United States Research Mission 2022

The State of Policies for Small-Scale Organizations and Nonprofit Accounting in the United States

Research Report

English Summary Edition

June 2023

The Japan Association of Charitable Organizations

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Introduction

Preface

In September 2022 the Commission on the Private Non-profit Legal and Tax System of the Japan Association of Charitable Organizations (JACO) dispatched a research mission to nonprofit organizations in Washington, D.C. and New York in order to study policies for small-scale organizations and nonprofit accounting in the United States. The mission had originally been scheduled for August 2021 and then for February 2022, but the COVID-19 pandemic forced repeated postponements, and it was only in September 2022 that the visit could finally be carried out.

The members of the mission were Professor Ryota Kaneko of Kokugakuin University (head of mission), Professor Masayuki Tamaruya of the University of Tokyo (deputy head), Associate Professor Yuko Uehara of Ritsumeikan Asia Pacific University, and Mr. Seiya Wakisaka, principal of the Wakisaka Tax and Accounting Office. The secretariat was served by Mr. Yoshiharu Shiraishi of JACO. Professor Tomohito Nakajima of Sanno University, who had taken part in the preparatory study sessions, was unable to travel but contributed to the report and conducted several online interviews.

This English Summary Edition condenses the findings of the full Japanese report, published in June 2023, into a single volume for readers outside Japan. It preserves the structure of the original: thematic chapters in Part 1, the record of the field interviews in Part 2, and concluding observations in Part 3. Detailed appendices reproducing the Form 990 and Form 1023 series, which occupy roughly a third of the Japanese edition, have been omitted; readers are referred to the IRS website for the current versions of those forms.

We wish to record our gratitude to the MRA House Foundation and the Toyota Foundation, whose generous financial support and patience through the repeated postponements made this study possible, and to the thirty-three organizations that received us and answered our questions with candour.

1. Background of the Study

Japan’s public interest corporation system has operated since December 2008 under a two-tier structure of "general corporations" and "public interest corporations". More than fifteen years on, the operational burdens of the system have become clear, while social expectations of the sector have risen. The number of public interest corporations has remained flat at roughly 9,600, and the annual increase is measured in tens rather than hundreds of organizations.

The contrast with other advanced economies is stark. Counting only organizations to which donations are tax-deductible, the United States had some 1.545 million charitable organizations, the United Kingdom about 169,000 charities and CIOs, and Canada about 86,000 registered charities. In Japan the corresponding categories — public interest corporations (9,671), certified NPO corporations (1,264), social welfare corporations (21,198), educational corporations (7,623) and rehabilitation corporations (164) — total only 39,756. Per 10,000 population the figures are 44.6 in the United States, 25.1 in the United Kingdom, 25.4 in Canada and 3.2 in Japan. Moreover, in Japan only public interest corporations enjoy exemption on their charitable activities themselves; the other categories are taxed on profit-making activities.

Table 1 Organizations Eligible for Tax-Deductible Donations, by Country

Country	Organizations eligible for deductible gifts	Per 10,000 population
United States	approx. 1,545,000 (incl. 501(c)(3) organizations)	44.6
United Kingdom	approx. 169,000 (Charities and CIOs)	25.1
Canada	approx. 86,000 (Registered Charities)	25.4
Japan	39,756 (five corporate categories combined)	3.2

Sources: IRS Data Book 2022; Charity Commission Annual Report and Accounts 2021-22; Canada Revenue Agency; National Tax Agency corporate number search site; Cabinet Office NPO website. Figures as reported in the Japanese edition.

The gap is not simply a matter of national wealth or of philanthropic culture. It reflects a difference in institutional design. In Japan, the administrative burden of applications, periodic filings and the three financial criteria consumes resources that could otherwise be devoted to charitable work; it exhausts small organizations, deters others from seeking public interest status at all, and prevents flexible, sustainable programme delivery. JACO's own annual survey of the sector has documented this pattern year after year.

2. Research Objectives

The purpose of this mission was to establish how the American system of nonprofit law, taxation and accounting affects the practice of nonprofit organizations — particularly small and medium-sized ones — and how it has enabled the sustainable supply of charitable services and the expansion of the sector as a whole. Five themes were set:

- the overall shape of American policy toward small-scale organizations;
- the relationships among the regulator, intermediary organizations and nonprofits;
- the practice and reality of law, taxation and accounting in small organizations;
- the state of nonprofit governance;
- nonprofit responses to the COVID-19 pandemic.

The study is a companion to the mission JACO sent to the United Kingdom in 2019 on substantially the same themes, the results of which were published in 2020 as "Report of the Research Mission to the United Kingdom: Policies for Small Charities and Charity Accounting".

3. Significance of the Study

Preparatory research made two things clear at the outset. First, the American nonprofit world is extraordinarily diverse: legal personality is a matter of state law, so there are fifty-one distinct regimes, while tax exemption is federal, and the two operate on different logics. Any sentence beginning "American nonprofit organizations are…" is therefore likely to be wrong. Second, and more important for our purposes, the American system varies its demands with the size of the organization. The documents an organization must file on formation, the returns it must file annually, and the assurance it must obtain over its financial statements all scale with its revenue. This principle of proportionality, applied consistently across federal and state regulation, is the single feature of the American system that Japan has most to learn from.

The significance of the study therefore lies less in cataloguing American rules than in identifying the design principles behind them: low barriers to entry combined with thorough public disclosure; regulation by prohibition rather than by permission; reliance on a dense ecosystem of intermediary bodies, rating agencies and journalists rather than on a single supervising agency; and the placing of financial judgement with the board rather than with the regulator.

4. Research Team and Schedule

(1) Members of the Mission

The mission was composed of the following (listed in Japanese alphabetical order):

・Yuko Uehara; Associate Professor, College of Sustainability and Tourism, Ritsumeikan Asia Pacific University
・Ryota Kaneko; Head of Mission, Professor, Faculty of Economics, Kokugakuin University
・Masayuki Tamaruya; Deputy Head of Mission, Professor, Graduate Schools for Law and Politics, The University of Tokyo
・Seiya Wakisaka; Principal, Wakisaka Tax and Accounting Office
・Yoshiharu Shiraishi; Secretariat, Senior Research Associate, Department of Research, JACO

*Tomohito Nakajima, Professor, Faculty of Management, Sanno University, contributed two chapters and conducted online interviews after the mission returned.

(2) Schedule

Field research was conducted from 4 to 15 September 2022 in Washington, D.C. and New York, with several interviews held online after the return to Tokyo.

■ **Sep 6 (Tue) — Washington, D.C.**

◇ City Wildlife, Inc.
◇ US-Japan Council
◇ Independent Sector
◇ Ikebana International Chapter No. 1
◇ Friends of World Food Program USA

■ **Sep 7 (Wed) — Washington, D.C.**

◇ Center for Values in International Development
◇ Peace Winds America
◇ Candid (online)
◇ The George Washington University (site visit)

■ **Sep 8 (Thu) — Washington, D.C.**

◇ International Society for Third Sector Research (online)
◇ National Archives Museum (site visit)
◇ George Mason University
◇ International Center for Not-for-Profit Law

■ **Sep 9 (Fri) — Washington, D.C.**

◇ Home Roots Foundation
◇ Council on Foundations (online)
◇ Outdoor Alliance
◇ Westminster Neighborhood Association
◇ Friends of Georgetown Waterfront Park
◇ Garfield Terrace Senior Citizens Resident Council

■ **Sep 10 (Sat) — Alexandria, Virginia**

◇ Old Town Alexandria: charity fundraising events (site visit)

■ **Sep 11 (Sun) — New York**

◇ Cooper Hewitt, Smithsonian Design Museum (site visit)

■ **Sep 12 (Mon) — New York**

◇ New York Mycological Society, Inc. (online)
◇ Museum of Modern Art
◇ Friends of the Children NY
◇ International Institute for Community Solutions, Inc.

■ **Sep 13 (Tue) — New York**

◇ VISIONS
◇ Médecins Sans Frontières – USA
◇ American Geographical Society of New York
◇ Japanese Medical Support Network-USA
◇ Okinawa Institute of Science and Technology Foundation, Inc.

