List of contributors xxiv Preface xxxv Abbreviations xlix

# PART I Economic findings and theories on nonprofit organizations 1

1 The nonprofit sector: introductory remarks What kind of nonprofit sector, what kind of society? Comparative policy reflections 3

HELMUT K. ANHEIER

- I Introduction 3
  - A Nonprofits as service providers 4
  - B Nonprofits and civil society 6
  - C Social accountability 9
- II Implications 11
- III Scenarios 13
  - A NPM scenario 14
  - B Social capital scenario 14
  - C Accountability scenario 14
  - D The corporate scenario 14
  - E The mellow weakness scenario 15
  - F Roles for the state 15
- IV Summary and conclusions 16
- 2 Good and not so good governance of nonprofit organizations: factual observations from the USA and Europe
- 2.1 Good and not so good governance of nonprofit organizations: factual observations from the USA 20

JOHN A. EDIE

I Introduction 21

	II Media reports: examples of not so good governance 22	
	III Response to the media: who is pushing for change?25	
	IVFour key events leading to improved good governance23	
	A Senate finance committee's "white paper" 28	
	B Report of the Panel on the Nonprofit Sector 28	
	C US Senate Passage of S. 2020 29	
	D California legislation 29	
	V Examples of good governance 30	
	A Independent audit 31	
		20
	<ul><li>D Compensation of CEO approved by full board of directors</li><li>E Conflict of interest policy 33</li></ul>	32
	F Whistleblower policy 33 G Travel policy 34	
	<ul><li>A BBB Wise Giving Alliance (Arlington, Virginia) 35</li><li>B BoardSource (Washington, DC) 36</li></ul>	
	C Council on Foundations (Washington, DC) 36	
	D Forum of Regional Associations (Washington, DC) 37 VII Summary and conclusions 37	
2.2	Good and not so good governance of nonprofit organizations:	
	factual observations from foundations in Germany 39	
	CHRISTOPH MECKING	
	I Introduction 39	
	II Not so good foundation governance 42	
	A Problem cases 42	
	B A lack of publicity 47	
	III Good foundational governance 48	
	A Government monitoring 48	
	B Self-regulation 50	
	C Principles of good foundational practice 52	
	IV Summary and conclusions 59	
3	Economic theories of a surrow ()	
3.1	Economic theories of nonprofit organizations	
J.1	<i>The economics of nonprofit organizations</i> 60	
	HENRY HANSMANN	
	I Introduction 60	
	II Structure and role 60	

vi

3.2

4 4.1

III Managerial agency problems 63
IV Entry and exit 65
V Refining the nondistribution constraint: executive compensation 68
VI Cooperatives versus nonprofits 69
VII Summary and conclusions 71
Principal–agent theory and nonprofit accountability 73
RICHARD STEINBERG
I Introduction 74
II Principal–agent theory in economics 75
A The problem defined 75
B Types of principal-agent problems 76
C Solving principal–agent problems 78
D Shortcomings of agency theory 80
III Applications: donors as principals, organizations as agents 83
A Quantity problems 85
B Leadership gifts 88
C Excessive fundraising and administrative expenditures 89
D Quality mismatch when donor-principals are homogeneous 92
E Quality mismatch when donor-principals are heterogeneous 93
IV Customers and clients as principals, nonprofit organizations as agents 96
V Internal agency problems 99
A Overview – interpreting empirical results 100
B Excessive compensation 102
C Financial incentive plans 105
VI Summary and conclusions 113
PART II The nonprofit sector: private law, trust law, tax law in selected countries 127
III selected countries 127
Anglo-American countriesNonprofit organizations in the United States129
JAMES J. FISHMAN
I Introduction 130
II The nondistribution constraint 131
III Public benefit and mutual benefit organizations 132
IV Private law, trust law, and corporate law 133
A Unincorporated associations 134

