effect of curtailing the freedom to associate is subject to the closest scrutiny."<sup>74</sup>
- In suburban Chicago, the Village of Schaumburg adopted a municipal ordinance requiring 75 percent of an organization's revenues be expended for "charitable purposes" as a condition for a solicitation permit. This was a condition that Citizens for a Better Environment, an environmental group with a door-to-door canvass, could not meet. In *Village of Schaumburg v. Citizens for a Better Environment* (1980), the Supreme Court nullified the ordinance (and similar state laws around the country that restricted charitable organizations to specific efficiency percentages) and rejected the argument that soliciting contributions was purely

commercial speech, citing previous cases on canvassing by religious and charitable organizations.<sup>5</sup> While the municipality had an interest in protecting its citizens from fraud, its remedy was an overly broad prophylactic measure. Instead, the court's opinion suggested that making information about organizations publicly available was a preferred route. The court's dicta on the benefits of public education could be seen as spurring regulators and watchdog groups to invest resources in educating donors to ask about fundraising and administrative costs, and, ultimately, for charitable organizations to have their IRS 990 forms posted on the Internet at multiple sites, including [www.guidestar.org](http://www.guidestar.org) and [www.eri-nonprofit-salaries.com](http://www.eri-nonprofit-salaries.com)—and ideally also at individual organizations' own websites.

- When government is a major source of nonprofit revenue, the points of control are conditions attached to government subsidies, grants, and contracts, such as the ban on abortion counseling by organizations receiving federal family planning funds. In *Rust v. Sullivan* (1991), the Supreme Court rejected a First Amendment challenge in a 5-4 decision, holding that the restrictions were simply to ensure that appropriated funds were not used for activities, including speech, that were outside the federal program's scope.<sup>6</sup> In the case of tax exemption itself, federal restrictions on charitable organizations' speech were upheld by restricting the amount of organizational resources a nonprofit could expend on lobbying (*Regan v. Taxation with Representation*, 1983).<sup>7</sup> Veterans' organizations remain free from this restriction.
- In 1991, the attorney general of Illinois sued Telemarketing Associates, a professional fundraiser, alleging fraud and deceptive trade practices.

Prospective donors had been told that a majority of donated funds would benefit Vietnam veterans, though only 15 percent of contributions went to the named charity, VietNow.<sup>8</sup> The lower courts in Illinois supported Telemarketing Associates' request to dismiss the charges on the same grounds as the Schaumburg decision: that charitable solicitation is highly protected speech. The Supreme Court reversed this thinking in *Illinois ex rel. Madigan v. Telemarketing Associates* (2003), ruling that fraudulent charitable speech is not protected and that a narrowly tailored fraud action was an appropriate remedy since the burden of proof for all of the elements of fraud, including intent, would be ample protection for speech by charitable organizations.<sup>9</sup> The ruling strengthened the hand of regulators while affirming that charitable speech must be carefully protected through using narrowly tailored remedies to address a compelling state interest.

- In the 2010 case of *Citizens United v. Federal Election Commission*, the U.S. Supreme Court again addressed the First Amendment rights of a nonprofit corporation, holding in a 5-4 decision that independent political expenditures were protected speech.<sup>10</sup> The headline news of the Citizens United case ended up not being the broader freedom of expression for nonprofits but the surprising outcome that the majority opinion extended that conclusion to for-profit corporations and labor unions, reshaping the political landscape. Writing for the majority, Justice Kennedy declared, "If the First Amendment has any force, it prohibits Congress from fining or jailing citizens, or associations of citizens, for simply engaging in political speech."<sup>11</sup> Ironically, in the ensuing campaign expenditure free-for-all, speech

from regular nonprofit organizations has been overshadowed by a proliferation of new entities—frequently 501(c)(4)s—and opportunistic pop-up political organizations.



With the continued growth of nonprofit financial activity, media reports of abuses, additional pressures on lawmakers from contentious social issues, and the permanent war on terrorism, discussion regarding legitimate versus illegitimate controls on nonprofit activity is likely to continue to grow. The IRS’s regulatory appetite was greatly diminished by revelations that IRS employees were screening new organization exemption applications against code words like “tea party,” “Patriots,” “9/12 Project,” “progressive,” “occupy,” “Israel,” “open source software,” “medical marijuana,” and “occupied territory advocacy.”<sup>12</sup> Under pressure from Republican members of Congress, IRS Exempt Organization Director Lois Lerner invoked the Fifth Amendment and subsequently resigned; the Exempt Organization division has been a lesser presence since that time. Due to the ongoing tensions between nonprofit organizations and government agencies, it is in the best interest of nonprofits to do four things:

- Educate the public about their role as vehicles of free speech and association in our democracy;
- Resist government controls that are aimed at limiting these rights;
- Proactively ensure that reasonable government controls are in place to protect the public’s contributions and organizations from fraud, theft, and insider transactions; and
- Support reasonable campaign finance reforms, so that the voices of plain citizens and plain organizations are not overwhelmed by a political-spending arms race.

**NOTES**

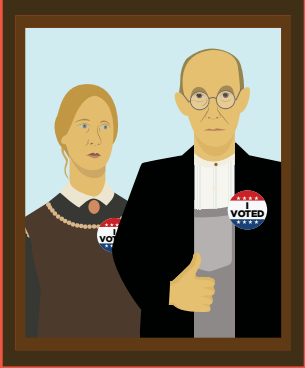
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8. Rick Cohen, “America’s Worst Charities Enriching For-Profit Telemarketers,” *NPQ Newswire*, June 7, 2013, [nonprofitquarterly.org/2013/06/07/america-s-worst-charities-enriching-for-profit-telemarketers/](http://nonprofitquarterly.org/2013/06/07/america-s-worst-charities-enriching-for-profit-telemarketers/).

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**JON PRATT** is the executive director of the Minnesota Council of Nonprofits and a contributing editor to the *Nonprofit Quarterly*.

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# The Shifting Boundaries of Nonprofit Regulation and Enforcement:

## *A Conversation with Cindy M. Lott*

At the federal, state, and local levels, there are distinct challenges to providing reasonable regulation and oversight for nonprofits.

While some states may have more structured and comprehensive regulatory processes, others struggle, leading to unequal monitoring across state lines. But as additional research is undertaken and as the states collaborate with greater ease, we can expect a significant impact from the more widespread use of technology.

**Editors' note:** *In this interview, Cindy M. Lott, who has worked with the state charities regulation and enforcement community for many years and who is now also working with the federal regulators, discusses the overall regulatory landscape of nonprofits. Lott sees a shift occurring at both the state and federal levels, with a new balance in the process of being struck—particularly in light of changing priorities and subsequent resource allocation at both levels of government. She views this shift as a harbinger of further change in the nonprofit sector.*

*Lott approaches the field from various perspectives, as she has held a unique set of positions in her career. She developed and ran the Charities Regulation and Oversight Project at Columbia Law School for over a decade, which focused on state charities officials, and is now developing a new program at the Urban Institute's Center on Nonprofits and Philanthropy that addresses the overall regulatory framework for the charitable sector, state and federal. Lott has been at the intersection of regulators, academics, and practitioners in the nonprofit sector—having served in each of those capacities over the last two decades—and has worked to bring all of them together to make visible regulatory challenges in the field. In addition to her new position as director of nonprofit management programs at Columbia University's School of Professional Studies, she just completed her first term on the IRS Advisory Committee on Tax Exempt and Government Entities (ACT); this year's report, released on June 8, is replete with recommendations—not only for the IRS, but also for the sector as it evolves in its working relationship vis-à-vis regulators.<sup>1</sup>*





Much of what is being done vis-à-vis state enforcement is done very quietly in this sector. State officials are not necessarily trying to put an organization out of business or make others doubt its effectiveness; they'd almost always rather help improve it and let it continue on with its mission.

**Ruth McCambridge:** *Cindy, let's talk about what the landscape of nonprofit regulation and enforcement has looked like over the past ten years, because there have been some shifts. We know that regulation may be uneven from one state to another, but the relationship between the states and the IRS has also been changing.*

**Cindy Lott:** Agreed. Some prefatory comments to lay a bit of groundwork for our discussion: First, there exist many misconceptions about charities regulation at the state level, most of which I attribute not only to a lack of empirical data but also to the very nature of state regulation in this field, which is more complex than most sector participants realize.

Second, as a baseline for discussing—and, more important, addressing—improvement in our sector's regulation, we have to recognize that we have a federalist system. No different from other sectors, the layers of regulation in the charitable sector—as well as the intersections of jurisdiction among the states and other federal agencies and local governing bodies—compose a 3-D matrix, if you will. States get to decide on their own what it is that they want to do in terms of regulation and enforcement of nonprofits—and even those priorities and decisions may change with the coming and going of state officials. They have their respective opinions about how many resources they're going to put into nonprofit regulation and how they are deployed and in conjunction with what. I have often said it is not the case that there are states that just don't do regulation and enforcement of nonprofits—but it can certainly look quite different from one state to another.

Much of what is being done vis-à-vis state enforcement is done very quietly in this sector. State officials are not necessarily trying to put an organization out of business or make others doubt its effectiveness; they'd almost always rather help improve it and let it continue on with its mission if there is a low-key way to have that happen.

And therein lies the tension: not everything regulators do is going to become a lawsuit or reach the media—although problems are much more likely to be heard in the media than they are in court. So, as a result, in this sector more than

perhaps other sectors, we don't know the true extent of enforcement.

In research conducted by Columbia University and the Urban Institute's Center on Nonprofits and Philanthropy, we tried to establish a baseline of what state charity offices and regulatory systems look like.<sup>2</sup> One of the things that we asked about were enforcement mechanisms, and we found that the most frequent enforcement mechanisms by far are letters and phone calls to nonprofits from state regulators or enforcers when they think that something may be wrong.

As for how problems are identified, whistle-blower complaints are one of the most frequent ways that state charity offices and other state enforcement mechanisms hear about potential issues, because there are simply never enough resources to be completely proactive in this space. So, our state charities regulators rely on nonprofit staff, board members, donors, the media, and the public to alert regulators as to where there may be an issue.

The hope is always that the problem may be resolved after a few well-directed calls and/or letters to an entity that appears to have compliance issues. Is that a fallible system? Absolutely. Is it easy or even appropriate for a state attorney general or a secretary of state to put all of those instances of inquiries or warnings on their website? Probably not. So the upshot is, we simply don't know the exact statistics on what types of enforcement—and what frequency of that enforcement—are being done state to state. But I can assure you from my years of working with all of the states, D.C., and even the territories—every jurisdiction is doing something.

That said, we definitely have states that tend to have more enforcement and also have more robust regulatory environments than others—and that can mean everything from carefully drawn charitable solicitation laws to actually thinking about adopting parts of uniform or model laws. There are a number of states that have recently revamped their laws, including New York, Delaware, and D.C. This reflects the reality that lately there has been much more going on in the charitable arena at the state level of regulation than in the past. The question for every state



individually is how to build a comprehensive, effective approach to regulation with sometimes quite limited resources.

The states have an amalgam of issues that they have to deal with when we talk about charities law. It involves more than a half-dozen different areas of law—trusts, corporate, solicitations, governance, criminal, antitrust, transactional, conservation easements, etcetera—and that’s why it can be tough for a state office to staff these matters unless you have an entire charities bureau to make sure that you have a comprehensive take on the landscape. For state attorneys general, for example, their bread-and-butter work—and a major priority—is consumer protection. And while there is a whole debate in the field about whether we actually want to view donor dollars as consumer dollars, when you’re looking at the rubric of an enforcement office it may be that the easiest way for state officials to think about deploying resources is to see it as an extension of consumer protection in some ways.

We do have thirteen states that have dedicated charities bureaus, but most states don’t.<sup>3</sup> Those states without dedicated bureaus are pulling skill sets and resources from various parts of their offices and putting them all together depending on what type of case they have. This model is very similar to how law firms used to staff nonprofit or charitable matters until many larger firms introduced formal practice groups for this work.

**RM:** *But it must be hard to keep all of those strands together and advancing unless you have them coordinated out of one place.*

**CL:** Not having a dedicated charities bureau in a state does not mean there isn’t a point person or attorney who serves as the lead on these matters. In fact, this was a major goal of the Charities Regulation and Oversight Project at Columbia Law School over the past decade: to raise awareness within some of the less active and/or resourced states such that every state would build capacity for this work. We also developed resources for states to help them institutionalize their regulatory and enforcement training and outcomes. I think the states have made huge headway on

this and recognize the importance of this sector in a manner that may not always have been the case; just this year, the state attorneys general collectively created a new standing committee on charities regulation and enforcement within the National Association of Attorneys General. In reality, however, the ability to execute regulation and enforcement is a budget issue for each state, so it is best to think about it as recognition plus resources.

Now is a particularly appropriate time for states to take up the two questions of recognizing the importance of the sector within their states and providing resources for regulation and enforcement, as the IRS is going through its own changes on these same two fronts. This will be an interesting discovery process, because the states and the IRS as enforcement sites have existed in parallel universes for a very long time, with a lack of information sharing between the IRS and the states.<sup>4</sup> If there is to be an effective regulatory framework of any sector in a federalist system, the states and the feds have to be able to communicate and execute their respective roles in what I call “interlocking jurisdiction.”

**RM:** *The lack of information sharing between the IRS and the states is legendary.*

**CL:** Well, it certainly has been a one-way valve. The states can always refer a case to the feds, but the feds can’t refer the other direction. What we’re seeing now at the IRS is a greater focus on the tax administration aspect of its role. The audit numbers at the IRS for the exempt organizations area are at an historic low. We are also seeing, with the advent of 1023-EZ, that the IRS has determined itself to be less of a gatekeeping function.<sup>5</sup> And, with its commitment to digitize and make publicly available the information it receives electronically, we are seeing a greater sharing of what information the IRS does collect. Taken together, this means that the IRS may not have as much information on an entity at the beginning of its life cycle, and the entity is likely never to be audited, but whatever information it gives to the IRS will now be in the public domain. Per its commitment of last year, in June of this year the IRS began

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to release digitized Form 990 information it has received from the nonprofit sector. And this is what states must now consider in determining where they will allocate resources for their own data collection from exempt entities, revamping their state laws, and dedicating personnel to educational as well as enforcement efforts.

Now, here comes the shift. While the IRS has reallocated its own resources due to changing priorities, the states happen at the same time to have been working on what is known as the Single Portal Initiative (also called the Single Portal Multi-State Charities Registration project). The goal is to enable a technological platform that will make it easier for the sector to provide information that is required at the state level.<sup>6</sup> In addition, the Single Portal platform will import the 990 data for an entity and populate the platform with that data. The 990 is going to remain extraordinarily important as a data source for regulators, but we also now have the states actively saying, “We need a better system of regulation and enforcement, and we’re willing to try to help build it ourselves.”

More important, the states are undertaking a mapping exercise to try to figure out, state to state, what information is asked of entities. The states are considering: Why do we collect this information? What do we do with this information? Is it really useful? Do we make public all that we require for compliance? In previous times, more data was always considered a good—and in this sector, even a public good. With cybersecurity and privacy concerns, data may now also be considered a liability. More and more, we see in many sectors the mantra of, “Collect only what you use and can secure.” The nonprofit sector is no different.