■ **After return — Tokyo (online)**

◇ NY de Volunteer (29 Sep)
◇ Friends of Mitchell Park, Inc. (6 Oct)
◇ Environmental Protection Network (11 Oct)

Part 1: Research by Theme

1. Overview of the U.S. Nonprofit Sector

Yuko Uehara

The United States is home to an enormous number of nonprofit organizations holding tax-exempt status. The mission concentrated on those recognised by the Internal Revenue Service (IRS) under section 501(c)(3) of the Internal Revenue Code (IRC), which are both the most numerous type and the type whose donors receive the most generous federal tax relief, and within that category on small organizations in particular. This chapter sets out the framework within which those organizations operate, the scale and shape of the sector, and the effect of the pandemic upon it.

1.1 The IRS and the Framework of Federal Tax Exemption

Because legal personality is conferred by state law, there is no single federal statute that defines the American nonprofit organization. Federal tax law, by contrast, applies uniformly. IRC 501(a) provides that organizations described in 501(c), 501(d) or 401(a) are exempt from taxation unless disqualified under IRC 502 (organizations whose primary purpose is business) or 503 (denial of exemption to organizations engaging in prohibited transactions). Section 501(c) itself enumerates twenty-nine categories of exempt organization, ranging from charities and social welfare organizations to labour unions, business leagues and cemetery companies.

To qualify under 501(c)(3), an organization must be organized and operated exclusively for one or more of eight exempt purposes: charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. It may not distribute earnings to members, may not engage in political campaign activity, and may devote no more than an insubstantial part of its activities to influencing legislation. Application is open to unincorporated associations and trusts as well as to corporations. Organizations that obtain federal exemption are frequently relieved of state and local sales and property taxes as well.

1.2 Public Charities and Private Foundations

Within 501(c)(3) a fundamental distinction is drawn between public charities and private foundations. An organization that satisfies IRC 509(a) — in most cases by passing the public support test — is a public charity; every other 501(c)(3) organization is by default a private foundation. As at 2016 there were roughly 1.08 million registered public charities and about a tenth as many private foundations.

An application for recognition of exemption (Form 1023) must be filed within 27 months of the end of the month of formation if exemption is to run from the date of formation. Form 1023 runs to some 28 pages; small organizations may instead use the three-page Form 1023-EZ, introduced in July 2014. The same graduation applies to annual reporting: public charities file Form 990, or the simplified Form 990-EZ or Form 990-N (the electronic "e-Postcard"), according to size. Private foundations file Form 990-PF whatever their size.

1.3 Scale, Activities and Finances of the Sector

According to the Urban Institute's "The Nonprofit Sector in Brief 2019", the number of nonprofit organizations registered with the IRS grew from about 1.48 million to about 1.54 million between 2006 and 2016, an increase of some 4.5 per cent. About 35 per cent of registered organizations were required to file a Form 990, 990-EZ or 990-PF. Among those reporting organizations, inflation-adjusted revenue rose 24.2 per cent and assets 30.9 per cent over the decade, against GDP growth of 13.6 per cent over the same period.

Public charities grew far faster than the sector as a whole: their number rose 19.6 per cent between 2006 and 2016, so that their share of all registered nonprofits rose from 61.2 per cent to 70.0 per cent. In 2016 they accounted for about three fifths of all reporting organizations and roughly three quarters of sector revenue and expenditure — some $2.4 trillion of revenue and $1.94 trillion of expenditure.

The sector is nonetheless dominated numerically by very small organizations. Excluding those with gross receipts under $50,000, which file only Form 990-N, some two thirds of public charities in 2016 had total expenditure of $500,000 or less; together these accounted for less than 2 per cent of sector expenditure. At the other end, organizations spending $10 million or more made up only 5.4 per cent of the population but 88.1 per cent of expenditure. By field, human services is the largest category (111,797 organizations — food banks, homeless shelters, youth and family services, sports bodies, legal services), followed by education (54,632, including booster clubs, parent-teacher associations, schools and universities), health (38,853) and hospitals (7,054). The last two are modest in number but very large in revenue and expenditure.

Table 2 Concentration of Expenditure among U.S. Public Charities (2016)

Expenditure band	Share of organizations	Share of total expenditure
$500,000 or less	approx. two thirds	under 2%
$10 million or more	5.4%	88.1%

Source: Urban Institute, "The Nonprofit Sector in Brief 2019". Organizations filing Form 990-N are excluded.

Charitable giving has grown over the long run. Total contributions reached $427.71 billion in 2018, having exceeded $400 billion in both nominal and inflation-adjusted terms in 2017. The Urban Institute’s overall assessment in 2020 was that the sector was in relatively good health and had enjoyed continued financial growth, though inflation-adjusted giving showed a slight downward drift.

1.4 The Impact of COVID-19

Contributions did not fall during the pandemic. Giving reached $484.85 billion in 2021: individuals $326.8 billion (about 67 per cent), foundations $90.9 billion (19 per cent), bequests $46.0 billion (10 per cent) and corporations $21.1 billion (4 per cent). Compared with 2018 on an inflation-adjusted basis, all four categories grew, but individual giving grew only 1.9 per cent against 14.0 per cent for foundations, 10.7 per cent for corporations and 6.7 per cent for bequests. Organizations dependent on individual donors were therefore under greater pressure than the headline figures suggest.

Federal relief — the CARES Act, the Paycheck Protection Program (PPP) and the Employee Retention Credit — is generally credited with keeping many organizations afloat. Even so, a survey by BKD CPAs & Advisors published in February 2022 found that the proportion of organizations expressing financial concern had risen from 28.2 per cent in 2021 to 48.7 per cent, while the proportion answering positively about their finances fell from 45.5 per cent to 28.5 per cent.

Table 3 Principal Survey Findings, 2021 and 2022

Year	Findings
2021	Changed the delivery of programmes or services (89%); revenue declined (70%); fees for programmes or services fell (61%); plan to discontinue existing programmes or services (29%)
2022	Budget shortfall (58%); demand for programmes and services increased (65%); plan to add new programmes and services (77%); troubled by staff shortages (71%)

Source: BKD CPAs & Advisors, "2021 State of the Nonprofit Sector Report" and "2022 State of the Nonprofit Sector Report".

The Urban Institute reported that 40 per cent of organizations surveyed spent more than they received in 2020, and that such organizations had shed 7 per cent of paid staff by the end of that year. Bodies that had relied on fees for service in 2019 were hit hardest, and arts organizations such as museums were judged especially likely to have suffered.

What struck the mission on the ground, however, was that the decisive variable was not the field of activity but the organization’s capacity to adapt — and, behind that, whether it had staff or volunteers able to carry out the adaptation. Even government support required application forms and reports to be prepared. Ikebana International Chapter No. 1 in Washington, D.C., whose activity had centred on exhibitions and events, moved its programme onto Zoom and increased its membership. The New York Mycological Society, whose members had previously walked in the woods together, maintained an unusually active flow of communication by e-mail, Facebook, Instagram and Slack, and roughly doubled its membership from about 700. VISIONS, by contrast, reported that all four long-established neighbouring agencies serving blind people in its area had closed.

1.5 Summary

Three features of the American arrangement stand out from a Japanese perspective. The first is the distinction between public charities and private foundations, with the more generous treatment reserved for organizations demonstrably supported by the public — a distinction Japanese law does not draw. The second is the graduated set of application and reporting forms, which relieves small organizations of burdens designed for large ones without depriving them of the tax benefits. The third is that these institutional arrangements are the precondition, not the consequence, of the "mature culture of giving" for which the United States is known. Where inequality is deepening, as it is in both countries, organizations that supply diverse services on a public-interest basis matter greatly; the question for Japan is how to design institutions and develop people who can sustain them.

2. Legal Framework and Measures for Small-Scale Organizations

Tomohito Nakajima

The defining characteristic of the American nonprofit world is diversity, and one of its most striking dimensions is diversity of size. IRC 501(c) lists twenty-seven categories of exempt organization, and IRS Publication 557 identifies thirty-five types in all. They range from grass-roots bodies with no income, sustained entirely by volunteers, to foundations holding tens of billions of dollars and making grants of billions each year. All are American nonprofit organizations; all are tax-exempt organizations. This chapter examines the legal framework, with particular attention to how it accommodates the small.

A note on terminology: a "nonprofit organization" that has acquired legal personality under state law is a "nonprofit corporation"; a nonprofit organization recognised by the IRS is a "tax-exempt organization", whether or not it is incorporated.

2.1 The Present State of Small-Scale Organizations

Analysis by the National Council of Nonprofits of IRS data for 2016 counted 1,425,024 501(c)(3) organizations, of which 1,298,348 (91.9 per cent) were public charities and 126,676 were private foundations. Broken down by annual revenue, organizations filing Form 990-N (gross receipts generally $50,000 or less) or reporting no revenue at all accounted for more than half — 55.3 per cent — of the total, and roughly three quarters (74.9 per cent) had revenue of $100,000 or less. On the criterion of income, in other words, most American nonprofit organizations are small.