B The charitable trust 135

C Nonprofit corporations 136 V Tax law relating to nonprofits 139 A State tax exemption: regulation and enforcement 139 B Federal tax law 140 C The functions of federal tax law 141 D Federal tax taxonomy: the charitable non-charitable distinction 143 E The charitable nonprofits: section 501(c)(3) organizations 143 F The public charity-private foundation distinction 144 G Restrictions on private foundations 146 H Evaluation of the private foundation restrictions 148 VI Fiduciary obligations 149 A Trust law: the duty of prudence 149 B Trust law: the duty of loyalty 150 C The nonprofit corporation: the board of directors 150 D Nonprofit corporate law: the duty of care 151 E The duty of loyalty 152 F Private law approaches 155 G State regulation of fiduciary and other obligations: the attorney general 155 H Federal regulation of fiduciary obligations 158 VII Charitable solicitation 161 161 A State regulation B Federal regulation of charitable solicitation 165 VIII Summary and conclusions 166 Harmonising nonprofit law in the European Union: an English perspective and digest 170 HUBERT PICARDA I Introduction 171 II General themes 173 A The contrast between the common law and civil law: reconciliation problems 173 B The impulse to codification and cross-border initiatives in Europe 175 C The comparable techniques of synthesis of views 176 D The need for a core vocabulary 177 E The flood of policy and statist agenda into the "third sector" and the law in England 178 F Overview of the English Charities Act and its problem area

viii

4.2

178

	G Specific cross-border European initiatives to preclude money laundering abuse by terrorists and criminals of charities and the third sector and for the development of the European association and other strategies 183
	III Organisational law 184
	A Trust 184
	B Company 184
	C Unincorporated association (volunteers) 185
	D Industrial and provident societies: charitable housing
	associations 185
	E Charitable incorporated organisations (CIOs) 185
	IV Duties of trustees and directors in relation to loyalty and duty
	of care 186
	A Duty of loyalty 187
	B Keeping to the objects 187
	C Duty to avoid or remedy conflict of interests 188
	D Duty of care 191
	V Enforcement of those duties and the enforcers 192
	A Enforcement of those duties 192
	B Enforcers 192
	C Methods of enforcement 194
	VI Summary and conclusions 195
5	Germanic countries
5.1	Nonprofit organizations in Germany 197
5.1	
	THOMAS VON HIPPEL
	I Introduction 200
	A The term "nonprofit organizations" 200
	B Empirical information 200
	II Institutional law 200
	A Association 200
	B Foundation 202
	C Other legal forms for nonprofit organizations 203
	III Tax law 205
	A Status of a tax-exempt organization 205
	B Tax benefits 208
	IV Fiduciary obligations of the board members 210
	A Duty of care 210
	B Duty of loyalty 211
	C Duty of prudence (investment of assets) 211

D Duty of obedience 213
V Governance and enforcement 214
A Internal governance 214
B State supervision 216
C Rights of founders, donors, beneficiaries and third parties 218
D Reporting, auditing and disclosure 219
VI Charitable solicitation 220
A Regulation for solicitation 220
B Limitations for fundraising costs? 221
VII Economic activities, enterprises and creditor protection 222
A Economic activities 222
B Nonprofit organizations and enterprises 224
C Creditor protection 224
VIII Recent reforms, reform proposals, standards of best practice 225
A Recent reforms 225
BRecent reform proposals225CBest practices225
IX Summary and conclusions 226
B Reducing legal uncertainty 226
5.2 Nonprofit organizations in the Netherlands 228
TYMEN J. VAN DER PLOEG
I Introduction 230
A The term "nonprofit organizations" 230
B Empirical information 230
II Institutional law 231
A Legal forms 231
B The association 231 C The foundation 233
A Introduction 236
B Duty of loyalty and duty of care 237
C Duty of prudence (investment of assets) 239
D Duty of obedience 241
V Governance and enforcement 241
A Internal governance 241
B External supervision 248