It has been assumed that the government, as a sector, would be the correct repository of all of this information—and that may remain true; but *which part* of the government is another matter. The states are becoming more consciously active in this area at the very time the IRS has moved to an emphasis on tax administration.

So, there are shifts happening within our federalist system; and, again, what was happening at the state and federal levels was occurring independently of each other, but the two shifts are

now dovetailing for a new regulatory reality. The IRS is doing its own rethinking about issues that have been going on for some time; and in the very same decade, the states were starting to become much more aware of what each other was doing. It just so happens that now those two trajectories are, I believe, intersecting. And that will change how people think about the balance of regulation of nonprofits.

**RM:** *Well, it's interesting, because I think that there has been some feeling for years that there were a lot of problems wafting about that nobody was picking up on unless the media exposed them—and sometimes not even then. The IRS wasn't following up on them, and it wasn't clear that the states were following up on them. And, in some cases, the problems extended beyond state borders; so they were problems that existed in a number of states, but nobody was coordinating any action against them. But the cancer charities fraud case was an exception. Could you talk a little bit about the importance of that development in all of this? I think it's almost emblematic of what it is that you're talking about.*<sup>7</sup>

**CL:** Yes, I am on record as saying that I think the cancer charities fraud case reveals the good, the bad, and the ugly of where regulatory activities are right now in the nonprofit arena.

First, let's remember that it took an excruciating four years to resolve even this particularly egregious case in which there was no gray area. Even in such an extreme situation, it took that long because the states had to share data in rudimentary ways and chase information down independently. That is where the Single Portal project, I think, is going to be incredibly helpful and a real tool for the enforcement community, where it is much needed as a data-sharing platform.

The legal complaint in the cancer charities fraud case is also a revealing primer on jurisdiction among the states and also vis-à-vis the feds—which in this case was the FTC.<sup>8</sup> Anyone reading the complaint will see the array of the different state laws, and you'll also note that in some states only the secretary of state had jurisdiction over X,

Y, and Z, as opposed to the AG's office. Long story short, the states don't all have the same jurisdiction by a long shot. So, these kinds of multistate collaborations help states also think through what they want their laws to look like, what they want to enforce, and who in each state should have the resources to do X, Y, and Z. The case was not only an example of what could be done collectively by the states and feds but also shone a light on some jurisdictional gaps. It was an example, too, of how painfully long it can take to investigate and litigate a multistate case that, ultimately, was pretty black and white.

**RM:** *Yes. And this is may be a hugely important point, because when you look at cases that do seem egregious, and the movement on them is so slow, it can feel like there are in fact no consequences—or the consequences can come so late and be so minimal that it almost feels like, why bother? But, it sounds to me like what you're talking about is something that's headed in another direction. Do you think that there is general agreement among the states and—this is probably a difficult question—among the state attorneys general to actually work in this more coordinated way?*

**CL:** Absolutely. But the states have always worked in coordinated ways to some extent. It's very common in antitrust cases, in consumer cases, all sorts of cases like that. Litigation models abound at the state level and among state AGs, and even secretaries of state or other state agencies that get involved in various multistate types of cases. Sharing information among states on a legal matter is one aspect, but coordinating an enforcement action is a whole other matter, requiring a huge amount of resources. That is true for any enforcement action.

But to your earlier question of what the status of regulation and enforcement is in the nonprofit arena: even when it looks quiet on the surface, that doesn't mean that there isn't an immense amount of activity going on under the surface at the state level. It's just that through the data-collection process and having to do the analytics around it, it has been a painfully complicated process, and

slowed by a lack of technology and resources. The Single Portal project will help further a situation where the state regulators will be only one of a number of accountability bodies. All of the data will be public, so anybody—the media, academics, anybody—can take that data and mash it up and do whatever they want with it for their own purposes.

**RM:** *That's amazing. That's like the Chicago open data project [Citizens Police Data Project] on police violence. It allows citizens and media to do their own investigations.*

**CL:** It's all part of the open data movement, but it also means that the regulators can have their own algorithms on their own back page, too. Open data brings much information to light—some of which may not always be flattering to the sector, especially one dependent on the trust of the public. A lot of money flows through this sector, and where there is money, you're going to have a certain percentage of fraud. Those folks who look to take fraudulent advantage of others are indifferent to where they find their nefarious opportunities, and our sector may be particularly appealing to them, given the general lack of resources for enforcement. The more the public, the media, academic researchers, and the regulatory community know about our nonprofit sector, the more patterns can be analyzed, correlations made, thoughtful and consistent regulation developed, and enforcement actions effectively and efficiently undertaken. The open data movement is not a friendly environment for those looking to commit fraud, so I say the sooner it comes to our sector, the better.

**RM:** *It's almost like you have to create the foundation for a more networked kind of approach. That's really what you're talking about.*

**CL:** The networked approach you refer to is what we were helping to promote for the last decade at the Charities Project at Columbia Law School, by bringing the states together for trainings and policy conferences. Now we are doing something similar with the states and feds combined at the Urban Institute's Center on Nonprofits and Philanthropy. The first step is to outline common

Open data brings much information to light—some of which may not always be flattering to the sector, especially one dependent on the trust of the public.

Some of the states, of course, have been having these conversations for years—and they have more robust regulatory regimes and simply have more resources dedicated to this sector. But with a multistate action, and one that involves a federal agency such as the FTC, there is a bigger intention at play.

understandings and challenges among jurisdictions, both state and federal, and then move into considerations of actively deploying resources. Some of the states, of course, have been having these conversations for years—and they have more robust regulatory regimes and simply have more resources dedicated to this sector. But with a multistate action, and one that involves a federal agency such as the FTC, there is a bigger intention at play. It is one message for a couple of the big states to go after an entity, but it's another message altogether to have all fifty plus D.C. and the FTC coordinate.

*RM: That's what I thought was really extraordinary about that particular situation.*

**CL:** We're not sure if such an effort has ever happened in any sector—all fifty states plus D.C., plus the feds on any litigation matter. So, though I do understand the complaints in the field about the cancer fraud prosecution—that it took so long and the sanctions seemed so minimal to some observers—the reality is that the case served to lay a groundwork for future actions, and it was also the culmination, frankly, of years of the enforcement community talking and thinking and saying, “We need to be able to do better and do it collectively.” With technology that now exists, it is really incumbent upon government to better utilize resources and share resources, and that's where we are headed now on multistate and fed-state interactions.

*RM: Very interesting. So, along with that, when we last talked, you mentioned something that was very provocative about the idea of legal standing. Because if we're going to make all of this information more and more accessible, what does that mean about who has standing to take action against a nonprofit? Where is the issue of legal standing now? Where would you expect it to go? There seems to have been a very narrow interpretation of who has standing to bring an action against a nonprofit in the past.*

**CL:** Well, let me back up for one second to talk more about who can go after whom in this sector.

We have a variety of federal agencies that can go after different aspects of nonprofit conduct. Then, we have the states, which are very much thinking about governance, nonprofit corporation law, trusts, and criminal jurisdiction, among other things. All of that theoretically interlocks, but there are still very limited resources in this space for dealing with regulation and enforcement in this sector, and little research to contextualize what regulators may be looking at.<sup>9</sup> But the more that we have information out in the public domain and the more that we have technology to make information accessible, the more bodies there will be that can act on the information and the more completed investigations and enforcement we will see.

To date, as a matter of law, we've always had the state attorneys general, who historically have had legal standing to bring an action against an entity or a board.<sup>10</sup> We're now seeing, however, small pushes for other types of stakeholder standing. Occasionally, we see beneficiaries who say, “Wait a minute—I represent an interest that is not being brought by AGs for whatever reason.” And we see marginalized members of the board and donors who say this as well.<sup>11</sup> And with more and more open data available, now these stakeholders are going to have new and better tools for making their case. This is what is new and different in our particular sector.

Other sectors have shareholder actions, class actions, individual rights to action. If resources are not dedicated to enforcement personnel at the state and federal level in the nonprofit sector, and with the rising tide of data available publicly—which makes more evident some of the enforcement gaps—I predict pressure will build to allow other forms of standing to bring an action, even in limited form, akin to *qui tam* actions in other areas of the law. Some of my legal colleagues may view this as blasphemous, given our centuries-old standing laws, but note that I am not advocating the change. I am merely noting what may be a natural outcome of the current trajectory of an underresourced enforcement community intersecting with a wealth of publicly available data. We may very well find in the near future that donors and beneficiaries who have

access to information about where these billions of dollars are going may, in fact, decide that they would like a say when they believe something goes off the rails.

**RM:** *The case at Sweet Briar College seemed to contain that dynamic.*<sup>12</sup>

**CL:** Yes, and we've had other instances where people want to bring a class action.<sup>13</sup> I think that we're going to see some really novel actions—well, they're not novel in other parts of our legal system, but they may be novel to this sector.

For better government regulation, it is time to look more pointedly at resources, research, and coordination, and to compare our sector to other fields and regulators—for example, financial regulation or healthcare regulation, the SEC, or even the FEC. We've simply not had as much recognition of the need for regulation and enforcement in some ways for our sector, which means we're never going to get the resources. This is why many of us advocate for more research in the field—to build upon that done by academics and researchers in the past but also to research specifically the regulatory issues. Even if this reveals some ugly truths at times, we need the data and the empirical evidence so as to be able to go to policy-makers and say, "This is what this sector looks like in real life and numbers, not just anecdotally."

**RM:** *Right. So, basically, you're saying that what is occurring out there is, number one, we still don't have a baseline to use almost as a guide to where to look for enforcement; and that does not exist because we don't have the research. Regulators are going essentially by their own experience and by their own records about what matters and what doesn't, and are often alerted to problems only by a stakeholder coming forward to complain. The states are, in fact, beginning to look at some collaborative activity that would, in concert with more research, begin to provide a more systematic way of looking at regulation and enforcement. And, two, at the same time, we're seeing the feds—specifically the IRS—pulling back a bit, both in terms of what*

*they do and in terms of how they're pulling back. I think our expectation of them as a major force is waning.*

**CL:** Many people do not recognize that there are federal agencies besides the IRS that involve themselves in the charitable sector. The Federal Trade Commission, for instance, has always had people that have dealt with charities issues. These FTC attorneys know the states because they have involved themselves in these issues—even participating in some of our trainings—and they've been good colleagues. As always, it is a matter of, one, recognition that these issues are important and, two, deploying resources. The FTC did that with the cancer charities case, to their credit. To be clear, this is not the first time the FTC has had a relationship with the states. We're hoping there will be some further steps and big-picture thinking about what these types of relationships can do in the future. The cancer charities case reminds the sector that the IRS is not the only federal agency with jurisdiction in this space—and that's a good thing. We have an enforcement ecosystem, if you will—a regulatory and enforcement ecosystem—and this cancer charities case really showed that.

One of the other interesting developments occurring in this sector right now is that the layers of jurisdiction are becoming more apparent, including at the local level. We are seeing this in particular with the examination of the definition of charity.<sup>14</sup> States don't have to have the same definition of charity that the feds do, and now even local jurisdictions are staking a claim on defining charitable activities within their borders. And this is going to be one of the issues that come to the fore over the next few years.

**RM:** *That is a very central question.*

**CL:** A very central question. This gets us back to the start of our talk: we have a federalist system. On the one hand, every jurisdiction can determine its own requirements independent of the other jurisdictions; on the other hand, when one regulator alters requirements, it may necessitate other regulators to recognize those changes and take that into account for their own requirements.

For better government regulation, it is time to look more pointedly at resources, research, and coordination, and to compare our sector to other fields and regulators—for example, financial regulation or healthcare regulation, the SEC, or even the FEC.

**RM:** *It's so much more of a collective effort, by the looks of it.*

**CL:** Well, it certainly is a multilayered effort—and sometimes, occasionally, it might be collective. Large policy questions abound: Should regulators employ collective efforts only sparingly, because, again, it is a federalist system? Are these collective efforts more efficient or less efficient? Do they homogenize requirements, or is it a useful leveling effect that brings consistency and predictability? What type and frequency of regulation and enforcement ultimately helps this particular and unique sector the most? These are not just fascinating academic questions; answers based on accurate empirical evidence will impact the charitable sector in fundamental ways never seen before.

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# The Rising *of the* STATES *in* Nonprofit Oversight

by Lloyd Hitoshi Mayer



WHILE THE IRS'S ROLE VIS-À-VIS NONPROFITS HAS BEEN UNDER FIRE, THE STATES HAVE BEEN EXPLORING BETTER WAYS TO COLLABORATE ON IMPROVING THEIR ROLE IN REGULATION AND ENFORCEMENT—INCLUDING A TEST CASE ON NONPROFIT FRAUD THAT INVOLVED ALL FIFTY STATES AND THE DISTRICT OF COLUMBIA. TECHNOLOGICAL ADVANCES WILL FIGURE PROMINENTLY IN THIS VENTURE.

**I**N AN EXTRAORDINARY DEVELOPMENT, ALL FIFTY states, the District of Columbia, and the Federal Trade Commission filed a federal lawsuit in May 2015 against four charities and their operators, alleging that they had defrauded more than \$187 million from donors.<sup>1</sup> While the dollar amount was staggering, the most unusual aspect of the lawsuit was the incredible level of cooperation among state nonprofit regulators. This cooperation was evident not only in the bringing of the lawsuit but also in its successful settlement less than a year later, with the defendant charities and their principal officers surrendering substantial assets, agreeing to dissolution of the charities, and acquiescing to being banned from fundraising and management of charities and charitable assets in the future.<sup>2</sup>

This development highlights the growing sophistication and cooperation of state nonprofit regulators. And it is not an isolated incident. Building on seeds planted over the past several decades, state regulators are both individually and collectively increasing their oversight of nonprofits.

This trend is fortunate for those who care about oversight of nonprofits, because it comes at a time when the Internal Revenue Service's efforts in this area are atrophying. Even before the recent controversy related to the handling of exemption applications filed by politically active nonprofits, the IRS faced a tight budget and a growing list of responsibilities, including significant rulemaking

and administrative duties related to the Affordable Care Act, or Obamacare. These pressures, in turn, led to a growing backlog of applications for recognition of exemption, a decline in the already low audit rate for tax-exempt nonprofits, and limited new guidance for nonprofits seeking to comply with the complex federal tax rules applicable to them.<sup>3</sup>

The mess involving exemption applications filed with the IRS by Tea Party and other conservative-leaning groups worsened this situation in several ways, however. It accelerated the development of streamlined application procedures—including, but not limited to, the new Form 1023-EZ—that significantly reduce the level of IRS review for new organizations. It also gave Congress another reason to underfund the IRS, forced a wholesale change in the leadership of the IRS Exempt Organizations Division, and almost certainly made employees throughout that division wary of pursuing all but the most egregious violations of federal tax law. IRS examinations of annual information returns (primarily the Form 990 series) are now at an anemic level of less than four-tenths of a percent annually. This is at

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States and localities have also become increasingly active in challenging the often very valuable property tax exemptions enjoyed by many nonprofits. These disputes have involved Princeton University; the Shrine of Our Lady of LaSalette, in Attleboro, Massachusetts; dozens of hospitals; and property owned by numerous other types of nonprofits.

a time when the number of tax-exempt nonprofit organizations has grown to over one and a half million—not including churches and other houses of worship that are not required to seek such recognition from the IRS.