The IRS Exempt Organizations Business Master File Extract permits a finer view. Organizations filing Form 990, 990-EZ or 990-N make up 77.0 per cent of registered exempt organizations and Form 990-PF filers a further 7.5 per cent. Among the former, 75.9 per cent have revenue below $100,000 — closely matching the National Council of Nonprofits figures. Among private foundations the distribution is weighted toward larger bodies: 53.4 per cent below $100,000, and three quarters below $500,000.

Finally, deductibility. Almost all of these organizations offer their donors a deduction: 79.6 per cent of Form 990/990-EZ filers, 83.6 per cent of Form 990-N filers and 97.7 per cent of Form 990-PF filers. Four conclusions follow. Exempt organizations in the United States are diverse in size, and small ones predominate numerically. A significant minority of small organizations operate without legal personality and are nonetheless exempt. Most small organizations do nevertheless incorporate, which shows that incorporation is within their reach. And smallness is no bar to offering donors a deduction.

2.2 Acquiring Tax-Exempt Status

Recognition under 501(c)(3) turns on two tests. The organizational test asks whether the articles of organization limit the organization’s purposes to those listed in 501(c)(3), do not expressly empower it to engage in activities that do not further those purposes, and dedicate its assets permanently to exempt purposes — in particular by providing that on dissolution the remaining assets pass to another exempt purpose or to a federal, state or local government. These provisions must appear in the articles themselves; bylaws will not do, nor will the statements of officers or the fact that the organization’s actual activities are exempt.

The operational test asks whether the organization in fact engages primarily in activities that accomplish its exempt purposes. It may not participate in political campaigns at any level; lobbying must remain an insubstantial part of its activities; no part of its net earnings may inure to the benefit of a private shareholder or individual; it may not be operated for private benefit; it may not be operated for the primary purpose of carrying on an unrelated trade or business; and it may not have illegal purposes or purposes contrary to public policy. It is worth stressing that an organization may carry on a trade or business as a major part of its activities and still qualify. What matters is whether the trade or business furthers the exempt purpose, not what proportion of total activity it represents.

Application is made on Form 1023. A small organization may instead use Form 1023-EZ if it expects annual gross receipts of $50,000 or less in each of the current and next two years, had gross receipts of

$50,000 or less in each of the past three years, and has total assets with a fair market value not exceeding $250,000. The eligibility worksheet poses thirty questions in all; every answer must be "No". The excluded categories include churches, schools, hospitals, supporting organizations, organizations maintaining donor-advised funds, private operating foundations, foreign organizations, successors to for-profit entities and organizations whose exemption has been revoked.

Table 4 Form 1023 and Form 1023-EZ Compared

	Form 1023 (Jan. 2020)	Form 1023-EZ (Apr. 2021)
Structure	Parts I–X	Parts I–VI
Length	18 pages of text; 40 pages including schedules	3 pages; no schedules
Attachments	Articles, bylaws and other documents as required	None — the form alone
Organizational / operational tests	Substantiated by the documents filed	Satisfied by the applicant's own attestation (check boxes)
Narrative	Detailed description of activities	Mission or most significant activities, 250 words or fewer
Filing fee	$600	$265
Filing method	Pay.gov	Pay.gov, electronic only

Source: IRS, Instructions for Form 1023 (Rev. Jan. 2020) and Instructions for Form 1023-EZ (Rev. Jan. 2023).

2.3 The Public Support Test for Small Organizations

A 501(c)(3) organization is presumed to be a private foundation unless it establishes otherwise. To enjoy the full range of tax benefits, including deductibility for donors, it must show that it meets one of the tests in IRC 509(a). On Form 1023-EZ this is done by checking one of the boxes at Part IV, item 2.

The 509(a)(1) test asks whether the organization normally receives at least one third of its support from public sources — governmental units, and contributions from a broad range of individuals, companies and foundations. "Normally" means measured over the current and preceding four years. Contributions from any single private source count toward public support only up to 2 per cent of total support; gifts from governmental units and public charities are not subject to that cap. An organization falling below one third may still qualify under the facts and circumstances test if it receives at least 10 per cent from public sources and is organized and operated so as to attract continuing public support.

Because revenue from exempt activities enters neither the numerator nor the denominator of the 509(a)(1) calculation, an organization that depends on programme fees will find that test hard to satisfy. Such an organization may instead rely on 509(a)(2), which requires that it normally receive more than one third of its support from gifts, grants, contributions, membership fees and gross receipts from activities related to its exempt function, and not more than one third from investment income and net unrelated business taxable income. The calculation excludes support received from "disqualified persons" — substantial contributors, officers and directors, certain owners of contributing entities and their families — the point being to confirm that a fee-charging organization serves the general public rather than a circle of insiders.

2.4 Acquiring Corporate Status under State Law

Legal personality is conferred by the law of each state, so there are fifty-one nonprofit corporation regimes. They are not, however, wholly independent of one another. The American Bar Association's Model Nonprofit Corporation Act (MNCA), first published in 1952 and revised in 1987, 2008 and 2021, has been adopted in whole or in part by many states — at least thirty-seven have adopted some part of the 2008 revision and eight have adopted it in full. In Florida, Illinois, New York and Pennsylvania the general business corporation statute applies to nonprofit corporations; Wyoming, Georgia and Ohio have their own distinct nonprofit statutes.

For a small organization the practical questions concern the required organs. Directors constitute the board and are responsible for management. The minimum number varies by state — one in some, three in others — though the IRS takes the view that a 501(c)(3) organization needs at least three. Most states set no age requirement, though some require directors to be eighteen or of full age. Officers are responsible for day-to-day operations; most states require a president, a secretary and a treasurer, some additionally a vice-president, and most permit one person to hold more than one office.

Members are, in most states, optional. Of the fifty states and the District of Columbia, forty-three make membership optional; three make having no members the default; Delaware and Kansas require a membership structure; and six treat the directors as the members where there are none. An organization without a statutory membership operates through a single tier — the board — rather than the two tiers familiar in Japanese incorporated associations, which is a considerable simplification where human resources are scarce. Informal membership schemes remain possible.

Summarising from the standpoint of a small organization: three directors will satisfy the IRS; a president, a secretary and a treasurer will satisfy most state statutes, and one person may often hold more than one of those offices; and if no statutory membership is adopted, the organization can operate as a tax-exempt nonprofit corporation with a single decision-making tier. IRS Publication 557 even supplies a model form of articles of incorporation in which the applicant need only fill in the state of incorporation, the corporate name, the city or county of the principal office, the names and addresses of the incorporators and the date of signature.

2.5 Summary

The IRS data show that large numbers of small nonprofit organizations operate as recognised charitable bodies, some incorporated and some not. That picture matches what the mission saw: small organizations pursuing their missions freely, drawing on donations, volunteers and support from local government and business. The legal framework that sustains them has two layers. At the federal level, a simplified application procedure for small organizations; at state level, a corporate form that requires no membership structure and can be operated by a minimum complement of people. In both, the organization is free to choose the structure and mode of operation that fits its size and its actual activities.

3. Form 990 and Financial Reporting

Seiya Wakisaka

What surprised the mission most was the central place occupied by Form 990. It is the annual return through which a 501(c)(3) organization reports on itself to the IRS, and it corresponds broadly to the periodic filings a Japanese public interest corporation makes to its supervising agency. Its role, however, is far larger. It is not merely filed; it is published, and a whole apparatus of evaluation, journalism and grant-making rests upon it. It also carries financial information. Larger organizations prepare financial statements under FASB standards in addition, but many small and medium-sized organizations do not, and for them the financial information in Form 990 is in substance their financial statements.

3.1 Overview of the Form 990 Series

A 501(c)(3) organization must file by the fifteenth day of the fifth month after the end of its fiscal year. Which return it files depends on its size. An organization with gross receipts of $200,000 or more, or total assets of $500,000 or more at year end, files the twelve-page Form 990. Part IV of that form is a checklist of required schedules; a "Yes" answer triggers a schedule (A to R) supplementing the main return. Very few organizations complete all of them, and a modest-sized filer may need only a handful. An organization with gross receipts below $200,000 and assets below $500,000 may file the four-page Form 990-EZ. An organization with gross receipts of $50,000 or less may instead file Form 990-N.