Х

C Rights of third parties 254 D Reporting, auditing, and disclosure 256 VI Charitable solicitation 258 VII Economic activities, enterprises, and creditor protection 259 259 A Economic activities 259 B Nonprofit organizations and enterprises C Creditor protection 260 261 VIII Recent reforms, reform proposals, standards of best practice A Recent reforms 261 262 **B** Reform proposals C Best practices 263 IX Summary and conclusions 263 Romanic countries Nonprofit organizations in France 265 KATRIN DECKERT 268 I Introduction A The term "nonprofit organization" 268 **B** Empirical information 268 C General remarks on the legal environment in France 269 II Institutional law 272 A Associations 272 **B** Foundations 280 285 III Tax law relating to nonprofits IV Fiduciary obligations of board members 287 A Introduction 287 B Duty of loyalty 287 C Duty of prudence 288 D Duty of obedience 291 E System of civil liability in nonprofit organizations 293 V Governance and enforcement 293 293 A Internal governance 307 **B** State supervision C Rights of third parties 312 313 D Reporting, auditing and disclosure VI Charitable solicitation 319 VII Economic activities, enterprises and creditor protection 319 A Economic activities 319 322 **B** Creditor protection

6

xi

VIII Recent reforms, reform proposals, standards of best practice 323 IX Conclusion 324 7 Transformation countries Nonprofit organizations in Hungary 7.1325 ZOLTÁN CSEHI I Introduction 327 A The term "nonprofit organizations" 327 B Hungarian Nonprofit Act: special rules and benefits for registered charities 331 C Empirical information 333 II Institutional law 334 A Purpose and characteristics 334 B Requirements of the NPO Act 338 C Establishment 340 D Winding up 343 III Fiduciary obligations of the board members 345 A Introduction 345 B Duty of loyalty 348 C Duty of prudence 350 D Duty of obedience 351 E Incompatibility rules of registered NPOs 353 IV Governance and enforcement 355 A Internal governance 355 B State supervision 363 C Rights of third parties 367 D Reporting 369 V Economic activities, enterprises and creditor protection 374 A Economic activities 374 B Creditor protection 375 VI Recent reforms, reform proposals, standards of best practice 376 VII Summary and conclusions 377 Nonprofit organizations in the Czech Republic 7.2 379 KATEŘINA RONOVSKÁ I Introduction 381 A The term "nonprofit organisations" 381 B Empirical data 383 II Institutional law 383 A Legal forms 383

xii

384 **B** Associations C The foundation, the endowment fund, the public benefit 388 institution III Tax law relating to nonprofits 396 A General 396 B Survey of tax privileges 397 IV Fiduciary obligations of the board members 398 398 A Introduction B Duty of loyalty 398 C Investment of assets (duty of prudence) 400 D Duty of obedience 401 V Governance and enforcement 401 A Internal governance 401 **B** External supervision 407 C Rights of third parties 411 D Reporting, auditing, disclosure 413 VI Charitable solicitation 416 VII Economic activities, enterprises and creditor protection 417 A Economic activities 417 418 B NGOs and enterprises 420 C Creditors' protection 421 VIII Recent reforms, proposals, standards of best practice A Recent reforms and proposals 421 **B** Best practice 425 IX Summary and conclusions 426 Nonprofit organizations in the People's Republic of China 428 THOMAS VON HIPPEL/KNUT B. PIBLER I Introduction 431 A The term "nonprofit organizations" 431 **B** Empirical information 431 II Institutional law 432 434 A Foundations B Social organizations (associations) 439 442 C Civil non-business institutions D Charitable trusts 444 E Foreign nonprofit organizations 446 III Tax law relating to nonprofits 446 IV Fiduciary obligations of the board members 447

7.3

xiii

A Duty of loyalty 447 B Duty of prudence (investment of assets) 450 C "Duty of obedience" 454 V Governance and enforcement 455 A Internal governance 456 B State supervision (external supervision) 461 C Rights of third parties 462 D Reporting, auditing, and disclosure 465 VI Charitable solicitation 468 VII Economic activities, enterprises, and creditor protection 469 A Economic activities 469 B Nonprofit organizations and enterprises 470 C Creditor protection 470 VIII Recent reforms, reform proposals, standards of best practice 470 470 A Recent reforms **B** Reform proposals 471 C Best practice 473 IX Conclusion 474 A Growing significance of NPOs 474 **B** Increased regulation 474 C Skepticism regarding NPOs 475 D Thoughts on liberalizing NPO regulations 475 E Legal uncertainty 476 The board of nonprofit organizations 479 PART III The board of nonprofit organizations: law and practice 8 8.1 The board of nonprofit organizations: puzzling through the gaps between law and practice – a view from the United States 481 EVELYN BRODY I Introduction 482 **II** Discussion 486 A To whom (or what) are board duties owed? 486 B Organizational type, organizational size 489 C Inside the black box: board/management relations 491 D Group authority, individual responsibility 506 E Are charity members shareholder-subsitutes? 519

