

European Foundation Centre (EFC) Comments

On the Discussion Document:

**“Draft Recommendations to Member States regarding a code of conduct for non-profit organisations to promote transparency and accountability best practices
An EU design for implementation of FATF Special Recommendation VIII – Non-profit Organisations”¹**

Executive summary:

The European Foundation Centre (EFC)² has read the proposed Draft Recommendations (DR) to Member States regarding a code of conduct for non-profit organisations (NPOs), which were released by the European Commission on 22nd July 2005. The EFC understands that these recommendations are aimed at promoting, on a voluntary basis, transparency and best practices within the non-profit sector to protect it against potential abuse for the financing of terrorism and other kind of criminal abuse, and wishes to submit the following preliminary comments on the DR:

- I. While welcoming the introductory statement of the DR outlining the vital work of the sector, the EFC deeply regrets that so little time is being allocated for an adequate consultation of the sectors concerned on such key issues.
- II. Government oversight should be proportionate to the risk of abuse, and be effective while flexible. It should not put at risk the efficiency nor the plurality of the activities and the various forms of intervention of foundations.
- III. The EFC wants to underline the importance of proportionality based on risk and on the size/activities of the NPOs in setting the appropriate level of rules, oversight and compliance requirements.
- IV. NPOs should not be discriminated against in relation to other organisations and enterprises as regards oversight and requirements of disclosure of information or management procedures, because of the different nature of their purpose and modus operandi.
- V. Draft Recommendations should not put at risk the cross-border work of foundations not only within the European Union but also at the international level. This should be clearly stated.
- VI. One cannot link the tax status of an organisation, which is defined at the national level mostly in tax laws, with transparency and accountability requirements set up at European level. This raises legal problems by mixing tax requirements on the one hand and civil or common-law elements on the other hand, at two levels of different competence between Member States and the European Union, in particular as regards direct taxation.
- VII. The EFC urges the Commission to carry out appropriate consultation with the sector to review:
 - o The proposed list of risk-indicators to assess the risk of abuse for terrorist financing and other kind of criminal abuse
 - o The potential development of “European Guidelines” as proposed in the textin order to make relevant, effective and well-balanced proposals to help to achieve the set objectives.
- VIII. The foundation sector at European level and in national jurisdictions has representational organisations and self-regulatory mechanisms seeking to promote transparency and accountability, but also the effectiveness of foundations, whatever their size and fields of support and operations. The EFC will be pleased to contribute and share its work in these areas.

¹ http://europa.eu.int/comm/justice_home/news/consulting_public/code_conduct_npo/draft_recommendations_en.pdf

² see annex 1 “About the European Foundation Centre (EFC)”

General remarks

1. The EFC welcomes the introductory statement of the Draft Recommendations regarding the vital role played by non-profit organisations (NPOs), underlining that care must be taken not to undermine the work or reputation of the sector. NPOs have indeed a unique role to play in our society to address citizens' needs and support their actions and voice, alongside, in complementarity, or in cooperation with other actors.
2. The foundation sector encompasses a variety of organisations with different structures and sizes, concerns and activities. While the document wishes to find an approach that minimises the risk of abuse, without over-burdening the sector, the EFC believes that the text should stress the need to have a balanced approach not to overstrain in particular small foundations and put their activity at risk. The proportionality between transparency/accountability requirements (administration, disclosure, accounting etc) and the size of the organisation (income/assets, staff) and the scale of its activities should be considered throughout the document.
3. Both in terms of public oversights/regulations, and privately run monitoring systems, the cost of demonstrating compliance should be commensurate and not outweigh the benefits gained.
4. Foundations already face significant barriers when it comes to cross-border activity in the absence of an appropriate European Foundation Statute and the lack of an enabling EU-wide tax framework. Any new measures stemming from these recommendations should not add to the complexity and cost of foundations' EU-level work, but contribute to providing the necessary tools for foundations to operate cross-border at EU-level in an effective way.
5. The Draft recommendations should not lead to potential follow-up measures which would constitute a further obstacle to cross-border giving possibilities, by individuals and legal entities, in Europe and beyond.
6. Open dialogue and appropriate consultation procedures with foundations and their umbrella organisations at European and country levels should be put in place to review existing transparency and accountability rules, practices, mechanisms and oversight and assess which existing measures and potential new initiatives would be best effective to achieve the stated purposes. At EU level the EFC has resumed in 2004 its work on advancing good practices in the foundation community as well as accountable international grantmaking and operations of foundations. Preliminary outcomes will be available in 2006.
7. Public trust is essential to the work and effectiveness of foundations and other NPOs. They must be fully involved in the process to bring about positive and long-lasting change in the area under review.