Table 5 The Form 990 Series: Filings and Compliance Cost

	Form 990	Form 990-EZ	Form 990-N
Gross receipts (Form 990 also required if assets ≥ $500,000)	$200,000 or more	under $200,000	$50,000 or less
Estimated number of filings	333,400	245,200	743,800
Estimated average total time	107 hours	64 hours	5 hours
Estimated average out-of-pocket cost	$2,600	$500	$20
Estimated average monetized burden	$8,700	$1,400	$90

Source: IRS, estimated tax compliance cost for the FY2023 Form 990 series.

3.2 Form 990-N

Form 990-N may be filed only electronically and asks for eight items: the employer identification number; the tax year; the legal name and mailing address; any other names used; the name and address of a principal officer; the website address; confirmation that annual gross receipts are $50,000 or less; and, if applicable, a statement that the organization has terminated or is terminating.

Form 990 dates from 1941 and has more than eighty years of history; Form 990-N is comparatively recent, introduced in 2008. Before then, small 501(c)(3) organizations with annual receipts of $25,000 or less had no filing obligation at all. Form 990-N was created precisely in order to bring every 501(c)(3) organization within the filing net, and the threshold was raised to $50,000 at the same time. The critical consequence was that exemption could now be revoked automatically where an organization failed to file for three consecutive years.

Organizations filing Form 990 or 990-EZ must demonstrate their public charity status on Schedule A. Form 990-N filers file no Schedule A and are not required to meet the public support test — yet they receive exactly the same tax benefits as larger organizations. In Japan, by contrast, an organization receiving the same tax relief is examined against the same criteria and asked for the same documents whatever its size, with the result that bodies unable to employ specialist staff either never apply for public interest status or withdraw their applications after being challenged on points of detail. One interviewee who had founded nonprofit organizations in both countries put it plainly:

> In the United States, setting up and running a nonprofit organization causes almost no stress in dealing with the IRS or the states. In Japan, although you are trying to do something good for society, you are picked up on points of extraordinary detail.
>
> — *NY de Volunteer*

Form 990-N contains no standardised financial statement and no other document need accompany it. Grantmakers, however, may ask for more. As one very small foundation explained:

> Form 990-N is a very simple document — just the address and the name. We are a small organization, we do not receive very much, and the IRS does not go into detail. But some organizations and foundations ask you to file a Form 990. We recently went to apply for a living fund for women, and that organization asked for Form 990, not Form 990-N.
>
> — *Home Roots Foundation*

3.3 Form 990-EZ

About a fifth of 501(c)(3) organizations file Form 990-EZ. The four pages comprise basic information followed by Part I (revenue, expenses and changes in net assets or fund balances), Part II (balance sheet), Part III (statement of programme service accomplishments), Part IV (list of officers, directors, trustees and key employees) and Part V (other information). Organizations the mission visited that file Form 990-EZ prepared no financial statements other than the form itself, so it is fair to say that for most small American nonprofits Form 990-EZ or its equivalent is the financial reporting.

On the revenue side eight broad captions are used, some with sub-lines. The number of top-level captions is close to that of the Japanese public interest corporation accounting standard, but three of the eight (sales of assets other than inventory; gaming and fundraising events; gross sales of inventory less returns and allowances) show cost of sales as a sub-line so that a gross margin is reported as revenue, which the Japanese standard does not do. Conversely the Japanese standard sub-divides far more finely — "income from investment of basic endowment", for instance, splits into interest, dividends and rent.

The expense side is where the two diverge sharply. The Japanese standard divides expenses first into programme and administrative expenses, and then into more than twenty account captions on each side. Form 990-EZ has no programme/administrative split and just five expense captions: grants and similar amounts paid; benefits paid to or for members; salaries, other compensation and employee benefits; professional fees and other payments to independent contractors; occupancy, rent, utilities and maintenance; and printing, publications, postage and shipping, plus other expenses. Part III requires expenses to be stated for the organization’s three largest programme services, so an organization running several programmes must track cost by programme; but no allocation between programme and administration is required, no apportionment calculation is needed, and the bookkeeping is undemanding.

> We have almost no expenses. Some, yes — we have to pay the accountant, and recently we had to pay a lawyer to renew our tax exemption, and there are website costs. The filing is very easy. We just file the 990-EZ. If we had received other government grants we might have had to prepare additional financial documents, but we have not in the last five years.
>
> — *Friends of Georgetown Waterfront Park*

The balance sheet is simpler still: assets in three lines (cash, savings and investments; land and buildings; other assets) and liabilities as a single total, each at the beginning and end of the year.

Asked how they felt about this, interviewees were consistent:

> Disclosure is essential for an American nonprofit, because it helps people who want to donate, or to work with the organization, to understand potential conflicts of interest. Most board members here receive no compensation for serving; if they do, users of the financial statements will want to know. Reporting compensation lets people see where their money is going. If a great deal is going to two or three staff members, they can judge whether the organization is well run and whether they want to support it.

— *US-Japan Council*

> Several people have asked me, "do I have to put my name and my salary in here?" I answer that it is the tax law, so yes. Some are uncomfortable. What matters is the donor's need, and it stands higher than the individual's need for privacy. It is a difficult balance. I worked in Germany before, and privacy protection in the EU is far stronger than in the United States.

— *Médecins Sans Frontières – USA*

3.4 Form 990

The full return runs to twelve pages: Part I summary, Part II signature block, Part III statement of programme service accomplishments, Part IV checklist of required schedules (38 items), Part V statements regarding other IRS filings and tax compliance, Part VI governance, management and disclosure, Part VII compensation of officers, directors, trustees, key employees, highest compensated employees and independent contractors, Part VIII statement of revenue, Part IX statement of functional expenses, Part X balance sheet, Part XI reconciliation of net assets and Part XII financial statements and reporting. Financial information occupies four of the twelve pages, compensation two, and governance one.

Part VIII groups revenue into only four top-level captions — contributions and grants; programme service revenue; other revenue; and miscellaneous revenue — against nine in the Japanese standard. The American form gathers all non-exchange revenue under "contributions and grants" and sub-divides it into six lines (federated campaigns, membership dues, fundraising events, related organizations, government grants, all other contributions), whereas the Japanese standard splits non-exchange revenue across five top-level captions and then sub-divides each. The Japanese presentation has more captions but scatters non-exchange revenue, which arguably makes it harder to read.

One feature is unexpected. Form 990 classifies revenue as related to exempt purposes, unrelated business revenue, or revenue excluded from tax under sections 512–514. That is a tax classification. There is no classification by donor restriction. The Japanese standard, by contrast, separates the statement of changes in net assets into general and designated sections, so that restricted gifts and subsidies are shown apart. The explanation is simply that Form 990 is filed with a tax authority. Larger organizations the mission visited did prepare FASB-based financial statements alongside, and those do classify by restriction; organizations whose only financial information is Form 990 make no such distinction.

Part IX, the statement of functional expenses, uses twenty-four account captions — the same number as the Japanese standard, and broadly similar in content. Two differences matter. The first four captions in Form 990 are grants and assistance: to domestic organizations and governments; to domestic individuals; to foreign organizations, governments and individuals; and benefits paid to or for members. The Japanese standard has "grants paid" and "donations paid" too, but low in the list and undifferentiated. Where a grant exceeds $5,000, Schedule I requires the recipient's name, address, EIN, amount and purpose. This reflects a preoccupation the mission heard about repeatedly:

> What was emphasised in the United States is that the IRS is almost abnormally sensitive to whether funds from nonprofit organizations are being used for improper purposes such as money laundering. Having been badly burned in the past by funds reaching the Mafia or terrorist organizations, the IRS now restricts grant recipients in principle to 501(c)(3) organizations; sending funds to other bodies or to individuals is generally not permitted.

— *Japanese Medical Support Network-USA*

The second difference is caption 11, fees for services (non-employees), which is sub-divided into management, legal, accounting, lobbying, professional fundraising services, investment management fees and other. The Japanese standard has no such breakdown. The mission heard that the IRS does not accept vague payments such as "honoraria"; only fees for professional services are recognised, and the accounts of each event must record when, where, by whom and for what.

Expenses are then allocated across three columns: programme service expenses, management and general expenses, and fundraising expenses. Programme service expenses are those primarily furthering the exempt purpose; lobbying directly related to the exempt purpose belongs here, as does unrelated business activity that nonetheless constitutes a programme service. Management and general covers the overall direction and administration of the organization, including the salaries of the chief executive and staff except to the extent their time is spent supervising programme or fundraising work, board and committee costs, general legal services, accounting, audit, insurance, human resources, the annual report and investment management. Fundraising expenses are those incurred in soliciting cash and non-cash contributions, gifts and grants, including publicising and conducting campaigns and preparing solicitation materials.