F What really happens to a wayward charity fiduciary? 522

III Summary and conclusions: how can practice be improved? 529

xiv

8.2	The board of nonprofit o	rganizations:	some corporate governance
	thoughts from Europe	531	

KLAUS J. HOPT
I Nonprofit organizations and corporate governance: an introduction from a European perspective 532
A The state of the discussion in Europe 532
B Deficits of control in nonprofit organizations and ways out 534
II The board of nonprofit organizations: what can be learned from the corporate governance discussion? 539
A The board of nonprofit organizations: differences between the United States and Europe 539
B The board of nonprofit organizations in Europe 540
III Organization and functioning of the board of nonprofit organizations 543
A One-tier/two-tier boards 543
B Composition and size of the board 545
C Board committees 549
D Remuneration and audit in particular 550
E Education, professionalization and evaluation 553
IV Responsibility of the board of nonprofit organizations 554
A Duties of the board of a nonprofit organization 554
B Liability of the board of a nonprofit organization 557
C Enforcement, legal and non-legal 559
<ul> <li>9 The duty of obedience</li> <li>9.1 Rediscovering the duty of obedience: toward a trinitarian theory of fiduciary duty 564</li> </ul>
ROB ATKINSON
I Introduction 566
II Identifying the duty of obedience 569
A Locating the duty of obedience in the tripartite scheme of fiduciary duties 569
B Locating the duty of obedience in four fiduciary contexts 578

III Normative analysis: evaluating the duty of obedience 611

A Normative analysis of the weak form of the duty of obedience 612

B Dead hand control in the law of charity 614

IV Summary and conclusions 618

9.2	Duty of obedience: the German perspective 619
	RAINER HÜTTEMANN
	I Introduction 619
	II Law of foundations 620
	A Dead-hand control 620
	B Alteration of purpose under § 87 German Civil Code 624
	C Other amendments of the articles of a foundation 625 D State laws 626
	F Current reform proposals 628
	III Charitable associations and corporations 629
	IV Duty of obedience and charitable giving 630
	V Impacts of tax relief 631
	PART IV Good governance of nonprofit organizations:
	activities and regulatory problems 635
10	Fundraising
10.1	The regulation of fund-raising by charities and voluntary
	organisations in England and Wales 637
	PETER LUXTON
	I Introduction 637
	II Public charitable collections 641
	III Fund-raising 653 IV Trading 657
	V EU regulation 659
	VI Self-regulation 660
	VII Summary and conclusions 660
10.2	Comparing regulation of fundraising: self-regulation or
	governmental regulation? 662
	WINO J. M. VAN VEEN
	I Introduction 663
	II Governmental regulation 665
	A Fundraising and legislation: general remarks 665
	B Legitimacy of government regulation of fundraising 668
	C The instruments of government regulation 669
	D Compliance and effectiveness of government regulation 675 III Self-regulation of fundraising 679
	A Defining self-regulation 679
	6 <u>6</u>

xvi

<ul><li>B Legitimacy of self-regulation 682</li><li>C Instruments of self-regulation 684</li><li>D Standards for fundraising 688</li></ul>
E Self-regulation: concluding remarks 692
IV Comparing government regulation and self-regulation 693
A Authorization versus accreditation 693
B Punitive versus preventive 694
D Tullitive versus preventive
C Informing the public 695 D The mechanisms: implementation and enforcement 696
V Summary and conclusions: government regulation or self-regulation? 697
11 Asset management in nonprofit organizations
11.1 Asset management in nonprofit organizations 699
CARSTEN CARSTENSEN
I Introduction 699
II Economic aspects of asset management 700
A The role of foundations 700
B Fundamentals 701
C Fulfilment of the foundation's purpose 701
D Preservation of the foundation's capital 701
E Disposition of the proceeds 703
F Asset management 703
III Asset management and the tax law 704
A Payout in time 704
B Asset management and economic activity 705
C Asset management and securities transactions 705
D Asset management and real estate 705
E Asset management and alternative investments 706
IV Special rules for the association 707
A Membership fees and donations 707
D Freservation of the association of the
C Trustee function of the association
v Summary and consideration
11.2 Legal standards for capital investments by foundations in hedge
funds according to German and American law 709
MAXIMILIAN HAAG AND ANDREAS RICHTER