So, what have state nonprofit regulators been doing during this time of decline in IRS oversight? Individually, many of them have been working hard to review and improve their laws and procedures governing nonprofits, as well as increase efforts to reach the regulated community and those who advise that community.

### Individual State Initiatives

In the wake of the Enron disgrace and other scandals that rocked the for-profit sector, California enacted the Nonprofit Integrity Act of 2004 to improve the governance procedures and enhance the filing requirements for charities, other nonprofits that hold funds for charitable purposes, and commercial fundraisers.<sup>4</sup> Significant new requirements included in the act are a shortened period for registering with the attorney general (thirty days after the initial receipt of property); mandatory audited financial statements and detailed audit-committee requirements for charitable corporations with gross annual revenues of \$2 million or more; mandatory board or board committee review of senior officer compensation; and numerous additional filing requirements for commercial fundraisers.

In 2013, New York enacted the Nonprofit Revitalization Act based on recommendations from Attorney General Eric T. Schneiderman's Leadership Committee for Nonprofit Revitalization, made up of representatives from the New York nonprofit community.<sup>5</sup> The act sought to relieve burdens on that community by reducing the number of categories for nonprofit corporations under New York law, simplifying certain formation procedures, and increasing revenue thresholds for certain auditing requirements. It also imposed enhanced corporate governance standards—including those relating to conflicts of interest, related party transactions, whistle-blowing, and financial audits—and gave the attorney general increased enforcement authority. More specifically, the act requires a written conflict of interest

policy (with certain provisions for boards of all nonprofit corporations), mandates certain procedures for related party transactions, and requires a whistle-blower policy for nonprofit corporations with twenty or more employees and over \$1 million in annual revenue. New York also recently announced a project to systematically review its registration and financial filing procedures for charities and fundraising professionals.<sup>6</sup>

These efforts are in addition to the increasing availability of state nonprofit filings through Internet-accessible databases, prominent announcements of investigations into alleged wrongdoing by nonprofits, and required annual reports detailing the high fundraising costs of certain nonprofits. On the latter point, examples include California's commercial fundraisers reports, Massachusetts's *Report on Professional Solicitations for Charity*, and New York's *Pennies for Charities* report. In addition, state regulators have been working to enhance the other information available on their websites, providing an increasing number of plain-language guides on topics ranging from formation to fiduciary duties to dissolution. State regulators have also become regular presenters at many conferences focused on nonprofit legal issues, including meetings of the Exempt Organizations Committee of the American Bar Association, Section of Taxation; the Georgetown Law Representing and Managing Tax-Exempt Organizations conference; and the Loyola Law School Western Conference on Tax Exempt Organizations.

At least one state has taken a more innovative approach to combating what it perceives as unduly high fundraising expenses: An Oregon statute now disqualifies charities from eligibility to receive contributions that are tax deductible for purposes of Oregon's income tax and corporate excise tax if program expenses fall below 30 percent of total annual functional expenses for the most recent three-year period. In December 2015, the Oregon Department of Justice announced the first three nonprofits to fall afoul of this rule; it remains to be seen whether any of them try to challenge their disqualification in court.<sup>7</sup>

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property tax exemptions enjoyed by many nonprofits. These disputes have involved Princeton University; the Shrine of Our Lady of LaSalette, in Attleboro, Massachusetts; dozens of hospitals; and property owned by numerous other types of nonprofits.<sup>8</sup> With no relief in sight for many state and local government budgets, these challenges show no signs of ebbing.

At the same time, state nonprofit regulators appear to have mostly avoided or backed away from getting involved with the regulation of political activity by nonprofits. While California and New York have been particularly active in this area, those states ultimately passed new election laws expanding disclosure of political activity by all types of entities, not just nonprofits, and disclosure of funding sources for such activity.<sup>9</sup> By doing so, they avoided any need to modify the laws specifically covering nonprofits. In New York, the attorney general actually revoked previously issued proposed regulations that would have targeted for disclosure political activity by tax-exempt organizations, on the grounds that the election law changes made the proposed regulations largely redundant. This is almost certainly a positive development, given the IRS's experience with regulating political activity by tax-exempt organizations, as it keeps this difficult and risky task in the hands of the state agencies that administer state election laws and thus are better suited to oversee such activity. That risk is illustrated by the ongoing litigation challenging California's attempts at requiring tax-exempt nonprofits to submit to the state attorney general the list of donors they file with the IRS. The U.S. Court of Appeals for the Ninth Circuit has upheld on its face the attorney general's ability to demand this information, but a federal district court has barred this demand with respect to one particular, politically active nonprofit: the Koch brothers-funded Americans for Prosperity.<sup>10</sup>

### Collective State Efforts

State nonprofit regulators have also been increasing their communication and coordination across state lines. While such efforts can be traced back to occasional projects under the auspices of the National Association of Attorneys General

(NAAG), they gained a more formal structure with the launch of the National Association of State Charity Officials (NASCO) in 1979. In particular, NASCO's annual conference, which includes both public and regulator-only sessions, provides an ongoing opportunity for state regulators to meet each other, share their experiences, and learn about new developments. NASCO has also played a critical role in helping develop the Unified Registration Statement for nonprofits engaged in charitable solicitation, and the more recent Single Portal Initiative, which seeks to develop a one-stop Internet platform for charitable solicitation registration and reporting for all states that require such filings. NASCO has also begun to show a willingness to critique IRS oversight efforts—not just behind the scenes but also publicly, as shown by the concerns it recently raised about the new IRS Form 1023-EZ.<sup>11</sup>

The Single Portal Initiative is a good example of how long it can take for such collective efforts to bear fruit. The Initiative can be traced at least as far back as 2003, when the U.S. Department of Commerce provided initial funds for the project to GuideStar, which was working in partnership with NASCO.<sup>12</sup> Almost thirteen years later, the Initiative published an official Request for Information, seeking input on the pilot website that NAAG and NASCO plan to launch by the end of 2016.

In 2006, the National State Attorneys General Program at Columbia Law School developed the Charities Regulation and Oversight Project directed by Program Executive Director and Senior Counsel Cindy Lott.<sup>13</sup> The project provides an opportunity for state regulators to gather together to learn about various topics of common interest, including conservation easements, fraud in the charitable sector, and future trends in state regulation of charities. It also supports in-depth research into state regulation and enforcement of the charitable sector, in cooperation with the Urban Institute's Center on Nonprofits and Philanthropy.<sup>14</sup>

Finally, NAAG recently formed its Charities Committee, which joins a dozen other NAAG special committees that focus on topics ranging from agriculture to federalism to substance abuse. This move is significant, because it

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institutionalizes attorney general–level attention to the oversight of charities. Consisting of eight attorneys general, the committee’s description highlights the breadth of its role:

The NAAG Charities Committee mission is to assist and enable attorneys general concerning charities registration and enforcement issues and matters by providing information, communication and support; to facilitate cooperation among the various areas of attorneys general offices that handle charities registration and enforcement through open dialogue and communication; to plan, organize and conduct training and annual seminars in coordination with the National Association for State Charities Officials and its assistant attorney general members for the exchange of ideas and information on matters relevant to charities registration and enforcement; and to promote the development of effective charities registration and enforcement programs and education for the protection of citizens and increasing awareness of our duties to our citizens.<sup>15</sup>

### Ramifications for Nonprofits

So, what do these developments mean for nonprofits? There are several important takeaways:

- **The IRS is not the only sheriff in town.** Especially for charities, state regulators have the authority and willingness to pursue wrongdoing. Like the IRS, they face budget pressures and competing priorities, but state regulators are showing an ability to manage these pressures through both innovation at the individual state level and coordination with other states and federal agencies at the national level. Forums such as NASCO, NAAG’s Charities Committee, and the Charities Regulation and Oversight Project will only continue to enhance state regulators’ ability to do more with their limited resources and to work together.
- **For compliant nonprofits, increased state innovation and cooperation is (mostly) good news.** A primary goal of the ongoing state efforts is to reduce the regulatory burdens on nonprofits that are in good faith seeking to comply with applicable state laws. For

example, New York’s Nonprofit Revitalization Act amended New York’s Not-for-Profit Corporation Law to raise revenue thresholds for certain audit requirements and to simplify the classification of nonprofit corporations. The Single Portal Initiative’s stated goal is to significantly reduce the administrative burden on nonprofits and professional fundraisers that solicit charitable contributions in multiple states, by providing a single online system for required registration and reporting. At the same time, however, these initiatives often impose additional governance requirements on all or some nonprofits, as exemplified by some of the recent changes to New York law and California’s Nonprofit Integrity Act of 2004.

- **For noncompliant nonprofits, there is less room to fly below the radar.** As states update and revise their laws governing nonprofits and the procedures for enforcing those laws, fewer out-of-compliance nonprofits will be able to escape scrutiny. And increased communication between the states means less opportunity for out-of-compliance nonprofits to avoid oversight by simply ending activities in a given state or relocating to a different state. For example, one aspect of the Single Portal Initiative is to bring together IRS Form 990 data with state registration data, making it easier for state regulators to identify nonprofits that are operating in their jurisdictions without having properly registered or reported, as well as to spot fraudulent activity. These developments are good news for the nonprofit sector as a whole—they should reduce bad behavior, such as that highlighted in the FTC/50-State & DC Lawsuit, that damages the sector’s reputation. At the same time, however, less sophisticated and less well-resourced nonprofits that, while otherwise acting properly, have been able to ignore at least some state legal requirements with relative impunity, may no longer be able to do so—including with respect to both charitable solicitation and property tax exemption.

The bottom line is that nonprofits need to be aware that even as IRS enforcement of the federal requirements for tax-exempt organizations continues to be battered by limited resources and

congressional criticism, the states have quietly laid the groundwork for more effective individual and collective oversight of nonprofits. That groundwork is starting to bear fruit, as illustrated by the recent multistate lawsuit, the renewed Single Portal Initiative, and the NAAG Charities Committee, as well as the addition of increasing governance obligations to the nonprofit laws of California and New York. Nonprofits, therefore, must be sure to treat compliance with their state legal obligations as seriously as compliance with their federal tax obligations, as well as making sure to keep track of the ongoing state law developments that could impact them in numerous ways.

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# Changes *in the* IRS Oversight of Nonprofits:

## *A Conversation with Virginia Gross*

While the IRS's enforcement capacity has diminished in recent years, there are changes afoot that will influence how it continues to both monitor and regulate nonprofits in the near future. Instead of focusing on reviewing certain industries for particular issues, it is moving toward more objective, wholesale examinations of all exempt organizations that file 990s—and this will likely lead to greater scrutiny for a larger number of nonprofits.

**Editor's note:** *This interview with Virginia Gross, member of the Exempt Organizations (EO) subcommittee of the IRS Advisory Committee on Tax Exempt and Government Entities (ACT), delves into the current state of the regulation of exempt organizations by the IRS. Gross describes a major shift at the IRS that combines a greater use of technology to review returns with a more siloed approach to its various roles. All of this adds up to a sense that there will be less discretion by the Exempt Organizations division right at the point when the floodgates have been opened with the Form 1023-EZ.*

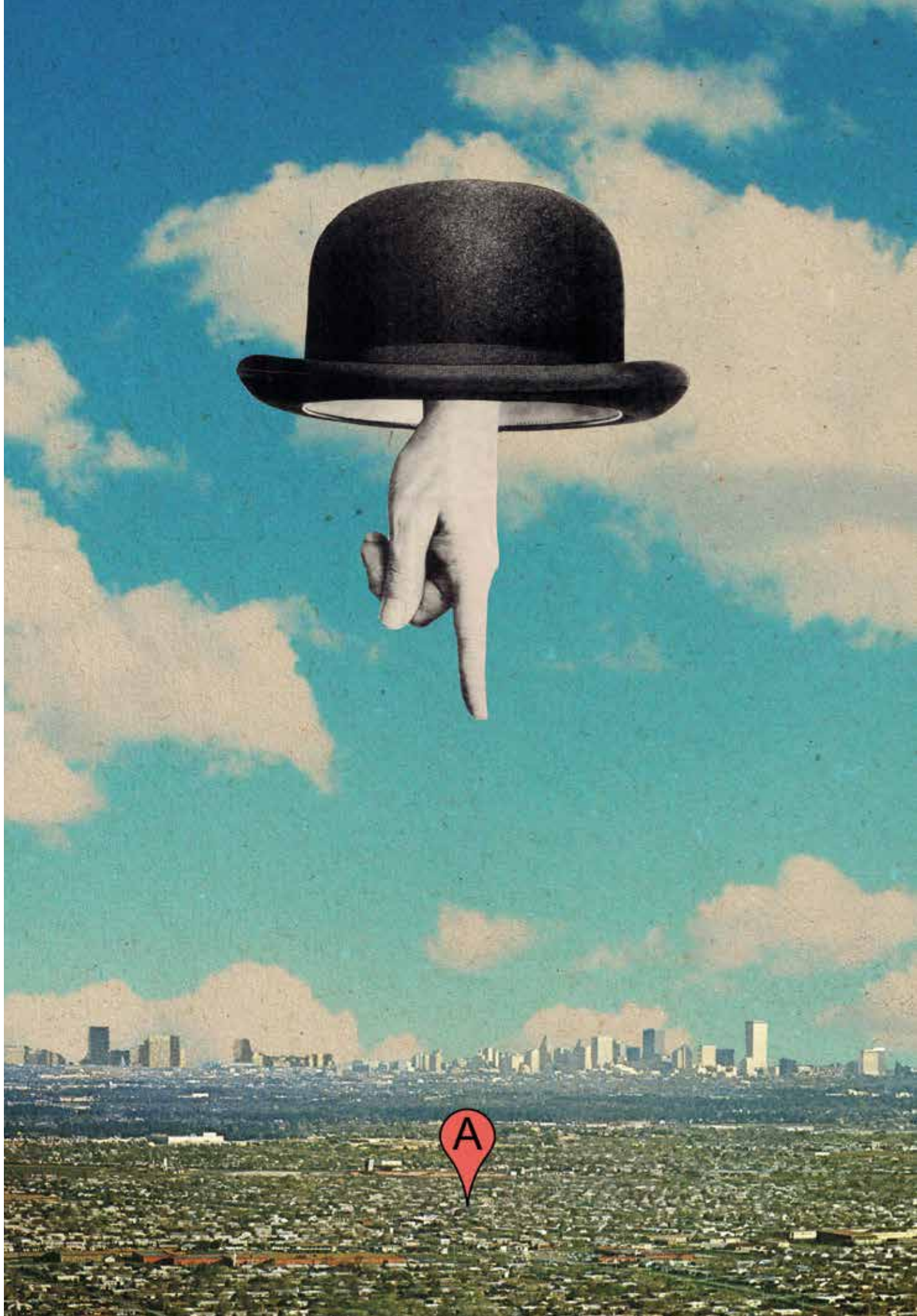
*As a shareholder with Polsinelli PC, Gross focuses on providing advice and counsel to nonprofit and tax-exempt organizations on all aspects of tax-exempt organizations law—such as their formation, qualification, activities, and business ventures—and advises nonprofit clients on issues regarding their operations, fundraising practices, grantmaking, unrelated business income planning, joint venturing and partnering, and the use of supporting organizations and for-profit subsidiaries. Her publications include Nonprofit Governance: Law, Practices & Trends (2009) and The New Form 990: Law, Policy, and Preparation (2008), published by Wiley & Sons. She is also a contributing author to The Jossey-Bass Handbook of Nonprofit Leadership and Management (2011) and Nonprofit Management 101: A Complete and Practical Guide for Leaders and Professionals (2010).*

**Ruth McCambridge:** *The assumption on the part of nonprofits has always been that the IRS had a primary role in its monitoring and regulation—and sometimes, though relatively rarely, in enforcement. Can you talk a little bit about how that may have changed over the past decade or so?*

**Virginia Gross:** The IRS has always had a role in determining whether an organization fits into a particular tax-exempt organization category—and it still does. It has produced guidance in the form of revenue rulings, information letters, and lots of private letter rulings, allowing taxpayers to ask specific questions about whether their

activities qualified, whether certain things they do could jeopardize their status, and what would be the tax treatment of those activities. And then, certainly in the past, we saw a lot of compliance checks. Many of these compliance checks have been industry-specific, like the big hospital compliance check many years ago—and, of course, the college and university study several years ago was a huge one.