The Japanese standard has only the first two of these. The addition of a fundraising column is the substantive difference, and it is treated with great seriousness in the United States.

> There are many grey zones in the three-way split. The most important thing is to establish a methodology and to apply it to every transaction. We considered and analysed what our typical costs are and how they should be treated. The auditors then confirm that they are satisfied with the policy we wrote and review transactions to see that we follow it. Nonprofits have a great deal of flexibility in developing the methodology, because each is a little different. What matters is to think your policy through, write it down and follow it. Joint costs are where it gets really awkward.
>
> — *World Food Program USA*

Two further contrasts deserve note. The Japanese standard requires a supplementary schedule dividing the statement of changes in net assets into public interest purpose accounting, profit-making accounting and corporate accounting, with a further split by individual public interest programme. Form 990 has no such segmentation; FASB-based statements sometimes present results by programme, but the basis is left to the organization and exists to help supporters understand the work, not because the law compels it. The reason for the Japanese requirement is that the segmentation feeds the calculation of the "balance of revenue and expenditure" criterion in the authorisation regime. There is nothing corresponding to that criterion in 501(c)(3); segmentation exists for management and for explanation to supporters.

JACO’s own 2018 survey recorded practitioners’ frustration with this design: the divergence between accounting segments makes analysis of surpluses and deficits both difficult and meaningless; the clerical complexity of apportionment is out of all proportion to the size of the accounts; the system is hard to explain even to a corporation’s own directors. More than eighteen per cent of respondents found the standard inconvenient, and the free-text answers asked repeatedly for a design built around the user rather than the regulator.

Asked what software they used, most of the organizations the mission visited named QuickBooks — a package written for commercial businesses. That this is possible reflects the small distance between nonprofit and commercial accounting in the United States.

> We use QuickBooks. Put the data in and the profit and loss, the balance sheet and the detailed results by programme come straight out. There is no nonprofit edition, but if you can do commercial bookkeeping you can use it in a nonprofit.
>
> — *NY de Volunteer*

3.5 Governance Disclosure in Form 990

Form 990 began in 1941 as a two-page return and has grown to twelve. Its most significant amendment came in 2007, when disclosure of governance was made mandatory, turning the return into an instrument of self-regulation.

> The 2007 amendment meant that an organization wanting a good public image could show that it was properly governed by ticking the appropriate boxes. The main effect was a matter of self-regulation and good practice. Some organizations are not interested in good practice and simply do not engage. But I think most care how they are perceived through Form 990.

— International Center for Not-for-Profit Law

The contrast with Japan is complete. Japanese public interest corporations file detailed documents every year, but those documents are used only for the supervising agency's checks and are not published. They cannot improve the corporation's public image, because nobody outside the agency reads them. Designing the return so that it is useful to the regulator, to the citizen and to the organization's own governance at the same time is a lesson Japan could take.

3.6 Summary: Transparency and Proportionate Regulation

Transparency is treated in the United States as foundational, and Form 990 sits at the centre of it. The mission was given a historical account of why:

> After the Second World War the Cold War began and suspicion of communism appeared everywhere. Nonprofits were no exception. Senator Joseph McCarthy set up what became the Cox Committee, and there were hearings to which Rockefeller, Carnegie and other leading foundations were called; they said, "we are trying to bring welfare to society and should not be subjected to this unfair scrutiny." And then they realised that the reason they were being scrutinised was that the sector was not transparent. The government did not know what the sector was actually doing. Nor did the public. They understood that it is a two-way relationship — both sides have to be transparent. That led to the Tax Reform Act of 1969: disclose in your return almost everything you did during the year, so that everyone knows and nothing is hidden. The money comes from the general public and from governments, and everyone has a right to know how it was used. Transparency is the foundation of everything. Without transparency there is no efficiency; without efficiency there is no success.
>
> *— Candid*

The second lesson is proportionality. Form 990-N, filed by the majority of organizations, asks only for basic information; Form 990-EZ and Form 990 add progressively. Asked whether Form 990-N was not too simple, the answer was:

> It depends on how useful you think it is for society to have a great many different nonprofit organizations. Many nonprofits are very small. I think the barrier to entry for forming a nonprofit ought to depend on the benefit nonprofits bring to society. In America the view seems to be that the more the better. If you think you can do something good for our community, please go and do it. We make it really easy for you to start. As you grow, the level of accountability rises with you — but we make it as easy as possible to form. That is probably the philosophy of this country.
>
> *— Candid*

As at 1 December 2021 Japan had 4,175 public interest incorporated associations and 5,439 public interest incorporated foundations, 9,614 in all — less than one hundredth of the number of American 501(c)(3) organizations — and the year-on-year increase was thirty-three, of which the associations accounted for two. If public interest corporations are to matter in Japanese society, their number has to grow. The American approach of refraining from heavy regulation of start-ups and small bodies, keeping their documents easy to prepare and their accounting simple, is worth serious study.

4. Nonprofit Accounting in the United States

Ryota Kaneko

The United States is not a centralised state. Corporate law is state law, so a nonprofit organization is incorporated under the statute of a particular state and the legal form available in California may differ from that available in Oregon. Federal tax preferences, by contrast, are uniform: the Internal Revenue Code applies nationwide, and organizations of very different legal forms receive the same federal treatment. This chapter concerns the accounting of organizations described in IRC 501(c)(3), of which more than a million are registered and whose tax treatment is the most favourable of the 501(c) categories.

4.1 The Two Layers of Accounting Information

Federal law requires every 501(c)(3) organization to file Form 990 annually. It carries not only accounting information but also a description of the organization, its governance and the compensation of those it pays most. Three consecutive years of non-filing costs the organization its exemption, so almost all file, and websites exist that aggregate the resulting data. Because most American nonprofit organizations are comparatively small, simplified versions — Form 990-N and Form 990-EZ — are available.

Form 990 is part of a tax return. Larger organizations additionally publish financial statements in an annual report, and those statements are frequently audited by a certified public accountant. They are prepared under the standards set by the Financial Accounting Standards Board (FASB), which writes for businesses and private nonprofit organizations alike; much is common to both, but there are nonprofit-specific provisions, and the audit is directed to compliance with those standards.

Some states require audited financial statements from nonprofit organizations meeting a threshold, usually expressed in revenue, and some require disclosure from organizations soliciting within the state. Organizations below the thresholds, or doing little fundraising, are outside these rules, and many therefore publish no FASB-based statements at all. Even so, voluntary publication of audited statements is common, because donors ask for them, or may be expected to.

4.2 State Regulation of Financial Statements

Requirements vary greatly. Some states have no audit requirement whatever; others set thresholds on total revenue or on contributions received; several provide for a review, which is cheaper and less demanding than an audit; a few impose requirements on any organization that employs professional solicitors, whatever its size. The thresholds are revised from time to time to reflect price levels.

Table 6 State Audit Requirements — Representative Examples

State	Requirement
Alabama, Arizona, Colorado, Delaware, District of Columbia, Idaho, Indiana, Iowa, Kentucky, Missouri, Montana, Nebraska, Nevada, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Utah, Vermont, Wyoming	None
California	Audited financial statements if annual gross revenue exceeds $2 million
New York	Audited statements above $1 million; reviewed statements from $250,000 to $1 million; statements only below $250,000. Audit required regardless of size where professional solicitors are used
Illinois	Audited statements if contributions are $300,000 or more; from $25,000 to $300,000 only where professional fundraisers are used
Pennsylvania	Audited statements above $300,000; reviewed or audited from $100,000 to

State	Requirement
	$300,000; compiled, reviewed or audited from $50,000 to $100,000
Washington	Audited statements if revenue exceeds $3 million for three consecutive years; audited statements or a CPA-prepared Form 990 from $1 million to $3 million
Alaska	Single audit required where state financial assistance exceeds $750,000
Texas	GAAP financial statements, open to public inspection, where contributions are $10,000 or more

Source: compiled from the National Council of Nonprofits' state law audit requirements and the statutes of the individual states. Twenty-two states and the District of Columbia impose no requirement.