I Introduction 710

xvii

II Specific characteristics and risks of capital investment in hedge funds 712 A Fund structure and management 712 B The fund's investment strategies 714 III Legal standards for investments by charitable organizations 715 A Founder's will and duty of loyalty 715 B Precept of secure and lucrative investment 718 C Precept of timely use of funds 726 D Prohibition of favoritism 729 E Additional restrictions in US tax law 731 F Liability of the foundation bodies for breaches of duty 735 IV Summary and conclusions 738 Nonprofit organizations and economic activities/enterprises 12 Nonprofit organizations and economic activities/ 12.1enterprises 740 CARL HEMSTRÖM I General background 741 II Foundations and nonprofit associations 746 A Background 746 **B** Introduction 747 C Management and economic activities 754 D Accounts and reports 759 E Auditing 763 F Liquidation 767 12.2 Nonprofit organizations and enterprises: the Danish foundation law as an example 770 SØREN FRIIS HANSEN I Outline of Danish law on foundations 770 A General principles for nonprofit organizations in Danish law 770 B Foundations in Danish law 772 C Tax treatment of foundations under Danish law 777 II Corporate governance in Danish enterprise foundations 780 A The Danish management system 780 B Accounting and state supervision 782 III Financial performance of enterprises controlled by enterprise foundations (the Studies by Thomsen et al.) 784 IV Summary and conclusions 786

xviii

# 12.3 The protection of members and creditors of nonprofit organisations 789

SUSANNE KALSS

I Introduction 789

- II Protection of creditors 791
  - A General 791
  - B Limitation of activities of nonprofit organisations, in particular associations 792
  - C Minimum capital requirements principle of capital maintenance 798
  - D Accounting, auditing, disclosure 800
  - E Insolvency law 803
  - F Liability of organs and members 804
- III Protection of members 806
  - A Rights of voice 807
  - B Right to entrance fees and membership fees 808
  - C Member protection under competition law 810
- IV Summary and conclusions 812

# PART V Good governance of nonprofit organizations: self-regulation, disclosure and supervision 813

13 Self-regulation

Foundation governance in Switzerland 815

THOMAS SPRECHER

I From corporate governance to foundation governance 816

- A Corporate governance 816
- B Common points and differences 816

C Foundation governance 817

- II Foundation governance in Switzerland 818
  - A Basis 818
  - B Self-regulation efforts 820
  - C The Swiss NPO Code 823
  - D The Swiss Foundation Code 825
- 14 Disclosure, reporting, auditing
- 14.1 Financial reporting by nonprofit organizations: United States developments 829
  - STANLEY SIEGEL
    - I Introduction 830

A Fundamental issues concerning the character, objectives, reliability and availability of nonprofit financial reporting 831
B An overview of pre-1990 financial reporting by nonprofits 834 II The current accounting principles governing nonprofit
financial reporting – the business enterprise model extended 835
A The FASB takes over regulation of nonbusiness financial accounting 835
B The present GAAP framework applicable to nonprofit 836
III Financial disclosure under the federal income tax laws: Form 990 and Guidestar 842
A Form 990: the Internal Revenue Service administers public financial disclosure by nonprofits 842
B Analyzing the Form 990 disclosures: relevance, reliability and disclosure standards 843
IV Possible future directions – mandatory audit and public
reporting, "social accounting" – costs, benefits and questions 845
A Arguments for and against mandatory disclosure on the SEC model 845
B "Social accounting" for the nonprofit organization 846
14.2 Charity Commission regulation of the charity sector in England
and Wales: the key role of charity audit regulation 849
GREYHAM DAWES
I Key features of the registered charity sector in England and Wales 850
II How the Charity Commission monitors and regulates the sector 851
A 'Proportionality' and the 'risk-based' approach 851
B 'Cause for concern' criteria for regulatory intervention by the Commission 852
C The basic information return for all registered charities 853
D Summary Information Returns (SIR) – simple basic public domain data 855
E Regulatory uses of charities' filed annual reports and audited accounts 856
F Regulatory compliance – a policy of persuasion before enforcement 857
G Charity inquiries summarised on the Commission's website 858
III Regulating the quality of charity audit reports 859
A The framework of professional audit regulation 859