But a lot has changed internally that, in the end, will have external effects. It is a reorganization that more strictly assigns certain kinds of tasks to specific departments. First, we've had the big shift of employees from the Exempt Organizations division to the Chief Counsel division, and now that



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division is doing everything with private letter rulings, technical advice memoranda, and formal guidance. The EO division is now more about the determinations function (which concentrates on reviewing applications for tax-exempt status) and the exam function (which involves auditing exempt organizations).

This likely has flowed from the 501(c)(4) brouhaha, which caused Congress to take a look at the EO division and work at eliminating discretionary or subjective power over nonprofits. I don't think that ten years ago we would have seen things like the spending bill associated with PATH, the Protecting Americans from Tax Hikes Act of 2015, where you had Congress saying to the IRS that it couldn't issue the 501(c)(4) regulations—that they were going to restrict the IRS from doing that.

**RM:** *So, it's the imposition of limitations on the IRS's discretion?*

**VG:** Exactly. And the IRS itself is moving to be more objective in other areas, too. That lessening of discretion is also seen in a more automated exam function—one that is being implemented more broadly and organized around a system of approximately 190 Form 990 queries, designed to surface potential compliance risks. What the IRS is saying is that this is going to lead to more objective examination and review of exempt organizations, because basically they'll take all the 990s, they'll run them through the queries, and then, based on those queries, they'll identify the organizations that are more at risk for noncompliance.

So, rather than having to pick an industry and say, "We're going to study colleges and universities," "We're going to study hospitals," or, "We're going to study social clubs," the new process will instead study all exempt organizations that file 990s, and decide who's going to be examined based on those queries.

**RM:** *Can you talk a little bit about the queries?*

**VG:** Well, they're keeping those very close to their chest. But I can imagine they might touch on such matters as loans with officers or directors, the existence or not of a conflict-of-interest policy,

and how you're answering certain questions on Schedule L—and seeing if all that matches up. Certainly, they might look for information that could give rise to intermediate sanctions, or items that might give rise to questions concerning unrelated business income. I think that those more major categories and topics would be what the queries are focused on, but we really don't know. This is purely speculation on my part.

**RM:** *When would the queries be made?*

**VG:** I think after the returns are filed, it would be part of the review process of the returns. Right now, I believe that less than 1 percent of exempt organizations are examined, because it takes a lot of manpower to pull a 990, review it, and decide if there are things on it that should be questioned or looked at further.

**RM:** *What are we headed for now?*

**VG:** The new process will vastly increase the number of returns the IRS can look at, and there may be a greater likelihood of a more qualitative exam if the query process raises warning flags.

The IRS has stated publicly that it will be doing more limited-scope exams and correspondence exams. So, I would imagine that the first line of attack might be a letter from the IRS asking for an explanation. Or, if a return surfaces a number of problems, an organization might get a letter saying a revenue agent is going to be coming to visit and needs to look at its books and records.

**RM:** *So, the way people answer questions on their returns will be under tighter scrutiny in the future because we're dealing with a more automated system?*

**VG:** I think that exempt organizations will want to be very careful about how they're answering questions on the Form 990—making sure that they're being very accurate. And they will want to be very careful about completing the other required parts or schedules if they're answering a question that then requires a schedule or another part of the



form to be filled out. The IRS has stated that in 2016 its goal is to conduct 7,000 exams—which is up from 6,300 in 2015.<sup>1</sup>

**RM:** *Can you talk a little about what effect the use of the Form 1023-EZ has had on the flow of the approval process for tax exemption?*

**VG:** Because of the EZ, the backlog of applications has dramatically decreased. Apparently, over half of new organizations are able to file the EZ, so that has freed up the IRS to look at the other 1023s and 1024s—the long forms being filed. And last I saw, it was about 100 days average turn-around time as compared to about nine to twelve months previously. So, this is a really good time to be filing a Form 1023 or 1024, because they are being processed more quickly.

**RM:** *Is the overall effect of that a positive or a negative, do you think?*

**VG:** I think for the long form it's a very positive result, because there's a lot of satisfaction. You can form an organization and know that you're probably going to have your determination letter from the IRS in four months, and then you can be fully operational. Now, with the EZ organizations, I still hear a fair amount of complaints about how their activities and organizational documents are not going under any kind of serious review by the IRS to make sure they're meeting the requirements of their tax-exempt status.

**RM:** *So, there's less of a problem getting through over the threshold.*

**VG:** Right.

**RM:** *Are we likely to see a real increase in the numbers of nonprofits?*

**VG:** Oh, yes, I think we are. The IRS is reporting that 58 percent of the determinations so far have been on the Form 1023-EZ, and the approval rate this fiscal year has been 94 percent. With the easier Form 1023-EZ process, I think the number of new Section 501(c)(3) organizations will be

increasing. But I don't know the statistics. Also, the IRS just announced that the user fee for the 1023-EZ is going down—from \$400 to \$275, effective July 1, 2016.

One other point about the EZ forms is that the IRS is going back to 3 percent of the 1023-EZ filers and asking them a series of questions. That's their backend check on the 1023-EZ filer.

**RM:** *What other changes are we potentially looking at?*

**VG:** One of the changes we are seeing as it relates to exempt organizations is that there seems to have been a decision made to be a little more formal about how things are being done—that the determinations folks are the ones best suited to be making determinations and the exam folks are the ones best suited to be making adjustments and corrections, but not determinations. For example, if the IRS is examining an exempt organization, the examining agent can no longer approve a change to the organization's exempt status. The agent can only revoke the current exempt status, and then the organization is going to have to apply to have the new exempt status recognized. So there will be a waiting period between the two events. And part and parcel of that is also a question that's been getting a lot of discussion at conferences and such, which is when you request a private letter ruling on whether an exempt organization can engage in certain activities, can you get a ruling on whether the organization can keep its tax-exempt status, or will the activity jeopardize its exempt status? Well, we can no longer do that. We can write in and say an organization wants to do these activities, and, for example, ask if they are permissible activities for a 501(c)(3) organization. But the Chief Counsel division can't rule on whether the activities are going to jeopardize the exempt status or cause the organization to lose its status, because that's a determinations function.

**RM:** *What else will our readers potentially experience as changes from the IRS?*

**VG:** Well, as I mentioned, the EO division shifted a number of employees over to Chief Counsel,

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As far as exempt organizations are concerned, I don't think they should feel like the playing field isn't what it used to be. . . . But it does mean that they probably need to pay more attention to their Form 990s going forward. There may be an increase in the IRS's ability to review the activities of exempt organizations with this shift to the data-driven decision making.

and that's where more of the guidance is coming from. They're being very forthcoming, though, in telling taxpayers that, when they come in for a private letter ruling, they should request a pre-ruling conference and talk about the issues ahead of time. So, they're being very generous with those pre-ruling conferences, and encouraging them. And I think that's a positive change that your readers may want to know about.

Another thing the IRS is trying to do is become more organized through something called Knowledge Networks, or K-Nets. These are collections of written materials and other resources that function as networks to organize the wisdom in the agency in a more cohesive and consistent way, for everyone at the IRS to use—but within the IRS only. They're not going to be made public for the rest of us to use. They already have a K-Net on private foundations and one on unrelated business income, for instance. I think there are six altogether that are applicable to exempt organizations. But the IRS *is* making public its new “issue snapshots” on various exempt organization issues.<sup>2</sup>

Again, the idea is consistency and objectivity in giving guidance and making determinations—the intention being that if everyone is reading from the same playbook, the law will be more consistently applied.

**RM:** *So, the big news, really, is that the IRS is trying to organize itself—at least internally—to be more consistent and less vulnerable to attacks. At the same time, it's broadening the way it will alert itself to problems related to individual organizations, rather than looking at particular fields for particular issues. Do you think it will still be looking at doing some of those field-wide compliance checks, or do you think this really is a replacement?*

**VG:** I think it's going to be moving away from industry compliance checks and more toward what the IRS calls “data-driven decision making”—where the IRS is trying to remove subjectivity out of the mix.

But the law has not changed. So, as far as exempt organizations are concerned, I don't

think they should feel like the playing field isn't what it used to be. I mean, they're still having to abide by the same laws. It shouldn't change how they're doing things. But it does mean that they probably need to pay more attention to their Form 990s going forward. There may be an increase in the IRS's ability to review the activities of exempt organizations with this shift to the data-driven decision making.

**RM:** *In short, how do you think nonprofits might experience the relationship with the IRS differently over the next few years?*

**VG:** Well, in our June 2016 advisory committee report, we are encouraging the IRS to engage in more communication with the sector and include more voices in those conversations.<sup>3</sup> And we are encouraging the IRS to give the sector easier access to the knowledge and tools it needs to be compliant, through educational materials and informal guidance that apply to current types of issues experienced by nonprofits. So much of the existing guidance is very dated. We're hopeful that the IRS will be able to do this, but unfortunately it is still under severe budget restraints. But, for now, the IRS is working with what it has to reach out to the sector and to oversee exempt organizations in a meaningful way.

#### NOTES

1. Comments from Margaret Von Lienen, director of exempt organizations examinations, delivered at the TE/GE Joint Councils on February 26, 2016, as reported in the *EO Tax Journal*.
2. See [www.irs.gov/government-entities/tax-exempt-and-government-entities-issue-snapshots](http://www.irs.gov/government-entities/tax-exempt-and-government-entities-issue-snapshots) for access to the “issue snapshots.”
3. Amy Coates Madsen et al., “Stewards of the Public Trust: Long-Range Planning for the Future of the IRS and the Exempt Community,” in *Advisory Committee on Tax Exempt and Government Entities (ACT): 2016 Report of Recommendations*, IRS.gov, Forms and Publications, June 8, 2016, 89–156.

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# Regulation *of* Nonprofit *and* Philanthropic Organizations: *An International Perspective*

by Mark Sidel

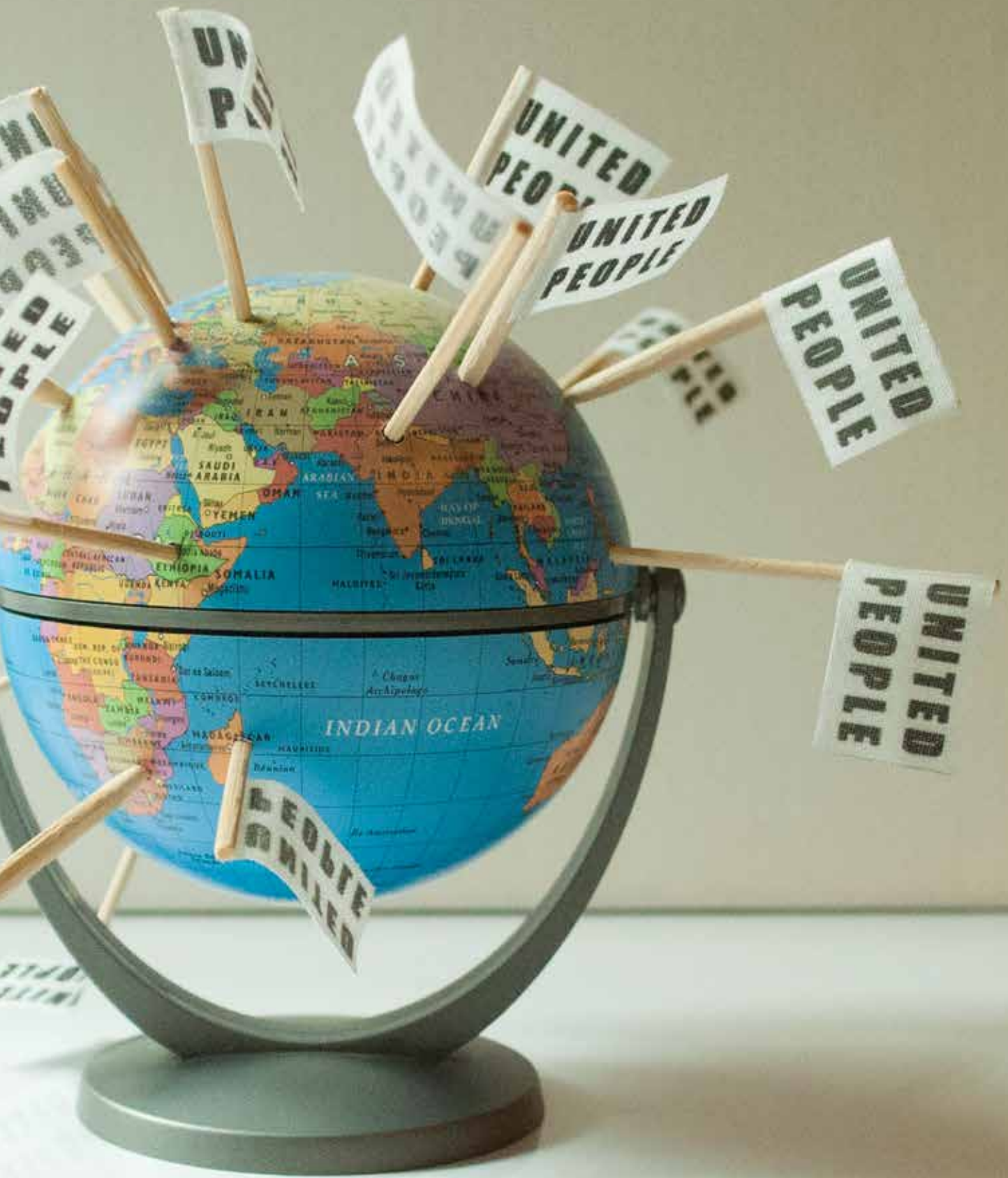
Despite the great diversity in local, regional, and international nonprofit sectors, there are important trends on the international scene vis-à-vis civil society. While this is generally seen as an important component of democracy, there are also active attempts to shut down dissent and exclude foreign influences on issues such as human rights.