4.3 FASB as the Standard Setter

Until the early 1960s nonprofit accounting was treated as something separate from business accounting. Through the 1970s standards and industry guidance were issued by the AICPA, by universities and by the umbrella bodies of particular kinds of nonprofit, so that education, health and welfare organizations were subject to different treatments and the resulting disclosures were hard for outsiders to interpret; the committees writing the guidance were largely part-time and unpaid, and industry-specific guidance was strongly influenced by the industry concerned.

FASB was established in 1973 under the Financial Accounting Foundation, itself a private nonprofit organization endowed by a wide range of stakeholders, precisely in order to produce reliable and neutral standards. It sets standards for private entities including both businesses and nonprofit organizations, draws accounting professionals, practitioners and academics into its deliberations, and employs a substantial paid staff, which secures its independence. Since 2009 a Not-for-Profit Advisory Committee of fifteen to twenty members, chaired by an appointee of the FASB chairman, has considered issues specific to the sector; its conclusions go to the Board and, if approved, are published.

Concepts Statement No. 4 (1980) identified the objective of nonprofit financial reporting as the provision of information useful to resource providers in making allocation decisions, placing them, as in business accounting, at the centre of the user group, and treated accountability as extending beyond the safekeeping of assets to their efficient and effective use. Statements 116 and 117 (1993), on contributions and on the presentation of nonprofit financial statements, replaced fund accounting with accrual-based reporting for the entity as a whole, standardising the statements and improving comparability. They were closely studied when the Japanese public interest corporation accounting standard was drawn up. Since then the nonprofit standards have been codified as ASC Topic 958.

4.4 Principal Features of the Standards

(1) Two classes of net assets

From 1993 until the 2016 revision, net assets were reported in three classes: permanently restricted, temporarily restricted and unrestricted. ASU 2016-14 reduced these to two — net assets with donor restrictions and net assets without donor restrictions — on the grounds that the boundary between permanent and temporary restriction had become indistinct and that three classes complicated the statements without aiding the reader.

Table 7 Net Asset Classification Before and After the Revision

Former standard	Current standard
Permanently restricted net assets Temporarily restricted net assets Unrestricted net assets	Net assets with donor restrictions Net assets without donor restrictions

Source: FASB ASC 958-10-65-1.

The change of terminology matters. Restrictions on nonprofit net assets arise not only from donors but also from law and from the governing board, and "unrestricted" invited the inference that no one at all had restricted the funds; the new labels state the position accurately, and the notes must now describe restrictions more fully. The move to two classes was driven less by a change of principle than by the Uniform Prudent Management of Institutional Funds Act, in force in nearly every state, which relaxed the obligation to maintain the nominal amount of an endowment: if an amount originally permanently restricted may be varied, the boundary with temporary restriction becomes indistinct.

(2) Functional and natural expense classification

American practice has long classified nonprofit operating expenses by function — programme, management and general, and fundraising (ASC 958-720-05-4) — where business accounting classifies by nature. FASB formerly required a statement of functional expenses only from health care entities; the current standard abolishes that special rule and requires all nonprofit organizations to disclose operating expenses both by function and by nature, in the statement of activities, in a separate schedule or in the notes, as the organization prefers.

The standard also requires additional description of the method by which joint costs are allocated among programme, management and fundraising. Objections raised during the consultation included inconsistency with the Form 990 classification and the cost of preparing both classifications.

(3) Fundraising expense and joint costs

ASC 958-720-45-7 defines fundraising expense as the cost of activities undertaken to induce contributions — there is no equivalent category in business accounting. It covers the salaries and benefits of development staff and grant writers, the maintenance of donor lists, and the cost of publicising and conducting campaigns and events; membership development costs are distinguished from it.

Because a high ratio of fundraising and management expense implies fewer resources reaching programmes, organizations have an incentive to allocate joint costs generously to programme, and empirical work has found both unreported fundraising expense and evidence of adjustment to reported programme ratios. The AICPA's SOP 98-2 (November 1998) was issued to bring discipline to this. It sets three criteria — purpose, audience and content — for treating a joint cost as programme or management: the purpose must be to accomplish the mission, the audience must be selected for its need of the service rather than for its capacity to give, and the content must call for specific action by the beneficiary. Costs failing these tests are fundraising, and the type of activity, the allocation method and the amounts allocated to each function must then be disclosed. Before SOP 98-2 the prevailing practice had been to allocate most joint costs to programme.

(4) Volunteers and contributed nonfinancial assets

Volunteers present a hard measurement problem. Under FASB standards, contributed services are recognised only where they create or enhance a nonfinancial asset, or require specialised skills, are provided by individuals possessing those skills, and would have to be purchased if not contributed. The effect is to recognise only what can be valued with reasonable objectivity, at the cost of leaving most everyday volunteering out of the statements. Japan's NPO corporation accounting standard permits some recognition of volunteer effort; most other Japanese standards do not.

ASU 2020-07 (July 2020) requires contributed nonfinancial assets to be presented as a separate line in the statement of activities, apart from cash contributions, and to be disaggregated in the notes by category — land, food, pharmaceuticals and so on — with, for each category, a statement of whether the assets were used or monetised (and if used, in which programmes), the policy on monetisation, any donor restrictions, and the valuation technique and principal market used. The problem the standard addresses is real: pharmaceuticals donated on condition that they be used outside the United States, for instance, would be overstated if valued at United States market prices. Because contributed nonfinancial assets are especially important to smaller organizations, this is a point of particular relevance to them.

4.5 A Worked Example: Médecins Sans Frontières USA

The mission visited MSF-USA, which publishes a full set of FASB-based statements. For the year ended 31 December 2021, total revenue was $642,579,171 (2020: $561,166,314). Contributions from the public accounted for $623,375,919 of that, and the statement of activities discloses them by category of donor: individual gifts $410,367,677, supporter gifts $48,897,677, planned gifts $127,644,762, foundations $13,058,899, corporations $20,691,761 and multi-year grants and pledges $2,715,000. Such disaggregation by donor type is not universal American practice, but it follows naturally from a revenue structure dominated by gifts. Unconditional multi-year pledges are recognised as revenue in the year the promise is made, whether or not cash is received. Almost all revenue falls into net assets without donor restrictions.

On the expense side, programme expenses of $512,964,841 represent about 85 per cent of total expenses and contributions of nonfinancial assets ($601,024,970 combined), and are dominated by the emergency medical programme ($486,495,329). Among support expenses, fundraising at $81,018,587 vastly exceeds management and general at $5,734,422 — MSF-USA is the largest fundraising entity in the MSF movement, accounting for about 30 per cent of the movement's income and more than twice the size of the second largest, Germany, so the scale of its fundraising operation, and its cost, follow.

FASB standards also require a statement of cash flows, which MSF-USA presents by the indirect method and which shows positive free cash flow in both years; Japanese public interest corporations rarely prepare one. The notes explain the treatment of contributed services, recognised at fair value where they create or enhance a nonfinancial asset or require specialised skills that would otherwise have to be purchased: against total revenue of some $650 million, MSF-USA recognises $1.3 million of donated legal advice, supported by formal letters from the firms stating hours worked at their rates.

4.6 Summary and Outlook

American nonprofit accounting information comes in two layers: the figures reported in Form 990 under federal law, uniform across the country, and financial statements prepared under FASB standards and usually audited. Form 990 and the FASB standards are national, but disclosure and audit requirements differ sharply from state to state. The combination of federal and state regulation, and of tax-driven and accounting-driven figures, makes simple comparison with Japan difficult.

FASB-based statements are published by only a part of the sector. Smaller organizations often publish none. But as an organization grows, exceeds a revenue threshold, receives large private grants or takes government funds above a certain level, preparation and disclosure become unavoidable. The standard setter is itself a body within a private nonprofit organization, and its independence from any particular constituency is deliberately protected.

The FASB nonprofit standards are detailed, and they are notably rich in requirements relating to gifts: the treatment of fundraising expense, of volunteers, of contributed nonfinancial assets — matters on which Japanese standards are often silent. The MSF-USA statements display several presentations rarely seen in Japan: revenue disaggregated by donor type, contributions receivable, board-designated net assets shown separately. If Japan is serious about cultivating a culture of giving, more detailed disclosure about gifts will be indispensable, and American practice remains a useful reference.

5. The Audit of Nonprofit Organizations

Yuko Uehara

The IRS exists to collect federal tax, not to supervise nonprofit organizations, and it does not require them to be audited. Audit obligations arise instead where an organization receives federal funds, or where state law so provides. This chapter sets out the American audit landscape, the federal and state requirements, and the position of small organizations, drawing on the cases the mission encountered in New York and the District of Columbia.