Specific comments

Draft Recommendation:

A. Recommendations to Member States to address the vulnerabilities of NPOs

1. Oversight mechanisms (page 2)

The EFC notes that the proposed Draft Recommendations link the granting of a) special tax status b) access to public grants and c) rights to collect funds from the general public - to the registration of non-profit organisations (into publicly accessible systems) and wants to underline the following points:

⇒ EFC Comments

8. The EFC wishes to stress that oversight mechanisms should not undermine the efficiency nor the plurality of the activities and the forms of intervention of foundations. Mechanisms that do not increase the compliance burden for the sector should be given due consideration.
9. In any event, registration should be kept as an information exercise and not as a requirement for approval for constitution.

10. One cannot link systematically the tax status of an organisation - defined at the national level mostly in tax law - with registration and transparency and accountability requirements, without giving due consideration to the nature of the organisation, its purpose and the nature of its activities, which are the bases upon which tax benefit status is defined at the national level in many countries across the Union.
11. The ability to receive public funds or contracts should be linked to the ability of the organisation to carry out the work for which it sought and received the funds.
12. NPOs should not be discriminated against in relation to other organisations and enterprises as regards oversight and requirements of disclosure of information or management procedures, because of the different nature of their purpose and *modus operandi*.
13. *Assessing risk of abuse*: Whereas competent authorities should be empowered to request information on alleged cases of NPOs' unlawful operations, they should not put the reputation of the NPOs at risk, and the latter should always be granted the rightful right to appeal.
14. *Audits* -Whereas tax authorities can be encouraged to carry out regular reviews of non-profit organisations receiving special tax treatment, audits of NPOs should be undertaken by private independent auditors and not by public authorities.

The EFC assumes that "tax audits" in the meaning of the DR refers to reviews at the national/regional levels assessing whether an NPO still qualifies for its "tax privileged status". All EU Member States grant some tax privileges to non-profit organisations, however the procedure for obtaining this status varies considerably throughout the EU. In most countries the decision of the appreciation of "public benefit" nature of an organisation does not automatically lead to tax privileges. A separate decision mostly by tax authorities is needed. However, some countries lack a formal procedure and decisions are in those cases often based on advance rulings and allow in some cases an extensive discretionary power to the authorities. In order to gain more legal security and clarity, one could consider encouraging national legislators to introduce clear and user-friendly rules, which would improve the overall situation while avoiding discriminatory discretion practices. We would therefore propose the following text:

"Tax authorities should be encouraged to carry out regular reviews of NPOs receiving special tax treatment, with due consideration of the size and activity of the organisation. Where needed, national legislators should amend national tax laws and regulation with a view to introducing clearer and more user-friendly rules concerning the requirements for receiving a tax privileged status."

15. Foundations stand under some form of (national/regional) state supervision defined by law. Duplication of supervisory structures should be avoided and it should be ensured that the existing ones operate effectively.
16. Whereas audits should be encouraged, oversight, control and potential audits should take due account of the size of the organisation and its activities.

Draft Recommendation:

A.2. Encourage compliance with the proposed Code of Conduct

- **Linking privileged tax status, award of public grants and the right to public fundraising for NPOs, which fulfilled the registration requirement and comply with transparency and accountability measures (page 3)**

⇒ EFC Comment

The Draft Recommendations raise a series of critical legal issues, which are problematic.

17. The DRs in the current drafting link up/confuse civil law as well as transparency and governance issues with tax law elements. In other words it mixes governance/disclosure issues with public

benefit work requirements for granting special tax status. The EFC wishes to stress that in many EU countries special tax status is defined by tax laws according to various criteria including the “public benefit” or “charitable” purpose of the organisations and all the implications thereof (non-distribution constraint, etc.).

The proposed “Code” appears to suggest that in addition to national requirements for tax-exemption; the “privileged tax status” would depend upon specific governance requirements, which could in fact be in conflict with current national laws and with the wide choice of legal forms that are available for NPOs in civil and in common law. Overall this section introduces a yet unspecified understanding of the “tax-privileged nature” of foundations and other NPOs. We therefore recommend removing the reference to the privileged tax status from this paragraph and reword the paragraph on Tax Authorities under point A1 as proposed in comments n°14.