**T**HE WORLD IS A REMARKABLY DIVERSE PLACE, SO any attempt to discuss recent trends in international regulation of nonprofits is fraught with difficulties. Comparing countries is very challenging, and local context differs from place to place. Well over two hundred countries have various forms of regulation of nonprofit and philanthropic organizations in place—which is to say that virtually all countries do (with the exception of a few places, like North Korea). Discussing such trends is thus always subject to the dreaded caveat, “but in x. . . .”

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There can be no doubt that we are seeing constraints on nonprofit organization and advocacy in a number of countries.

Yet, even with an understanding of the broad diversity of local context and national approaches, we can see important trends under way in recent years in the regulation of nonprofit and philanthropic groups in countries around the world. Over the past year, a key development has been the increase of constraints on civic space—and those constraints are often accomplished using regulatory means. In order to give some specificity to this, I use China as an example, but this trend is occurring in a number of other countries and regions, as well.

### The Complex Picture of Nonprofit and Philanthropic Regulation

There can be no doubt that we are seeing constraints on nonprofit organization and advocacy in a number of countries. The International Center for Not-for-Profit Law (ICNL, with which I work), the United Nations Special Rapporteur on the rights to freedom of peaceful assembly and of association, and many other national and international bodies have labored over the past several years to document that shrinking space around the world.

Developments in China illustrate the complexities of this trend. On the one hand, China is clearly moving to limit civic and organizational space through regulatory action. Particularly since the Xi Jinping administration came to power in 2012, labor and feminist activists have been jailed, an array of advocacy organizations have been closed, liberal intellectuals have been criticized, and a pall has descended on some public and advocacy aspects of Chinese life. In the regulatory sphere, the strongest example of this trend is the new Chinese Law on the Management of Domestic Activities of Foreign Nongovernmental Organizations (Foreign NGO Law), which was adopted in late April.

The Foreign NGO Law employs virtually the entire spectrum of constraints on foreign NGOs and foundations that is available to a state: restraints on and restrictive processes for registration; state management and supervision; requirement of local partners—and legal responsibility on those partners for the work of foreign NGOs; pre-reporting and approval and

postactivity reporting of planned activities; and restraints on financial activities, among many others. It is not going too far to say that, in this area, it is as if China had catalogued the ways in which governments can restrain local nonprofits through legal means and then employed virtually all of those means in regulating foreign NGOs. Other countries also regulate the work of foreign NGOs, but often in more targeted ways; India, for example, targets foreign funding through the Foreign Contributions Regulation Act, which has been in place since 1976. China has chosen a wider brush.

On the other hand, while the growing restrictions against and repression of domestic advocacy groups and legal constraints against foreign NGOs are an illustration of nonprofit and philanthropic regulatory developments, they are not the entire picture: the Chinese state uses a broad brush yet chooses its targets carefully: While domestic advocacy groups and at least some foreign NGOs are under significant constraint, numerous other groups continue to expand and develop in China, in perhaps the most extensive development of a nonprofit sector anywhere in the world in the past several decades.

In China, domestic social services organizations, social enterprises, and other groups that are perceived as valuable to the state are not seeing the levels of constraints that the advocacy and foreign sectors are experiencing. The new domestic Charity Law in China, adopted earlier this year, illustrates this. While the Chinese nonprofit community is most certainly not free from constraints and controls, it views the Charity Law quite differently from the new Foreign NGO Law. It is seen as at least partly facilitative of the growth and expansion of the Chinese nonprofit sector and of legislative reforms in regulation—such as more streamlined registration for domestic charitable organizations—that the Chinese nonprofit sector has long requested and with which China has experimented in certain areas of the country.

In China, if not always abroad, there is some recognition that the Chinese state is molding its nonprofit sector—encouraging the formation and development of groups that it sees as useful,

while constraining, bureaucratizing, and repressing domestic advocacy groups that are perceived to threaten the state and the Communist Party.

### Does International Law Play a Role in Ameliorating Constraints on Civic Space?

All of this points to a key element in the development of nonprofit and philanthropic law around the world. These developments are almost always country-based, not regional or international, and regional or international legal arrangements play relatively little role in ameliorating constraints on civil society.

A number of actors would like more regional and international regulation of nonprofit and philanthropic action. Usually, these are groups focused on ensuring broader rights to freedom of association and supporting efforts to reform restrictive legal frameworks in various countries. There is regional and there is international regulation in a number of other areas, of course, but expanding it for nonprofits and philanthropy currently seems difficult. Organizations and commentators like ICNL and the UN Special Rapporteur are engaged in uncovering what little in international law seems to apply to the nonprofit arena. Expanding regional and international legal standards to provide a more enabling environment for nonprofit and philanthropic organizations is a long-term—and certainly worthy—project. But, on the relatively rare occasions where regional or international law on freedom of association comes to the fore, it is often, regrettably, in a restrictive mode.

Two examples of this regionalization of nonprofit law will suffice. Since shortly after the September 11 terrorist attacks, the Financial Action Task Force (FATF), an international legal body combating terrorist financing, has included a provision (Special Recommendation VIII) that primarily seeks to prevent nonprofit and charitable organizations from being used as conduits by terrorist groups. The goal is laudable, but in many countries implementation of that measure has led to unnecessary and unfortunate restrictions on the work of nonprofits. Sometimes, those limitations are a good-faith attempt to implement the international legal strictures against the use of

nonprofits by terrorists. But all too often nations are using the broad language of Special Recommendation VIII to, for instance, restrict funding to nonprofit organizations or certain advocacy work that nonprofit organizations do, well beyond the international legal requirement and in ways that constrain the work of the sector. Being able to term such restrictions an implementation of international antiterrorist funding provisions can be a legitimizing convenience for some governments.

A second example is how constraining legal environments are referenced and at times even copied by other nations that seek to impose the same restrictions. A good illustration of this is the proliferation in South Asia of regimes for restriction of foreign funding. For instance, there are restrictions on foreign funding in India that go back to 1976, when the original Foreign Contributions Regulation Act was enacted. Since then—with increasingly restrictive amendments—it has become harder and harder for NGOs and other charitable groups in India to access funding offered by foreign donors and other groups. That's a national system in India—and what's regional about that? What's regional is that, in recent years, other nations in South Asia have sought to impose their own restrictions on foreign funding to their own domestic NGOs and other groups, often in very similar terms to the original—and highly persistent—Indian law. In Bangladesh, for one, the government is deeply suspicious of the role of the country's vibrant and effective NGO sector, and has sought to enact a permission-based regulatory scheme for foreign funding of charitable organizations. Similarly, in Pakistan, the government has introduced restrictions on foreign funding in recent years.

### Problems in the “Closing of Civic Space” Narrative

Over the past several years, the environment for civil society has shrunk and tightened worldwide—a trend that ICNL and a number of other organizations have documented in Egypt, China, and dozens of other countries. Many meetings have been held and many articles published on the “closing space” phenomenon—indeed, it could be said that we are in an era of the closing

Over the past several years, the environment for civil society has shrunk and tightened worldwide—a trend that ICNL and a number of other organizations have documented in Egypt, China, and dozens of other countries . . . indeed, it could be said that we are in an era of the closing of civic space.

But the “closing space” narrative has become something of a mantra for nonprofit development around the world. It has been stated overbroadly and without sufficient nuance, and it requires some careful thinking.

of civic space. Two decades ago, as civil society expanded around the world, Lester Salamon, in a well-known piece he wrote for *Foreign Affairs*, called the development an “associational revolution.”<sup>1</sup> Today, as governments around the world shrink the space for civil society, we are seeing, rather, an associational *counter*revolution underway. But the “closing space” narrative has become something of a mantra for nonprofit development around the world. It has been stated overbroadly and without sufficient nuance, and it requires some careful thinking for the following reasons:

1. Constraints on nonprofits and regulatory tightening are often far more complex than the “closing space” theme allows. In a number of countries, for example, there isn’t a closing of civic space across the board but rather for a carefully selected range of nonprofits on which the state is focusing—often advocacy organizations. Other valuable and effective organizations such as social enterprises, social service groups, and others may, in fact, see their space remaining similar to what they once had—or even opening up. This is the case, to some degree, even in a country like China. There has perhaps been no greater development of nonprofit and hybrid organizations anywhere in the world over the past decade than in China. At the same time, the Chinese state has put significant constraining pressure on advocacy organizations, grassroots organizations, and some foreign NGOs. To describe all this as merely “closing space” oversimplifies the process of molding and channeling the nonprofit sector that is under way in China and many other countries.
2. The “closing space” mantra and criticism show little regard for national sovereignty. I (and others) may not like what the Chinese state is doing to restrain the civic and advocacy space available to grassroots, advocacy, and some foreign nonprofit groups—including their new Foreign NGO Law. But implicit—and often stated—in the external analysis of “closing space” developments is the idea that countries carry out these policy shifts illegally and illegitimately. Thus, in recent years, we

have heard discussions of the Chinese overexercising sovereignty over advocacy and foreign NGOs, or “using” sovereignty for repressive means. There is an irony here: in the long sweep of decades of strengthening the capacity of states such as China, a process in which many foreign foundations and NGOs have participated actively and with Chinese support, we are now in an awkward position when a stronger China decides to use its strengthened capacity in ways with which we disagree.

• • •



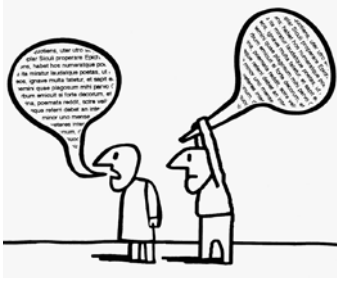
The “closing space” phenomenon and debate will continue to dominate global dialogue on nonprofit and philanthropic regulation for at least several years to come. More work must be done vis-à-vis the developments of these regulatory constraints on countries around the world, and groups like ICNL and the UN Special Rapporteur are doing that quite effectively—indeed, I applaud their work (and participate in ICNL’s work on this). But we must practice caution in our approach to the “closing space” mantra, and try to ensure that it does not oversimplify the complex developments we are witnessing during a crucial time for the development of nonprofit and philanthropic sectors around the world.

**NOTE**

1. Lester M. Salamon, “The Rise of the Nonprofit Sector,” *Foreign Affairs* 73, no. 4 (July/August 1994): 109–22.

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# Dr. Conflict

by Mark Light, MBA, PhD

Consultants sometimes organize their approach to nonprofit boards around a set of strict norms and assumptions that are not exactly on point. Here, the good doctor's advice contains a gentle "Physician, heal thyself" nudge.

**D**EAR DR. CONFLICT: I am a consultant who has been doing strategic planning with a nonprofit that is facing significant marketplace changes. The executive director is very knowledgeable on many levels. She has a great board president, who is a whiz at finance and is very supportive.

There are a couple of issues: (1) Most of the board members are retirees. This is not a problem; recent retirees make some of the best board directors! Yet, at least half of the members have been on the board for between ten and over twenty years. The board president has served as president for fifteen years.

One cannot question the passion these folks have for the commitment; however, I do feel some turnover is healthy, and I cannot persuade them of that fact. Far too many—in fact, the majority—are octogenarians. I am a big believer in the value of institutional history, but this is way too much. I have run into this before in cases where long-time board directors throw out term limits so they can keep on serving. They truly believe that what they are doing is in the best interest of the organization.

Of course, I made the recommendations for healthy turnover, diversity,

and so forth, but there is lip service and there is action, and clearly they don't want to take action. Ideas???

(2) The vice president is soon to be president, and he is not going to be good for the organization. He is a very aggressive person and shoves his ideas down everyone's throat. No one will stand up to him, and I understand why: it's exhausting!

If he becomes president, he will make the executive director's life miserable. He doesn't respect the ED, who is well respected in the field and has two master's degrees, including one in nonprofit management. No one on the board will admit to any discomfort or confront the problem. I advised the board to give the prospective president an out by having the current board president question if he has enough time to devote to all the changes ahead. Any other ideas???

—Can't Get Through

Dear Can't Get Through, You applaud these octogenarians for their commitment, and praise the value of recent retirees, but at the same time you want to get these lifers out the door.

Nationwide, the percentage of chairs and board members sixty-five and older is 27 and 16 percent, respectively;<sup>1</sup> if

the majority you're working with are really in their eighties, you may have a point, and your rationale that some turnover promotes diversity/brings in new blood makes sense. But that's still a lot of wisdom, wealth, and work to lose. That said, you could try to influence the board to go for term limits (71 percent of boards have them) by putting together a list of respected agencies in your community who have term limits, along with their rationale for doing so—maybe even have a few tell their stories to the board.

Now to your question about the aggressive incoming president. A solution is to have the next VP serve in a closer partnership with the new president to balance his style. But where is the ED in all this? This is a clue as to why there are so many difficulties. Robert Herman says, "Boards are much more likely to be active, effective bodies when they are supported by a chief executive."<sup>2</sup> Dr. Conflict guesses the ED is absent because she doesn't know how to take this role. The bottom line is, you can't get through, because you're not supposed to; that's the ED's job, armed with your support/counsel. Instead of a consultant, be a coach, and help the ED improve her leadership. She'll be better off, the board will be more effective, and you can take a much-needed vacation.

Dear Dr. Conflict,

As a consultant on governance, I am working with a board of directors that on the surface seems to be functioning in a reasonably harmonious and professional manner. It was only after private interviews with most of the directors that I discovered a deep divide in the board between an “old guard” (many of whom are former football players with little interest in the substance of the board’s work, and whose main focus is the social side of board activities) and a “new guard” (a group of younger members who take their fiduciary responsibilities seriously and want the board to operate in a more professional manner). The leader of the “old guard” clique is a former board chair. He dislikes the current board chair and works actively to undermine him, even to the point of calling other directors before board meetings to encourage them not to support the existing chair. What action would Dr. Conflict advise a consultant to take under such circumstances?

—What’s a Consultant to Do

Dear What’s a Consultant to Do,

On the surface, the board is harmonious and professional, but underneath the placid surface is a sharknado of old-guard board members advocating for their social interests against a new guard of younger, well-intentioned fiduciaries. Adding chum to the water is the former chair, who is undermining the current chair. Your own stance on the matter seems to be decidedly pro–new guard: fiduciary versus social interests, operate in a professional manner, etcetera.

So what to do? Start by examining your own appraisal that the board is “functioning in a reasonably harmonious and professional manner.” What indication do you have that this is true? I suggest starting with the core functions of the board: Lead the organization;

establish policy; secure essential resources; ensure effective resource use; lead and manage chief executive performance; engage with constituents; ensure and enable accountability; and ensure board effectiveness.<sup>3</sup> Then, evaluate whether or not the board members are doing their job “to exhibit the care, loyalty, and obedience on behalf of the organization [that requires] active and informed preparation and participation in the conduct of board business, including raising questions and issues that would reasonably be raised by any prudent person.”<sup>4</sup> This one has Dr. Conflict worried because of your description of the football players as having “little interest in the substance of the board’s work, and whose main focus is the social side of board activities.”

Assessing the performance of both the board and board members might begin with BoardSource’s excellent range of tools, followed by a consultant just like you to help the board understand its opportunities.<sup>5</sup> But however you do the assessment, do it you must.

Why? Consultants (like all human beings) often see what they expect to see based on their own biases. For example, how do you know that the former board chair is truly working actively to undermine the existing chair? Given that one of the duties of the board is to raise questions and issues, is doing so behind the scenes *verboten*? Does being an effective board member forbid one from having sidebar conversations with other members in the interest of the agency? Is lobbying other board members to support one’s motion hostile to good governance? If it were, the Civil Rights Act that just celebrated its fiftieth anniversary never would have become law.