5.1 Audit, Review and Compilation

A certified public accountant offers three levels of service. An audit provides reasonable assurance on the financial statements; a review provides limited assurance — a conclusion as to whether anything has come to the accountant’s attention causing them to believe that the statements are not prepared, in all material respects, in accordance with the applicable framework; and a compilation is not an assurance engagement at all, the accountant assembling statements from information supplied by the organization and expressing no opinion, though the fact that a professional prepared them lends a degree of credibility. Cost falls in the same order. The circumstances in which an audit is actually undertaken are set out in Table 8.

Table 8 Circumstances in Which a Nonprofit Organization Is Audited

1	A federal, state or local government requests a copy of audited financial statements
2	The organization expends $750,000 or more of federal funds in a year and is subject to the single audit requirements
3	A contract with a state or local government to deliver services in the community requires an audit
4	State law requires the filing of audited financial statements
5	A private foundation requires audited statements with a grant application
6	A bank requires an audit as a condition of lending

Source: National Council of Nonprofits, "Does your nonprofit need to have an independent audit?"

Some of these are legal obligations and some are not. Since an organization would rather spend its money on its mission, and since an audit may cost several thousand dollars even for a body with revenue below $1 million and typically $10,000 to $20,000 above that, many decline to be audited where the law does not require it. Others, wanting greater credibility at lower cost, choose a review or a compilation, and the sector’s own guidance encourages small organizations to ask grantmakers and lenders whether a reviewed statement would be acceptable. Some organizations are audited voluntarily because they regard demonstrating the reliability of their accounts as part of their responsibility to donors and to the public.

5.2 Federal Requirements: The Single Audit

An organization expending $750,000 or more of federal funds in a fiscal year must undergo a single audit under the Single Audit Act of 1984 as amended. The Act consolidated what had previously been separate audits of each federally funded programme into one engagement covering the entity. A single audit is considerably more detailed than an ordinary independent audit. Its purpose is to give the government assurance that federal funds are properly used and that the recipient operates adequate internal control. The auditor must be satisfied that the financial statements are fairly and accurately presented in accordance with federal cost principles, that the organization has an appropriate internal control structure, and that it complies with the laws and regulations applicable to the particular federal funds.

The reporting package is submitted to the Federal Audit Clearinghouse and is then freely available online to anyone. Where an organization receives federal funds under a single programme and no other requirement applies, a programme-specific audit may be elected instead. Peace Winds America, which the mission visited, receives federal funds and files with the Clearinghouse.

5.3 State Requirements

Requirements imposed by state law vary widely, as Table 6 in the preceding chapter shows, and some states impose none. Where an obligation exists it is usually triggered by total annual revenue or by contributions received. The mission's two destinations illustrate the two poles.

The District of Columbia has no audit requirement. Outdoor Alliance, founded in 2014 and reporting total revenue of $1,285,159 for the year ended 31 December 2021, receives no federal or state money — roughly 60 per cent of its income comes from charitable foundations, the balance from corporate support and individual gifts — and is therefore under no obligation from any source. It is nevertheless audited every year, as a matter of its own choice, because it wishes its financial information to be trusted.

Table 9 New York State Assurance Requirements

Annual gross revenue	Requirement
Over $1,000,000	File financial statements audited by an independent auditor
$250,000 – $1,000,000	File reviewed financial statements
Under $250,000	File financial statements; no audit or review required

Source: National Council of Nonprofits, "State Law Nonprofit Audit Requirements". An audit is required irrespective of size where the organization maintains a professional fundraising function employing professional solicitors.

VISIONS, registered in New York, reported total revenue of $18,136,421 for the year ended 30 September 2020 and is therefore well above the threshold. Its state filing runs to sixty-two pages, of which only the first three — form CHAR500 — are specific to New York; the remainder is the Form 990 filed with the IRS together with the audited financial statements. Both are also published on the organization's own website. The example makes the point that in the United States the state of incorporation materially determines an organization's audit obligations: had Outdoor Alliance registered in New York, it would have had no choice in the matter. Choosing the state of formation with the regulatory requirements in mind is a real consideration.

5.4 Small Organizations, Audit and Accountability

The National Council of Nonprofits reports that 92 per cent of 501(c)(3) organizations other than private foundations operate on less than $1 million a year and 88 per cent on less than $500,000. The great majority therefore fall below both the $750,000 single audit threshold and the New York $1 million threshold.

An organization the size of Outdoor Alliance may elect to be audited even when it need not be. For a body filing Form 990-N, with gross receipts of $50,000 or less, commissioning an audit to lend credibility to its statements is scarcely feasible. The New York Mycological Society and Ikebana International Chapter No. 1, both Form 990-N filers and both long-established, have never been audited. Neither knew of any organization of comparable size in their circles that had been; both said they would not consider one unless the law required it, preferring to concentrate their resources on their missions. What they emphasised instead was the intensity of communication within the organization and with members and donors, and the credibility of their commitment to the mission that this produced.

A further element completes the picture. Charity Navigator and similar bodies rate nonprofit organizations on four dimensions — accountability and finance, impact and results, leadership and adaptability, and culture and community — and publish the results free of charge online. Charity Navigator, itself a 501(c)(3) organization, currently rates roughly 200,000 organizations. Independent evaluation of this kind lets donors, prospective donors and the public form a view of an organization's performance without an audit, and so partially substitutes for assurance in the part of the sector where assurance is impractical. It is one of the elements sustaining the American culture of giving.

5.5 Summary

Four features stand out. First, an organization must attend to both federal and state requirements, and a large organization drawing on many funding sources faces a genuinely complex compliance task — an important structural difference from Japan. Second, the scope of the audit obligation is set by thresholds and graduated by size, in the same manner as the Form 990 series, and the thresholds are revised as circumstances change. Third, the system is built around transparency: Form 990 is available from the IRS website to anyone, most organizations publish it themselves, single audit packages are public through the Federal Audit Clearinghouse, and rating agencies add a further layer. Citizens can see into the sector through several independent channels, and that visibility is one reason the sector has grown.

Fourth, and most striking to the mission, was the attitude of the people involved. Asked whether they objected to the publication of their own compensation, everyone treated it as a matter of course, regarded transparency as both a responsibility and a benefit, and expressed pride in a system that requires it. Audit was understood as one instrument among several, to be used according to the organization’s circumstances. For Japan the lesson is one of balance: assurance requirements should reflect what users actually need and what organizations can bear, and for small organizations the guiding idea should be to nurture rather than to burden.

6. Governance of Nonprofit Organizations

Masayuki Tamaruya

In a federal system the law governing nonprofit organizations divides between the federal and the state levels. Organizational form is a matter of state law; federal law engages through taxation. Governance follows form, so state law ought to be decisive. In practice, enforcement of nonprofit law is weak in many states, with the consequence that the Internal Revenue Service, administering federal tax law, has come to play a substantial governance role.

6.1 Choice of Legal Form and Its Governance Consequences

Three forms are available: the charitable trust, the unincorporated nonprofit association and the nonprofit corporation. The choice is made by weighing ease of formation, the liability of the organization, the duties of those who run it, their personal liability, insurance and indemnification, volunteer liability, regulation and supervision, amendment, dissolution, fundraising, real property and business activity.

The charitable trust reaches back to England and was in use by the time of the Charitable Uses Act 1601. It is created by a unilateral act, has no legal personality and requires no registration, so it is easy to establish and flexible; but for the same reason the trustee bears unlimited liability for torts committed in the administration of the trust, which makes it ill-suited to activity of any scale, and trustees are held to a stricter duty of care than corporate directors, particularly in relation to investment. The unincorporated nonprofit association is formed where two or more persons agree to associate for a common nonprofit purpose. Having no legal personality it needs no statute, and its governance developed case by case; the resulting inconsistency prompted the Uniform Unincorporated Nonprofit Association Act of 1992, adopted in thirteen states, which confers the capacity to contract and to hold land and gives members and officers a measure of limited liability. The form is informal and flexible, and serves well as a bridge between founding an organization and incorporating it.