XX

	B The auditing Practices Board and its charity auditing standard (PN11) 865
	C Auditors' 'whistle-blowing' obligations to the regulator 868
	D 'Non-standard' audit reports – a regulatory 'trigger' 869
	E The Charity Commission's 'directions to independent examiners' 876
	F Additional requirements for accruals accounts 877
	G Charities subject to statutory audit 878
	H Special requirements for accruals accounts 879
	IV Promoting best practice in charity 'governance' for self-regulation 879
	A The problem: charity trustees are normally all or mostly non-executives (volunteers) 880
	B The solution: delegation to agents and (for larger charities) to paid executives 880
	C The 'voluntary' principle of charity trusteeship 881
	D Conflict-of-interests: 'staff-trustees'; 'user-trustees' 882
	E Trustee-appointment/removal powers 884
	F Delegation of trustee-powers: the charity law 'duty of care' 884
	G 'Internal controls' as an aspect of governance 885
	H Further developments: impact of corporate and other governance codes 885
	I Best-practice 'hallmarks' for benchmarking charities 888
	J SORP-Compliance Guides for special needs 890
	K The 'charity membership' issue 890
	V Future developments 891
	Appendix: the Public Oversight Board, the Audit Inspection Unit and Professional Audit Regulation 892
15 15.1	Enforcement by state supervision and tax authorities The Charity Commission for England and Wales 896
	RICHARD FRIES
	I Overview 896
	II Origins of the Charity Commission 898
	III The Charity Commission and regulation 899
	IV The status of the Charity Commission 900
	V Composition of the Commission 901
	VI Strategy and objectives of the Charity Commission 903
	VII Functions and powers of the Charity Commission 904
	A Registration 904

xxi

B Political activity and campaigning 906 C Supervision 907 D Support and guidance 907 **E** Investigation 908 F Limits on the powers of the Commission 908 VIII Accountability of the Charity Commission 909 IX Conclusion 910 X Annex - Scotland and Northern Ireland 912 Internal Revenue Service and States Revenue Department 15.2 oversight of nonprofit organizations in the United States 914 JOHN D. COLOMBO I Background 915 II Federal procedural oversight 916 A Inception 916 **B** Lifetime 917 C End of life 920 III Federal substantive issues 920 A Charitable purpose 920 B Limitations on exempt status 921 C Special rules applicable to private foundations 929 IV State revenue department procedural oversight 930 V State revenue department substantive issues 931 VI Overlap between tax oversight and state attorney general oversight 932 VII Future policy questions 934 A A central organizing principle? 934 B Commercial activities and exemption 936 C The role of disclosure and Form 990 937 D The general role of tax authorities in charitable oversight 938 15.3 Tax law as an instrument to strengthen the corporate governance of the nonprofit sector 940 THOMAS VON HIPPEL AND W. RAINER WALZ I Introduction: Tax cobbler, stick to your last 941 II Tax review 941 A Procedure of tax review 941 B Issues of tax review 942 III The impact of tax law concepts on corporate governance issues 943

IV Corporate government policy via tax law 944

xxii

A Foreign experiences with tax law 944

B The slow ways of civil law reform in Germany 944

C Justifying tax law as a useful policy tool 946

D Practical evidence of reform efficiency 948

VI Identifying useful tax law concepts 948

A Current German tax law 949

B Reform suggestions 951

Index 956