18. The text does not take into account the situation of foundations active across borders, and may put their activity at risk. Would foundations working cross-border have to register in the various registration systems to benefit from equal rights in all EU countries (namely, privileged tax status – right to collect funds and the award of public funds/contracts)? This point requires clarification. An additional difficulty arises from the various definitions and interpretations of what is public benefit/charitable from one country to the other across the European Union.
19. It is unclear in the current drafting whether this Draft Recommendation applies both at national and European levels, and covers the award of public grants of both national and European origins.

Draft Recommendation

- **The transparency and accountability principles and measures proposed in the Code of Conduct should be included in existing labels or in labels to be developed. Such systems could be run by public or private bodies and would examine compliance of NPOs with the transparency and accountability measures (page 3)**

⇒ EFC Comment

20. It would be useful to map existing certification/accrediting systems for NPOs at regional/country level and European level, including their goals and scope. It is also important to document existing self-regulatory mechanisms and initiatives, and those currently under development to promote best practices and synergies, where appropriate.
21. Public or private monitoring /certification systems should not hinder cross-border activities of foundations and transnational giving.

Draft Recommendation

- **Private monitoring bodies or NPO umbrella organisations should be encouraged to establish seals of approval for NPOs compliant with the Code of Conduct (page 3)**

⇒ EFC Comment

22. It is not clear in the current draft text whether the seal of approval set out in this DR is of the same nature as the “label” mentioned in the above DR. Terms may need clarification.
23. Monitoring by private bodies raises a series of questions that are not addressed in the current text and should be taken into account. These include:
 - the financial sustainability of monitoring schemes - who takes the cost of monitoring?
 Granting a seal, monitoring compliance and renewing a seal, having an appeal system, all these activities have a cost, which in most cases would be charged to the applicant organisation – this could be an issue for small non-profit organisations in particular.

--- In addition, liability of the monitoring agencies would be an issue of concern for umbrella organisations.

24. Monitoring can take on many forms, with certification as one possibility (a method which has mostly been explored by fundraising NPOs) but other approaches should also be encouraged and supported e.g.: self-assessment and reporting tools.

Draft Recommendation

A. 3. Awareness Programmes on Vulnerabilities of NPOs to Terrorist Financing and other Criminal Purposes

- Contributions to the **assessment of risk** of abuse for terrorist financing (page 3)

⇒ EFC Comment

25. The intended list of risk factors - provided in an annex to the DR - should be addressed after extensive consultation with the sector. Policies in the field should take into account the due diligence policies and processes developed by individual NPOs at the national and international levels. In particular it should not put at risk, as currently worded in point F of the Annex - "Beneficiaries, donors and partner NPOs", the international activities of NPOs in third countries where the actions of foundations or other NPOs are particularly needed.
26. Caution should also be given regarding the current set of "organisational structure" "risk indicators".
27. The EFC welcomes the proposal to encourage NPOs to assess their existing practices to further strengthen the prevention of their misuse for terrorist financing. Awareness programmes on vulnerabilities of NPOs as called for in the document, should go hand in hand with support and capacity-building schemes to help NPOs, where appropriate, to improve their transparency and accountability practice, and assess their existing practices. In other words, public and private support schemes should be put in place to promote the dissemination and sharing of good practices, and underpin peer-learning and educational efforts.

Draft Recommendation

B. Code of Conduct for non-profit organisations to promote transparency and accountability best practice

- NPOs should produce and keep up to date the organisation's "**Basic Identification Form**" that **should be sent to the authority** competent in fulfilling relevant registration functions. This authority should be informed of changes in the "Basic Identification Form" and of winding-up of the organisation (together with a statement on how the net assets of the NPO will be distributed). The "Basic Identification Form" should also be held publicly available at the registered office (page 4)

⇒ EFC Comment

28. The EFC supports transparency practices, however caution should be taken not to overburden small foundations with excessive paperwork. Foundations' by-laws cover some of the data currently mentioned in the "Basic Identification Form" e.g. name and acronym, objectives, and decision-making structure.
29. There may not be a need to introduce a new concept of data collection with the "Basic Identification Form". Most of this information is already available at the organisation-registered office or at the competent authority in many of the EU Member States. NPOs have to comply with the regulations concerning transparency in force in the countries in which they operate and they may be encouraged to complement such regulations with additional measures on a voluntary basis.
30. Priorities of the organisation, composition of its governance structure, procedures, programme interests and activities, income and expenditure could be made available in the organisation's regular activity reports.