If you truly believe the old guard is outmaneuvering the younger members and you have confirmed this theory, it could be time for you to take the role

of a coach and help the younger board members understand that politics are an unpleasant fact in all arenas, including nonprofits. Then, teach them how to make politics work for them to get what they truly want. They may be purists at heart and have disdain for the whole idea, but remind them that “the lack of power corrupts. If you don’t have power, you can’t stand up for what you believe is right.”<sup>6</sup>

#### NOTES

1. BoardSource, *Leading with Intent: A National Index of Nonprofit Board Practices* (formerly known as the *BoardSource Nonprofit Governance Index*).

2. Robert Herman, “Executive leadership,” in David O. Renz, ed., *The Jossey-Bass Handbook of Nonprofit Leadership and Management* (San Francisco: Jossey-Bass, 2010), 174.

3. David O. Renz, “Leadership, governance, and the work of the board,” in David O. Renz, ed., *The Jossey-Bass Handbook of Nonprofit Leadership and Management* (San Francisco: Jossey-Bass, 2010), 125–56.

4. *Ibid.*, 134–35.

5. To access the tools offered by BoardSource, visit [www.boardsource.org](http://www.boardsource.org).

6. Linda A. Hill and Kent Lineback, “The Best Way to Play Office Politics,” *Harvard Business Review*, [hbr.org/video/2226595804001/the-best-way-to-play-office-politics](http://hbr.org/video/2226595804001/the-best-way-to-play-office-politics).

**DR. CONFLICT** is the pen name of Mark Light. He is founder and president of First Light Group ([www.firstlightgroup.com](http://www.firstlightgroup.com)), whose mission is to bring your future within reach through executive coaching, sustainable strategy, teaching and training, and writing. Light is also senior professional lecturer at DePaul University School of Public Service.

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# Who Says a Common Agenda Is Necessary for Collective Impact?

by Brint Milward, Katherine R. Cooper, and Michelle Shumate

A common agenda or agreement on a core vision among collective impact stakeholders and leaders is important, but the process of creating a common agenda and incorporating diverse perspectives may be even more valuable. This article suggests that we revise the common agenda standard as a threshold for coming together and avoid the tension of hidden agendas by leaving room for exploring differences.

**Editors' note:** *This piece differs from those previously published on collective impact in that the implications stem from several decades of empirical research on networks. Although collective impact is often portrayed as a relatively new phenomenon, years' worth of network research suggest insights that may be useful to the all-important early step of determining an initiative's common agenda. The article also elaborates on an often underexplored area of collective impact. Although some parts of the collective impact framework have gotten increased attention (the backbone organization, equity in collective impact, strategies for mutual alignment), the notion of a common agenda is often taken for granted, when in fact it poses a real stumbling block for networks in their early stages.*

**A**GREEING ON A COMMON AGENDA IS one of the chief tenets of collective impact—and one of the prerequisites for moving collaboration forward. However, our experience working with collective impact initiatives and other, similar networks suggests that collective impact leaders often struggle to get buy-in from various community stakeholders in the crucial early stages. Specifically, we've seen that insistence on a common agenda sets a high bar, and may derail partnerships early on. More important, the common agenda may create barriers to entry for diverse partners if they hold views

at odds with “mainstream” values and assumptions.

Although we agree that a common agenda is important, we suggest that collective impact leaders should treat it as an aspiration rather than a destination. We draw upon several decades of network research and exemplar networks to suggest instead that focusing on the process of creating a common agenda allows for diverse perspectives to impact the initiative's trajectory. To that end, we identify common barriers to agreeing on a common agenda, including the “birds of a feather” tension and the “two hats” problem. We then offer suggestions for

reaching a threshold of agreement that moves initiatives forward—even if total agreement can't be achieved. There is much to be said for a principled agreement to disagree on some elements of a common agenda.

## Birds of a Feather

Over thirty years of network research has demonstrated that the easiest way to form a social network is to recruit people who share a common experience based on characteristics such as race, class, gender, or education.<sup>1</sup> This is the principle of *homophily*, or “birds of a feather flock together.” Because

partners with similar backgrounds can relate to one another, they bond more easily than those who don't. This means that the quickest way of building a common agenda is to rely on like-minded individuals.

This sounds dismal for those of us who value diversity and inclusion, but it needn't be so—there is another powerful finding from network research that helps mitigate the principle of homophily: Although bringing people together in the first place is made easier through similarities, networks are more innovative when diverse partners participate. Through the interaction of stakeholders with diverse goals, expertise, and backgrounds, networks become more innovative, effective, and resilient. In other words, effective networks adopt the principles of both “opposites attract” and “birds of a feather.”

The question of which principle networks honor—and when—poses a dilemma; however, leaders should recall that dilemmas cannot be solved—only managed better or worse. Therefore, one of the most important network management tasks is balancing the need for networks to have enough cohesion to hold themselves together, but not so much that they exhibit “groupthink” that causes them to reject new ideas and practices. From the standpoint of network research, managing the “birds/opposites” dilemma is one of the keys to network effectiveness.

One way that networks manage this tension is by explicitly acknowledging and accounting for differences. For example, in research conducted on the Southern Alberta Child and Youth Health Network (SACYHN), we discovered that the network dealt with this dilemma by having two “tables.” One table included the network members in the healthcare arena who created the network (“birds”), and the other

included members who had interests in education, members who had interests in social services, and members who represented diverse constituencies (“opposites”). The network acknowledged differences between the “birds” and the “opposites” by creating terms of reference that specified different obligations for the two groups. Core members, the “birds,” shared a common agenda, whereas “opposites” shared some, but not all, of those interests.

Both network evaluation and participant observation concluded that acknowledging this “birds/opposites” dilemma and creating an institutional structure to mitigate this tension was one of the keys to SACYHN's success. Over the life of the network, SACYHN has been viewed reputationally as the most successful child and youth health network in Canada.<sup>2</sup>

### Two Hats

In addition to creating a bias toward “birds of a feather,” the common agenda standard doesn't address the “two hats” problem, which is a shorthand way of saying that members have interests in their organizations *and* the network. This tension can lead to hidden agendas, which are toxic in networks.

The “two hats” problem cannot and should not be wished away. Network members may be torn between their own organizational agenda and the agenda of the network itself. Network research teaches us that there are two fundamental tasks that every manager in a network must adhere to: managing the network, and managing his or her organization *in* the network. One way to manage this tension is by creating a threshold of agreement, rather than insisting on a completely common vision of the desired outcome. For example, in rural Pima County, Arizona, a group of individuals created Friends of Redington Pass,

a collaborative named for the public lands joining the Santa Catalina and Rincon Mountains. The collaborative's first task was to recognize the legitimacy of the interests of all concerned. In this case, a common agenda took a back seat to respect for the differing interests of a group of other individuals: environmentalists, property owners, a cattle grazing permittee, horseback riders, hikers, off-road vehicle owners, and gun enthusiasts—a group with diverse views regarding conservation and availability of the Pass for recreational use. Their second task was to develop enough agreement so that they could negotiate a set of consensus recommendations to the U.S. Forest Service on how to better manage Redington Pass. In this example, recognition of the “two hats” problem was the basis for the more diverse group's willingness to join Friends of Redington Pass and thus gain standing as a body that deserves to be at the table as a partner with the Forest Service.<sup>3</sup>

### Implications of the “Birds of a Feather” and “Two Hats” Dilemmas for the Common Agenda

1. The SACYHN example demonstrates that, rather than having exact agreement, it's more important that partners speak honestly about their varying reasons for involvement in the network, and communicate clearly the degree of their commitment to the network.
2. In the example of Friends of Redington Pass, people approach a common agenda with different stakes in the problem—and it is necessary and healthy to acknowledge those differences, as this discourages hidden agendas. We argue that it is better to air these differences publicly rather than keep them hidden. This allows network managers to manage the dilemma of the “two hats” in an

## Strategies for Collective Impact Initiatives

1. **Reach a threshold of agreement.** In the case of Friends of Redington Pass, for example, the group found that a network's agenda could succeed with only a 60–70 percent agreement, so long as that agreement coalesced around “core” parts of the network's common agenda.
2. **Decide the extent to which your network needs a shared vision.** Stakeholders may differ in their values. In the case of SACYHN, the partners created a constitution that determined the extent to which the agenda must be held in common by all, as well as corresponding guidelines for governance and decision making.
3. **Encourage dialogue and acknowledge difference among network stakeholders.** Friends of Redington Pass demonstrates why it is so important to encourage stakeholders to voice opinions that diverge from the common agenda—and why the success of the network may depend on the inclusion of these voices at the expense of exact agreement.

open and frank way that views other agendas as legitimate and allows members to meet a threshold of agreement.

3. Some organizations are more critical to collective impact success than others, as illustrated by the SACYHN network's “two tables” approach. Agreement upon a common agenda may be more important for core organizations than for others.
4. Some elements of the common agenda may have more relevance for the network's success, while others may not. Group members disagreed on how open Redington Pass should be to the public (for example, the environmentalists argued for more protection of the Pass than the off-road vehicle group or the gun enthusiasts typically supported), but everyone realized that they were more powerful working together than separately to leverage their common interests for greater conservation resources to be dedicated to the Pass in the Coronado National Forest plan.
5. The creation and implementation of a common agenda has negative implications for equity—there's power not only in setting the agenda but also in forcing others to adhere to the agenda. Viewing the common agenda as a “continuing dialogue” makes it easier to

encourage and accommodate diverse views as well as to make adjustments based on new information or changed circumstances.



Today, Friends of Redington Pass serves as an umbrella organization to bring together groups and organize events that allow and encourage shared use of the land. Their experience—and that of SACYHN—demonstrates that both common *and* divergent interests can be a powerful force for bringing groups together and facilitating change for those working to improve educational, environmental, or health outcomes in a collective impact setting.

### NOTES

1. Janice Popp et al., *Inter-Organizational Networks: A Review of the Literature to Inform Practice* (Washington, DC: IBM Center for the Business of Government, 2014).
2. Ibid.; and Robin H. Lemaire, Keith G. Provan, and H. Brinton Milward, SACYHN network analysis and evaluation report (Calgary, AB: Southern Alberta Child and Youth Health Network [SACYHN], unpublished document, 2010).
3. Information in this section is from an interview conducted by Brint Milward, on May 17, 2016, with Kirk Emerson, professor of practice in collaborative governance at the

University of Arizona School of Government and Public Policy, and board president of Friends of Redington Pass.

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# The Sustainability Prerogative— Nonprofits in the Future of our Economy: A Conversation with Douglas Rushkoff

With digital companies like Amazon and Uber focusing primarily on returning share value to investors in a “growth above all” mindset, many question how sustainable their practices truly are. The stock market business emphasizes growth of the industry but places little value on the individual or the community fostering the industry. It may be time to consider transitioning into a different economic model, in which companies are structured like nonprofits: economically sustainable while building investments that will nurture society.

**Editors’ note:** Douglas Rushkoff’s best-selling books on media and popular culture, including *Present Shock: When Everything Happens Now*, have been translated into over thirty languages. He is professor of media theory and digital economics at CUNY/Queens, technology and media commentator for CNN, digital literacy advocate for Codecademy.com, and a lecturer on media, technology, culture, and economics around the world. In his new book *Throwing Rocks at the Google Bus: How Growth Became the Enemy of Prosperity*, he argues that we have failed to build the distributed economy that digital networks are capable of fostering, and have instead doubled down on the industrial-age mandate of “growth above all.” Central to his argument is the rise of a new dominant business form—and it is, ideally, nonprofit. This interview was first published on NPQ’s website on April 27, 2016.

**Ruth McCambridge:** Douglas, your ideas are so aligned with a lot of what we’ve been thinking about at NPQ in terms of where the general economy is going and what part nonprofits should have in its future. We have been talking with our readers about thinking bigger, understanding that there’s a major shift going on—and that they have to understand the hugeness of that shift and the capacities of it before it’s too late. But

the tendency in the nonprofit sector is to deal with one social issue at a time, and not with the larger construct of the economy or with the way individual enterprises reflect one economic priority over another. That leads to some pretty muddy thinking where valuing ourselves as economic engines goes.

I was hoping that you could describe just where you see the economy as regards the character of for-profit-style

growth and what it is doing to the planet, and then describe to some extent the whole distributed alternative and what we have to pay attention to in terms of a platform.

I can set this up with two simple questions: What is your book’s basic proposition, and can you describe your hypothesis about why an emphasis on growth would lead us down the wrong path at this point?

**Douglas Rushkoff:** I think that the nonprofit sector in particular is perfectly situated to help us transition to a different economic landscape. You know, most nonprofits think of themselves as doing something good, but what I want to try to make them more aware of is that the nonprofit structure *itself*—the way the business is actually structured—may be doing more good than whatever their particular business is.

And that's my basic premise: While the public looks at nonprofits as do-gooders, I'm looking at the structure of nonprofits and not-for-profit corporations as business entities. Because they're not for sale—because they're not shareholder or share value—maximizing companies—what they end up doing is promoting revenue and the exchange of value and the circulation of money, which revives a whole economy rather than enriching the few.

The major businesses that are around today—particularly digital businesses—don't understand those business basics. The way that digital companies make money is simply by returning share value to their investors. So, some young person or developer might have a great idea for an application or for a platform that makes revenue and helps people accomplish a purpose, that maybe helps other people do business, that maybe even makes users rich on one level or another. But this developer takes money from a venture capitalist, who then has a very different goal for the company. His goal for the company is that it gets acquired or that it reaches an IPO—meaning it gets listed on the stock exchange—within eighteen to twenty-four months. That's what the venture capitalist wants, and it's a win-or-lose landscape. That company has to hit a “home run”—which means it makes it all the way to IPO and becomes a multibillion-dollar company—or nothing. The venture capitalist who is now in

charge of the company would rather see the company die than be a “single” or a “double.” In other words, it can't just be a successful company, because that doesn't serve him.

What he needs is for this company to be “100x” return, meaning that one hundred times his initial investment has to be paid back in a sale. And the reason why he would rather the company die is because until the very last minute—the very last second—there's some possibility that even the dying company will be acquired. So, he will position the company for that. This doesn't mean having a successful sustainable business enterprise or making revenue; it means establishing a defensible monopoly over a particular industry. You don't even have to think of that industry—or that vertical, as they call it—as something you want to thrive, that you want even to survive; it's just something that you can so totally own that you have the ability to then leverage that monopoly to go get another one.

Look at Amazon with books. Amazon doesn't care about authors and publishers. It doesn't care if HarperCollins is making more money or less, or if authors reach more readers or fewer readers. It chose the book industry as its initial beachhead in the American economy because the book industry was weak. Oh, it was fine, hobbling along, but it was dying in the sense that it wasn't a growth industry. It couldn't compete against all the other growth businesses out there, from the Internet to oil or something else. We are a sustainable little industry. There's only so many people alive, so many people reading, so much time they can spend reading.