Draft Recommendation

- NPOs should follow **proper book-keeping** and prepare **Annual Financial Statements** of income and expenditures. (page 4)

⇒ EFC Comment

31. Requirements regarding bookkeeping and financial statements should be proportionate to the size, scale and activities of the organisations.

Draft Recommendation

- NPOs should keep full and accurate **audit trails of funds** transferred outside their jurisdiction and of funds transferred to any person delivering service on behalf of the originator NPO (page 4)

⇒ EFC Comment

32. This is too broad a recommendation – clarification should be provided and wording reviewed. What does this actually entail: Does this imply that a record must be kept of financial transactions with direct beneficiary organisations/person; or donor(s) abroad? A concern is to ensure a balance between due diligence, financial responsibility and financial reporting, without undermining the international work of foundations. Requirements regarding finance and audits should be proportionate to the size and activities of the organisations concerned.

Draft Recommendation

C. Considerations at the European level

1. **Development of “European guidelines” or a “European label” for NPOs complying with the requirements of the Code of Conduct (page 5)**

- The possibility for further developing “European guidelines” or a “European label” based on the enhanced transparency and accountability measures as set out in the present Code of Conduct should be examined. The principles for such guidelines or label could be worked out at the European level. The European Commission will further consider whether **Community funding of NPOs could be linked to compliance** with the enhanced transparency and accountability measures; and whether **registration of NPOs as lobby organisations** could be made conditional to compliance with requirements of the Code.

⇒ EFC Comment

33. The current text does not give many indications about what these guidelines or label would cover; how they would be developed; how they would be granted and reviewed; who would oversee their implementation; or how they would take due account of existing codes of practice established by foundations and NPOs themselves at the national and European levels. It raises questions as to its objectives, and concerns about the process which both need to be clarified.

These proposals need to be addressed in close cooperation with concerned European foundation and NPO networks. Appropriate consultation of the sector should take place regarding this proposal before developing new legislation or requirements. The EFC and its members will be pleased to contribute to the discussions and reviews.

Annex 1: About the European Foundation Centre

The European Foundation Centre (EFC) is an independent international association that promotes and underpins the work of foundations and corporate funders active in and with Europe. Established in 1989 by seven of Europe's leading foundations, the EFC today serves a core membership of more than 200 members, associates and subscribers; 250 community philanthropy initiatives; as well as a further 50,000 organisations linked through a network of 42 information and support centres worldwide. The EFC also has cooperation agreements with national and regional associations of foundations in Africa, North America, Latin America, Asia and Australia, which help extend its global outreach. The EFC hosts WINGS (Worldwide Initiatives for Grantmaker Support), a global network of some 100 grantmaker associations and support organisations.

The Centre fulfils its mission through:

- Representing its members' interests at the level of third parties such as European and international institutions
- Providing a public information record on foundations active in Europe
- Improving the visibility and understanding of the role of foundations
- Playing a consultancy role with respect to legal and fiscal issues and expansion of professional development opportunities for foundations' staff
- Convening foundations to facilitate exchanges of information and expertise
- Advocating good practice, openness and transparency
- Fostering the capacity of national-level associations of foundations, donors' fora, resource centres and other intermediary organisations serving the sector

The Centre is an independent international not-for-profit association under Belgian law. Ultimate authority vests in the EFC Annual General Assembly of Members, with governance entrusted to an elected Governing Council (www.efc.be/projects/gc), supported by a Management Committee. Strategic guidance is provided by a European Union Committee, an International Committee, and a Resource Development Committee. Operational responsibility is entrusted to a Brussels-based Secretariat under the supervision of the EFC Chief Executive.

Membership of the Centre implies commitment to the EFC brand. Members agree to adhere to the principles and objectives set out in the Prague Declaration, and to a voluntary and self-regulatory Code of Practice endorsed by members and revised and updated on an ongoing basis.

Details of EFC membership and activities are available at

www.efc.be, www.fundersonline.org, www.europeintheworld.info