Now, in real business, you can open one store, make pizza, sell pizza, make a profit, feed your family, and go on like that until you die. But in the stock market business, in traditional corporate

capital, that's not good enough. That doesn't work. You need to grow. You need to show your shareholders that your quarter-over-quarter business prospects are doing better and better, so that you can get a higher and higher share price and your shareholders are happy.

So, Amazon goes and looks at the book industry; it doesn't care if it kills it. All it needs to do is be able to dominate it completely so it can then leverage that monopoly into another industry, and yet another industry—whether it's drone planes or retail toys and clothing or cloud services or any other market. The same goes for Uber. It doesn't care if the drivers all go bankrupt. It doesn't care if the taxi business it's starting or the taxi marketplace it's running is ultimately unsustainable—because it doesn't need it. It's buying the taxi industry in order to flip it into something else—in order to move into drone delivery or logistics or some other market.

Traditional corporate capitalism always worked this way, but it was a bit slower. It took Walmart twenty or thirty years to bankrupt one of the communities it was extracting value from. So now Walmart is in trouble, because so many towns where it operates are impoverished. Once you have a Walmart, you can't make any money doing anything else. Everyone just either works for the Walmart or buys from the Walmart—that's it. And it's an extractive force, so eventually the towns go belly up, and now there are Walmarts closing, because the towns they're operating in have died.

But what happens when you do this digitally—when you do it with a digital platform like an Amazon or an Uber? That value extraction happens a lot faster. So, what used to take thirty years might now happen in three years. But they don't care, because they're going to move on to another and another and another. It's the scorched-earth practice.

**RM:** So, this is *antisustainability*?

**DR:** Yeah, and they don't really care, because the object of the game is to buy a business and then sell that business for enough profit that you never have to work again. And, as the world gets worse because of that activity, it doesn't really matter, because you've earned enough millions of dollars to insulate your family and yourself from the reality that you've created. So, that's really the whole idea: get a business and sell that business so that you have enough money to protect yourself from the devastation and the poverty and the unrest that's around you.

Now, the thing that I'm arguing to those people, to business people, is that the probability of being what they call a unicorn—the probability of having the one-out-of-ten-thousand chance of having a company that ends up being a Facebook or an Uber or a Twitter or whatever—is so small, that creating a sustainable business and shooting for some millions of dollars rather than creating an unsustainable business and shooting for billions of dollars is actually smarter business. It's better business because—worst case—you can always fall back on the fact that you have a revenue-producing sustainable business. In other words, why not at least have a company that generates revenue, that has a market that is thriving?

What I'm arguing is that digital companies—and all companies, really—should look at everyone from their supply chain through their consumption chain as people who they want to make rich. If you make your customers rich, then you've got wealthier customers and people who are going to come back. So, you need to start looking at money not as something that you extract from the economy and store in share price, but rather as something that you circulate through the economy and that you see

again and again and again and again.

A good company, in other words, understands that if it has wealthy customers and if it circulates money, it can earn the same dollar ten different times rather than just taking \$10 off the table. What traditional corporations have done is they've extracted so much money from the marketplace that there's not enough money for people to do the things they actually need. Most of the people are poor, and the corporations are rich—but they're so rich that they're suffering from a kind of a financial obesity, where they've accumulated all this money but they're really bad at deploying the money. They're bad at making money with their money.

In technical terms, corporate profit over value has been going down for seventy-five years. That means they're very good at collecting money but very bad at spending it, at using it, at doing anything successful. A big, for-profit pharma company now doesn't have the capacity to innovate. Instead, it looks around for little companies that are innovating, and then buys them. So, they're not really pharmacy companies anymore; they're holding companies. They may as well be a mutual fund or a bank. That's even what happened to Google. Google now calls itself Alphabet. It got so big that it really couldn't figure out how to innovate on its own anymore, so it buys drone companies and robotic companies and other software companies that do still have the ability to use their funds to innovate.

Now, in the nonprofit sector, unlike in the for-profit sector, the company can't sell itself, and it doesn't have shares that go up in value. Everything else is the same. You could be a nonprofit *store*. That doesn't mean you don't make revenues. It doesn't mean you can't pay yourself. It just means that the way you make money is not by making your share

price more valuable and then selling that to other people. It means that the investment that you put into the company stays in the company. You can't extract that when you leave.

So, it's much more like a family business—and if you look at the data, family businesses do better than shareholder-owned businesses in pretty much every single metric, and they last a whole lot longer. You're building a company not because you want to take value out of it and then use that money to bequeath an inheritance to your grandchildren but rather because you hope it will still be around when your grandchildren need a job, to circulate wealth when you die.

That's why I'm trying to convince Internet startups to be benefit corporations, multipurpose corporations, or, best of all, nonprofits. Once you're a nonprofit, you don't have to worry anymore. You can still borrow money if you want to and issue bonds and do other things, but it makes it impossible for shareholders to come and demand that you change your business. You know, if the mob is going to take over your restaurant, they don't care about your meals anymore; they're using your restaurant as a front for something else. That's what shareholders do: They use any goodwill that you've created with your little app, with your little company, that name that people have on their lips—and they use that as a front for an IPO, as a front for a flip. And, even if you get to IPO, that doesn't guarantee ongoing success. Take, as an example, my dear little friends at Twitter, who got to IPO and have this incredibly successful app that simply delivers 140-character messages to other people; who make \$500 million a quarter; and who are considered an abject failure by Wall Street because they peaked. You make \$500 million a quarter—but what about the next quarter? What if that's as



much money as a 140-character messaging app can make? What if just \$2 billion a year is all that this little tiny app can make? The market is going to drive them out of business, right? It's going to get rid of them. It's going to kill the company because it can't grow anymore. And that's tragic.

**RM:** *So tragic. I think it's exactly why we're losing so many newspapers. It wasn't about whether they could support themselves or not; it was about whether they were still growing.*

**DR:** Yep. We live on a planet that—I hate to admit it—might have a fixed quantity of real estate. From space, it looks like a sphere; it doesn't look like it's growing to me. This looks like it's about it. And it may be able to go on for a whole long time, way longer than people think, but it needs to start thinking about itself as a regenerative system—more like a coral reef or a forest than like a corporate marketplace that's supposed to expand forever. And whenever I say this, people accuse me of being Malthusian, that I'm saying things are limited and we're all going to die, and I'm really not saying that—

**RM:** *Well, hello! In fact, we are all going to die, and things are limited.*

**DR:** Things are limited, but you can still grow. It doesn't mean you can't have progress and change. You can have all sorts of innovations and shifts of stuff, but even if we may be able to grow—even grow forever—there's a certain point at which you can only extract so much water from an aquifer before it can't replenish itself fast enough and the aquifer is gone. Yes, in a billion years—assuming the planet is not gone—the aquifer will replenish itself, but maybe not fast enough for the human beings

who want so much more water from it than it can really supply.

The rate of the artificial marketplace is much faster than the rate of the real planet. It's not even the rate of real business. Most business—94 percent of business, something like that—is now derivative. People aren't even buying and selling real shares; they're buying and selling derivatives based on those shares. The derivatives exchange got so big that it bought the stock exchange. So, we're looking at a completely synthetic form of moneymaking. Seventy-four percent of the revenues earned—the money earned by the top 1 percent—was utterly passive synthetic income. It was valueless. It was just derivatives of derivatives. It was pure drag on the system, and it just doesn't work after a while.

**RM:** *Can you say a little bit about the concept of the commons? I know you've been talking about it throughout—nonprofits come out of that concept—but can you talk explicitly about how that needs to apply here?*

**DR:** The commons has gotten maligned. People talk about the “tragedy of the commons,” which is the idea that if no one owns the thing, everyone is just going to abuse it and take everything, and there will be nothing left. But, in reality, a commons is a managed common resource, and a real commons has very strict rules. So, if there's a pond in our town that we all fish from, we're going to have to make rules about this commonly used resource. We'll say, Okay, if you want to use this, you can only have ten fish a day, or twenty fish a week from this, and you can only use *this* kind of bait because this other kind is going to pollute the water. And then, as managers of this common resource, we have the ability to penalize or exclude those who

don't follow the rules that we've established to maintain that commons.

I mean, it seems like simple logic, but it's looking at a resource as something that we want to maintain over time. We want to maximize the value that everybody can create, as opposed to . . . well, the way a short-term company looks at something. The ideal scenario for them, I guess, is when you go to someone else's country, you mine for things—and you mine for things in such polluting ways that you make it impossible for the local community to do subsistence farming anymore. So now everybody has to work for your company if they want to have an income. And then even after you're gone, they don't have a way to sustain themselves, so they become utterly dependent on you and the World Bank or foreign lenders in order to buy chemicals or whatever they need to try to grow on their polluted topsoil. It's the anticommons view.

**RM:** *One last question: One thing I found fascinating is this concept of platform monopolies. What's the alternative to platform monopoly, and how do we get this sector focused on that and other modern concepts of the commons?*

**DR:** I think the most promising new structure I've been looking at is called a platform cooperative, and it's the opposite of what an Uber or an Amazon does. Uber and Amazon want to establish monopolies of their platforms. It's the same as the old chartered monopoly that destroyed the peer-to-peer economy of the late Middle Ages, but instead of it being the East India Trading Company or Walmart being defended by laws or their access to capital, now it's digital platforms that are defended by their very programming.

Right now, on a platform like Uber, you have drivers who are doing the

research and development for robotic cars that are going to replace them. So, they're investing their time and labor into something that will soon make them even more jobless than they already are. If it were a platform cooperative, then the difference would be that the drivers would own the platform instead of shareholders. Instead of investing \$5 billion or \$10 billion into this platform to give it a war chest to deregulate or reregulate markets in their favor, and to undercut everybody else in the industry (which is what that cash is for—it's to have lower prices than are manageable, than are sustainable), it would be a driver-owned platform and they could pay themselves fair wages. Moreover, even if they do obsolesce their own driving—even if they obsolesce their own careers—they would be owners in the company that they built, which is a totally different relationship to it.

If your neighborhood gentrifies, and if you're just a renter in that neighborhood, you're screwed. But if you own a building in the neighborhood that's gentrifying, at least your property value is going up. At least you're benefiting in some fashion. But, if you are just a disenfranchised worker, like an Amazon Turk or an Uber driver, there's no hope.

So, what I'm looking at is models that include workers as owners. And there are examples of them. There've been co-ops for a long time—for instance, there's WinCo, which is a competitor to Walmart out west. No, it's not a nonprofit, but it's a worker-owned cooperative that is beating Walmart in both prices and quality—and certainly in sustainability—because it pays its workers more and its workers are owners. I've talked to some of the biggest shareholders of Walmart, and they're so confused: "How can these people pay their workers more

money and still undercut us on price? That makes no sense." It's like, Yeah, well, they don't have the overhead that you have. They don't have the overhead of shareholders who want to extract all the value from this equation. And that's the real difference here.

What nonprofits have to realize is that growth can be a happy side effect of reaching more people and doing more things. The one advantage the nonprofit sector has over its for-profit counterparts is that you don't have the obligation to grow. You are not structurally required to grow. And if you don't play that advantage, then you're going to get eaten—one way or the other.

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# THE Nonprofit QUARTERLY

# 10 Places Where Collective Impact Gets It Wrong

by Tom Wolff

While the collective impact framework has brought renewed interest and attention to collaboration and coalition building, it is also overly reductive and it promotes top-down decision making over grassroots voice, among other shortcomings. It's time to challenge the collective impact juggernaut and bring communities what they need and deserve.

**Editors' note:** *This article is reprinted with permission. It was first published in March 2016 by the Global Journal of Community Psychology Practice ([www.gjcpp.org/en/](http://www.gjcpp.org/en/)), and was published on NPQ's website as a Voices from the Field article on April 28, 2016. It has been lightly adapted for publication in this magazine.*

IN 2011, JOHN KANIA AND MARK KRAMER published a five-page article called "Collective Impact" in the *Stanford Social Innovation Review*.<sup>1</sup> The article was a well-written summary of their views of large-scale social change efforts in communities. They suggested five conditions of collective impact:

1. Common agenda;
2. Shared measurement;
3. Mutually reinforcing activities;
4. Continuous communication; and
5. Backbone support.

In the original article and others that followed, Kania and Kramer were explicitly and implicitly critical of much of what came before them. In one chart, they compare isolated impact with collective impact as if those were the only two options, omitting the numerous

examples of community-wide coalitions that moved beyond isolated impact but were not explicitly labeled "collective impact."<sup>2</sup> (For one example, see the exhaustive survey of literature on healthy communities by Tyler Norris.<sup>3</sup>)

That short publication, extensive marketing by Kania and Kramer's consulting firm FSG, and a few follow-up articles have resulted in a remarkable revolution in government and foundation approaches to community coalition building and collaboration.<sup>4</sup> Many of these funding organizations are now declaring that they are using a collective impact approach.

The upside of this is that attention has once again been brought to the need to promote multisector collaboration in communities. The downside of this is

that collective impact is based on only a few case studies that the authors themselves were not involved in creating and implementing but rather observed after their development. The articles include neither research nor reference to learning from all the previous research, studies, and community experiences in the field. Observing successful coalitions provides the observer with one basis for learning about community coalitions, but being involved in successfully—or unsuccessfully—developing coalitions provides a deeper and more nuanced understanding of coalitions that apparently was not available to Kania and Kramer. Thus, not surprisingly, collective impact gets much about collaboration wrong regarding both the goals and processes of community change collaboration.

In light of the uncritical, widespread adoption and funding of collective impact by government agencies and foundations, it is necessary to examine and assess collective impact much more critically and thoughtfully. In this article, I articulate ten important issues and concerns that collective impact fails to adequately acknowledge, understand, and address. These failings have serious consequences for the engaged communities. I welcome the community of activists and scholars who are engaged in coalitions, partnerships, and collaboratives to react, disagree, and/or add to the list of concerns.

*1. Collective impact does not address the essential requirement for meaningfully engaging those in the community most affected by the issues.*

Collective impact does not set a priority of engaging those most affected by the issues in their collaborative impact processes. The grassroots communities most affected are not necessarily consulted or do not meaningfully share in collective impact decision making. The result is to ignore and denigrate critical community knowledge, ownership, and support for sustainability. This can further result in creating solutions that may not be appropriate or compatible with the population being served. This is not surprising, because Kania and Kramer come from a top-down business-consulting model. Collective impact never explicitly states that you need to engage the people most affected by the issue(s) driving the coalition. Unfortunately, collective impact's approach is not unusual; in general, collaboration processes used by coalitions of all kinds do not meaningfully involve grassroots community members or other stakeholders directly affected by their work.<sup>5</sup> This is a serious omission. Coalitions without grassroots voices are very likely to create solutions that do

not meet the needs of the people most affected by them, and treat people disrespectfully in their community change process.

Without engaging those most directly affected, collective impact can develop neither an adequate understanding of the root causes of the issues nor an appropriate vision for a transformed community. Instead, the process will likely reinforce the dominance of those with privilege and continue to support the existing non-profit organizations whose work does not create change based on meaningful community input and involvement.

*2. Collective impact emerges from top-down business-consulting experience and is thus not a true community-development model.*

The model of collective impact is mainly about engaging the most powerful organizations and partners in a community and getting them to agree on a common agenda. They explicitly state that collective impact is about bringing "CEO-level cross-sector leaders together."<sup>6</sup> In reality, what community coalitions need to do is engage both the most powerful and least powerful people in a community, finding ways for them to talk and work together to address the community's priorities for action and the impediments to change in institutions and organizations serving the community. This is the heart and soul of community-development coalition work and seems absent in collective impact.

Coalitions across the country have years of experience in bringing a wide range of community stakeholders to the table, not just the most powerful. Often, this was not the case. Early in the history of substance abuse prevention work, partnerships made the top-down mistake. At the start (in 1989), the Robert Wood Johnson Foundation's Fighting Back substance abuse prevention coalitions required having the most powerful

people in the community at the table—the mayor, the police chief, and the school superintendent.<sup>7</sup> As the community context of the substance abuse issue became clearer, we began to see that we needed all sectors of the community and the youth themselves at the table. At that point, the coalitions began to evolve and become more effective. Unfortunately, collective impact seems stuck in the old, less effective model, with CEO leadership central to the process.

*3. Collective impact does not include policy change and systems change as essential and intentional outcomes of the partnership's work.*

Many coalitions in the United States are focused on creating public health outcomes (prevention of substance abuse, obesity, opioid addiction, health disparities, etc.). In recent years, led by the Centers for Disease Control and Prevention (CDC), these coalitions have moved in the direction of policy and systems change as their most powerful and desired outcomes.<sup>8</sup> Certainly, in public health coalitions (which comprise many of the coalitions in the United States), following the CDC's lead and addressing policy change and systems change has become the gold standard of outcomes. Systems change is now recognized as a key priority and best practice in community change partnerships, so this is a serious omission in collective impact.

If we are not changing policies in order to change systems, we are continuing to do fragmented, isolated work. For years, community coalitions addressed specific, focused issues without asking about the ecological and historical factors that impact the outcomes. Smoking cessation coalitions taught us all this lesson dramatically as they went beyond smoking prevention education for young people to a focus on implementing antismoking policies in systems across the community—restaurants, schools, worksites,

public buildings. And it worked! Now, we better understand that policies are at the heart of the work of community coalitions. But where is the policy and system change in collective impact?

*4. Collective impact misses the social justice core that exists in many coalitions.*

Increasingly, coalitions are applying root-cause analyses to understanding their community issues. As they do this and understand the concept and ramifications of social determinants of health, critical social justice issues—such as income inequality, systemic and structural racism, sexism, and homophobia—become clear and urgent. Collaborative efforts then must mobilize to address these issues, which can be difficult to do in top-down collaboratives; those with the most power and privilege dominate and control top-down coalitions and often have an interest in maintaining their privilege and the status quo. Collective impact is a great tool for those who already have power, but it is less suitable and more challenging for those with relatively little power who are working to improve the lives of people and their communities.


For example, alternative partnership models, such as the REACH (Racial and Ethnic Approaches to Community Health) coalition funded by the CDC, are aimed at addressing systemic racism and create systems-level change. The REACH coalitions that emerged from the Public Health Commission were all required to do root-cause analyses of their community's issues.<sup>9</sup> This led to understanding the racial health disparities in their communities in the context of social determinants of health (housing, economic inequality, education, etc.) and the institutional racism that is part of each of these determinants and their related systems. With this approach, addressing structural racism became not just a possibility but a necessity.

*5. Collective impact, as described in John Kania and Mark Kramer's initial article, is not based on professional and practitioner literature or the experience of the thousands of coalitions that preceded their 2011 article.*

When dealing with an issue as complex as collective actions taken by the multiple sectors of a community, we need to be continually learning from those who came before us and from the communities themselves. When I first began working with coalitions almost forty years ago, even then I found valuable resources from a wide range of fields, including community psychology, civic engagement, racial justice, public health, political science, and organizational development, among others. Since then, the literature, experience, and tools for coalition building have grown exponentially and are used extensively by coalitions in a wide variety of circumstances.

Here is a small sample of comprehensive community-wide collaboration resources that are not cited (or maybe even known) by Kania and Kramer:

- Among the most acclaimed and used is Fran Butterfoss's comprehensive *Coalitions and Partnerships in Community Health*, which articulates her and Michelle Kegler's Community Coalition Action Theory (CCAT).<sup>10</sup>
- Other authors' significant scholarly writing about partnerships in public health include the previously mentioned Kegler, Meredith Minkler, and Nina Wallerstein.<sup>11</sup>
- In community psychology, community-wide collaboration has a long history in the work of Seymour Sarason,<sup>12</sup> David Chavis,<sup>13</sup> Stephen Fawcett,<sup>14</sup> Bill Berkowitz,<sup>15</sup> Pennie Foster-Fishman,<sup>16</sup> Vincent Francisco,<sup>17</sup> and my own writings.<sup>18</sup>
- There is an extensive literature and experience in the field of healthy communities, including two recent

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volumes of the *National Civic Review* focused on the topic, and important writing about healthy communities by others such as Joan Twiss and Judith Kurland.<sup>19</sup>

- There are also extensive related contributions from other fields: political science (Arthur Himmelman);<sup>20</sup> collaborative leadership (David Chrislip and Carl Larsen);<sup>21</sup> community development (William Potapchuk);<sup>22</sup> and community organizing (Gillian Kaye).<sup>23</sup>

This rich multidisciplinary literature teaches us that the process of communities working together to create collaborative change is very complex, and is impacted by multiple variables. The literature also identifies processes, methods, and models that have led to the creation of successful collaborations that create changes in programs, practices, and policies in communities. Collectively, we already know a great deal about the tools necessary to do this work. One of the most comprehensive and internationally acclaimed examples is the Community Tool Box. The Community Tool Box provides over seven thousand pages of free downloadable material on community health and development using collaborations and partnerships.<sup>24</sup>

Collective impact flounders by failing to learn from all these wonderful contributions in the literature and the field from all the above disciplines. How can collective impact propose converting a whole field with a five-page article that has virtually no references to the concepts and findings of others? And how can government agencies and foundations uncritically adopt such a model that mislabels observations about a few examples of community collaboration as valid research?

#### *6. Collective impact mislabels its study of a few case examples as research.*

The *Stanford* article cites a few successful examples of community coalitions

and draws their collective impact generalizations from them. This is a very limited sample, and it seems that Kania and Kramer only observed these coalitions and drew conclusions rather than having actually been involved in the messy work of creating coalitions like the ones they note. It is actually stunning to realize that Kania and Kramer changed the world of coalition building simply by observing and distilling insights from a few successful coalitions, but never actually tried creating, implementing, and evaluating a coalition themselves.

In my own work with hundreds of coalitions, I have found that there is much to be learned from the biggest, best-funded top-down coalitions that succeed and those that fail, as well as from the smallest that succeed and fail. I understand we draw our generalizations from the coalitions with which we work, and I have always done so myself; however, the fact that collective impact has become the gold standard for coalition building for government and foundations based on such a limited sample and such limited actual experience is deeply disconcerting. It is fascinating to note that many government agencies (federal, state, local) and foundations are now calling for all of us to follow collective impact as the model if we wish to be effective and funded. Yet this is an intervention with absolutely no evidence-based research. Aren't these the same government and foundation organizations that demand evidence-based research from us in all their program applications?

One has to wonder what makes funders so attracted to collective impact. Could it be that the five simple collective impact components allow funders to believe that coalition building can be simplified and that they finally have the key to success for these messy multivariable entities called coalitions? Or, could it be that collective impact's top-down approach is

most compatible with the foundations' approach to collaborative change? Or, could it be collective impact's avoidance of addressing policy or advocacy that makes collective impact coalitions a safer and less controversial funding bet?

#### *7. Collective impact assumes that most coalitions are capable of finding the money to have a well-funded backbone organization.*

Kania and Kramer's call for coalitions to have a backbone organization is welcome. Finding money for the staffing of coalitions has always been very difficult. Most funders want to fund the coalition's change mission, goals, and programs, but very few grantmakers want to fund coalition staffing and operating costs. It is great to see an emphasis on the requirement of support for these essential core elements of coalitions.

Unfortunately, here, again, collective impact gets it wrong by asking for too much from the backbone organization. Collective impact experts push for a well-funded backbone organization with multiple functions that require considerable resources and staff. These functions include "providing overall strategic direction, facilitating dialogue between partners, managing data collection and analysis, handling communications, coordinating community outreach, and mobilizing funding."<sup>25</sup> By giving all those responsibilities to the backbone organization, collective impact inevitably creates a top-down organization versus a truly collaborative one where leadership and responsibility are dispersed. The collective impact concept of a backbone organization is predicated on coalitions with extensive resources; however, in the hundreds of coalitions I have created, consulted with, or trained, very few can even afford paid leadership, much less a \$100,000 backbone organization.

*8. Collective impact also misses a key role of the backbone organization—building leadership.*

In well-run coalitions, the key role of the backbone organization must be to build coalition leadership, as opposed to *being* the coalition leadership. This is based on the shared value of instituting collaborative leadership as well as democratic governance and decision making for a coalition.

Collective impact barely discusses the idea that leadership in a collaboration is different from ordinary organizational leadership. Again, there is excellent literature that provides a guide to democratic and collaborative governance. Almost twenty years before collective impact, David Chrislip and Carl Larsen's *Collaborative Leadership* helped distinguish the unique characteristics and practices of collaborative leadership in coalitions, including the skills and functions of a collaborative leader and how they differ from traditional hierarchical leadership.<sup>26</sup>

Coalition leaders themselves often emerge from traditional, top-down nonprofit organizations and need to learn a new style of leadership that

facilitates ownership and leadership by the members. We have seen powerful, charismatic coalition leaders who can energize a coalition but who then fail when they cannot organize the energy that they stir up nor delegate the responsibility.

*9. Community-wide, multisectoral collaboratives cannot be simplified into collective impact's five required conditions.*

Coalitions are complex, constantly changing, and influenced by multiple variables. Having worked with numerous coalitions, I cannot imagine any five conditions that could apply universally. In *The Power of Collaborative Solutions*, I identify six principles and effective tools for consideration rather than prescriptive conditions:

1. Engage a broad spectrum of the community;
2. Encourage true collaboration as the form of exchange;
3. Practice democracy;
4. Employ an ecological approach that emphasizes the individual in his/her setting;
5. Take action; and
6. Engage your spirituality as your compass for social change.

For example, the first condition of collective impact is creating a common agenda, and this is highly desirable and necessary. When we assist community coalitions through visioning exercises—including root-cause analysis—and provide guidance that helps members develop a shared common agenda, it is an important accomplishment. However, we need to acknowledge that in some communities the conflicting self-interests can be insurmountable and the common agenda is either not achievable or requires a long time to come into being. Collective impact can frustrate those led to believe that complex activities, such as developing a common agenda (often called a mission statement), can be achieved simply and quickly. The difficulties in this kind of collaborative decision making can be even more frustrating when collective impact does not supply the community stakeholders with the tools that we know work.

*10. The early available research on collective impact is calling into question the contribution that it is making to coalition effectiveness.*

"The Collective Impact Model and Its Potential for Health Promotion," by

Summary Table: 10 Places Where Collective Impact Gets It Wrong

1.	Collective impact does not address the essential requirement for meaningfully engaging those in the community most affected by the issues.
2.	Collective impact emerges from top-down business-consulting experience and is thus not a true community-development model.
3.	Collective impact does not include policy change and systems change as essential and intentional outcomes of the partnership's work.
4.	Collective impact misses the social justice core that exists in many coalitions.
5.	Collective impact, as described in John Kania and Mark Kramer's initial article, is not based on professional and practitioner literature or the experience of the thousands of coalitions that preceded their 2011 article.
6.	Collective impact mislabels its study of a few case examples as <i>research</i> .
7.	Collective impact assumes that most coalitions are capable of finding the money to have a well-funded backbone organization.
8.	Collective impact also misses a key role of the backbone organization—building leadership.
9.	Community-wide, multisectoral collaboratives cannot be simplified into collective impact's five required conditions.
10.	The early available research on collective impact is calling into question the contribution that it is making to coalition effectiveness.

Johnna Flood et al., is among the first published scholarly assessments of the strengths and weaknesses of the collective impact approach.<sup>27</sup> The authors note the lack of resident involvement and the absence of policy and advocacy in the collective impact model, suggesting that: “Since many community coalitions are deeply concerned with advocacy and policy change, this omission can be problematic.” The study indicates that seeking a common agenda “will not be successful if done through coercive compromise” and without a backbone organization that has a “point of view” and a “broader mission, vision and values.”<sup>28</sup> The study also notes that the collective impact model does not provide detailed advice (nor tools) to help coalitions create the necessary continuous communication or common agendas. In its conclusion, the study states, “As our case study application suggests, collective impact appears to have utility as a conceptual framework in health promotion but one that may be usefully augmented by some ‘tried-and-true’ insights and strategies from CCAT (Community Coalition Action Theory).”<sup>29</sup> Additional thoughtful and insightful collective impact critiques are emerging in blogs and other online media from Mark Holmgren,<sup>30</sup> Vu Le,<sup>31</sup> and others.



I would concur with the view that there are some helpful contributions in the writings of Kania and Kramer. They bring fresh eyes to the work of collaboration. They have certainly brought coalition building back to the forefront for grant-makers and many others with influence in the government and foundation/non-profit sectors. Now we have to make sure that collective impact does not proceed without addressing the ten points noted above. Let’s work to improve collective impact so that it can take its place alongside many other valuable models and

resources designed to assist people and communities improve their well-being by engaging the grassroots communities themselves and creating a vision of transformative change. I am hopeful that, if communities using collective impact and funders promoting it address the ten shortcomings discussed in this article, we will see improved applications of collective impact emerge:

- Where those most affected by the issues lead the effort and share the decision making and the power;
- Where the collaborative action is based on an understanding of the social, political, and social justice context in which the issues of the community are embedded, and addresses these issues head on; and
- Where the collective impact work is more thoroughly based on the existing fields of coalition building and community development, learning from the acquired knowledge, experience, and available tools.

Let us hope that we can muster the courage to challenge the collective impact juggernaut and bring our communities what they need and deserve. I know we have the desire to do this, and now we need the will.

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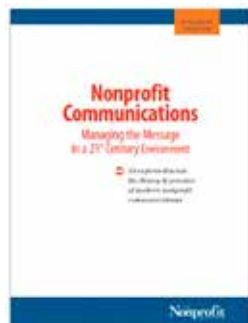
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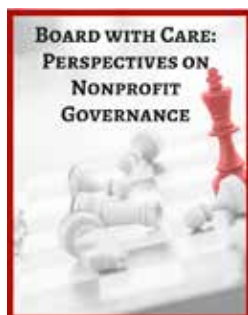
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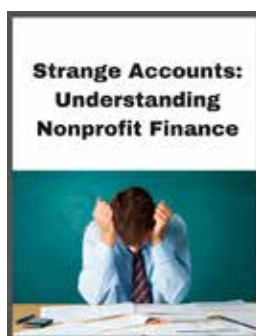
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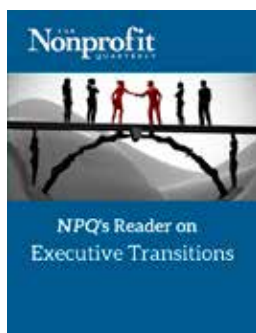
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