The nonprofit corporation is created by the state and governed by statute. Some states, such as New York, have a separate nonprofit corporation law; others, such as Delaware, legislate within the general corporations statute; the Revised Model Nonprofit Corporation Act aims at uniformity. Its defining feature is the non-distribution constraint, which extends to mutual benefit corporations such as labour unions, trade associations and clubs. To enjoy charitable tax treatment under federal law, an organization must in addition pursue one of the charitable purposes. The advantages of incorporation are considerable: the governance provisions correspond closely to those of business corporations, so corporate case law can be applied by analogy, and directors of nonprofit corporations today generally enjoy the protection of the business judgment rule; there is no doubt about standing, capacity to contract or to hold land; banks and counterparties extend credit more readily; and procedures for merger, acquisition and reorganisation are settled. The disadvantage is the time formation takes — though Delaware is quick, and elsewhere an organization can begin as a trust or association and convert later.

6.2 State Law: The Restatement of the Law, Charitable Nonprofit Organizations

Governance thus differs by state and by legal form, and nonprofit governance theory has lagged far behind corporate governance theory, with wide and long-tolerated variation among the states. In 2021, however, the American Law Institute published a Restatement consolidating the law of charitable organizations across state lines and across legal forms. Its six chapters cover definitions and choice of form; governance and management of assets; changes to purpose and organization; restrictions on assets, pledges and solicitation; government regulation of charities; and the standing of private parties.

Chapter 2, on governance, repays attention. Section 2.01 defines the fiduciary broadly, extending beyond formal directors to anyone exercising substantial authority over the charity, and measures the duty owed by the authority held. Section 2.02 states the duty of loyalty: to act in good faith in a manner the fiduciary reasonably believes to be in the best interests of the charity, and to deal reasonably with conflicts of interest and potential self-dealing. Section 2.03 states the duty of care — the care an ordinarily prudent person in a like position would exercise in similar circumstances — and applies to charity fiduciaries a rule corresponding to the business judgment rule, so that a trustee or director who acts without a conflict, on reasonably available information, and in the reasonable belief that the decision is in the charity's best interests is not liable for breach of the duty of care.

American charities are not, in general, subject to anything resembling the Japanese requirements on the balance of revenue and expenditure or on idle assets. Section 2.04 confirms that loyalty and care apply to the management, investment and expenditure of assets, and applies the prudent investor rule to assets held for investment: they are to be managed as a prudent investor would, in the light of the charity's purposes and any lawful terms attaching to them. Typically this means diversifying, taking a measure of risk and securing a return; leaving a portfolio of any size parked in safe assets is not permissible. Endowed funds may be spent or accumulated to the extent the charity determines to be prudent, having regard to the uses, benefits, purposes and duration for which the endowment was established.

To a Japanese eye, entrusting the investment of charitable assets to the directors' duties of loyalty and care looks abstract to the point of anticlimax. Read the other way, it states a basic principle: whether to spend or to accumulate is a matter of the fiduciaries' business judgement. The corollary — that where accumulation is chosen, diversified investment to build the asset base is what is expected — is worth more attention in Japan than it receives.

Section 2.05 defines the governing board as the body with ultimate responsibility for the charity's affairs; section 2.08 allows the constitution to modify fiduciary duties and to exculpate, though not for intentional or grossly negligent misconduct, unlawful acts, bad faith or disregard of charitable purpose; and section 2.09 immunises volunteers from liability for negligence and allows indemnification, with provision for liability insurance.

The contrast with the Japanese debate is instructive. Where Japan emphasises strengthening and tightening the governance of public interest corporations, the Restatement is largely concerned with mitigating the duty of care, permitting the modification and exculpation of fiduciary duties, and providing immunity and indemnity, so that charity fiduciaries can act without undue fear of legal risk. The line, however, is drawn firmly: intentional and grossly negligent misconduct and breaches of loyalty are not excused. Financial regulation likewise rests on the board's judgement rather than on uniform rules.

6.3 Federal Tax Law and the 2008 Form 990 Reform

At federal level, section 501(c)(3) requires that the organization be organized and operated exclusively for the listed purposes, that no part of its earnings inure to insiders, that it not disseminate propaganda or attempt to influence legislation as a substantial part of its activities, and that it not intervene in political campaigns. The organizational requirement is judged on the founding documents; the operational requirement on the facts.

Federal law imposes conflict-of-interest rules on private foundations but leaves governance generally to the states. Private foundations are subject to excise taxes on self-dealing (§4941), excess business holdings (§4943), jeopardising investments (§4944) and taxable expenditures (§4945), and must distribute annually 5 per cent of the market value of their investment assets or face a further excise tax (§4942). These excise taxes are formally taxes but function as intermediate sanctions, rising with the gravity of the conduct; revocation of exemption is reserved for cases of serious and uncorrected misconduct. Public charities, by contrast, are subject to no financial regulation at all: whether to spend on charitable work or to retain and strengthen the financial base is left to the board. The 1969 reform that introduced the distinction was itself prompted by charitable scandal, and it is significant that even then the legislature continued to trust organizations actually engaged in charitable work.

As awareness grew that state-level governance had reached its limits, expectations turned to the federal level, and the 2008 revision of Form 990 became the pivotal measure. It drew heavily on proposals from Independent Sector, the umbrella body formed by private nonprofit organizations in 1980, and its distinguishing feature was its emphasis on disclosure. Form 990 sets out governance best practice and asks whether the organization follows it. Part VI asks, for instance, whether any officer or director has a family or business relationship with another, and whether the organization has become aware of a diversion of assets; a "Yes" requires narrative explanation on Schedule O. An organization that makes its Form 990 widely available on its website is relieved of the duty to supply copies. Doubts were expressed at the time about whether disclosure could improve governance; subsequent research indicates that the disclosed information is used by the media, by researchers and by grantmaking foundations and government agencies, and that better governance does help prevent misconduct.

6.4 Governance Codes and Their Use

A great many governance codes are published in the United States — by law reform projects, by nonprofit associations, by rating agencies, by professionals in the field, by state attorneys general and by the IRS. The most important is Independent Sector's "Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations" (2007, revised 2015), which sets out thirty-three principles.

Its origin is bound up with the 2008 Form 990 reform. The Senate Finance Committee was then examining a wide range of nonprofit regulation and invited the sector to constitute a body to recommend improvements; the resulting Panel on the Nonprofit Sector reported in 2005, and so the sector was able to propose regulation it regarded as reasonable rather than excessive.

The thirty-three principles fall into four groups. Legal compliance and public disclosure covers compliance with the law, a written code of ethics, conflict-of-interest and whistleblower policies, document retention, protection of assets, and disclosure. Effective governance covers board composition, size, diversity, meetings and independence; the board's hiring, oversight and annual evaluation of the chief executive; separation of the offices of chief executive, chair and treasurer; board self-assessment, terms and limits on re-election; five-yearly review of the constitutional documents and of the mission; and the presumption against paying directors. Strong financial oversight covers accurate records with an independent audit or review, asset management and investment policies, a prohibition on loans to directors and officers, a requirement that a significant part of the budget be spent on programmes while operational and fundraising capacity is maintained, and travel expense policies. Responsible fundraising covers truthfulness toward donors, use of gifts in accordance with donor intent, a gift acceptance policy, training and supervision of fundraisers, a prohibition on commission-based compensation, and respect for donor privacy.

The principles descend to considerable detail — Principle 20 provides that directors should ordinarily serve without compensation and that, where compensation is paid, the organization should document how the amount was determined and disclose both the amount and its basis to anyone who asks. JACO has observed that the code is so detailed that it treats as principles matters that in Japan would belong in operating rules.

The code is nonetheless instructive on one point in particular. In Japan the tendency in strengthening the governance of public interest corporations and educational corporations is to impose statutory limits on the proportion of board members having family or business relationships. In the United States neither the Internal Revenue Code nor most state nonprofit statutes regulate director independence formally. What regulates it is precisely this private code: Principle 12 provides that two thirds of the board should be independent, and lists the circumstances destroying independence — receiving compensation as an employee or contractor; having one's compensation set by someone who is themselves compensated by the organization; receiving, directly or indirectly, financial benefit from the organization other than as a beneficiary of its charitable work; and family relationship. The commentary to Principle 12 cross refers explicitly to the disclosure of independent directors required by Form 990, while acknowledging that some organizations may have good reason not to require independent directors. Avoiding formal statutory regulation of director independence and leaving the matter to disclosure and a private code, with the code's content linked to the federal disclosure requirement, is a model worth considering in the Japanese debate.

6.5 Enforcement and Its Limits

The central difficulty in enforcing nonprofit law, at both state and federal level, is unevenness. The agencies responsible — state governments and the IRS alike — are chronically under-funded, and behind that lies the reality that legislatures, which control appropriations, show little interest in nonprofit governance. New York and California, where charitable and philanthropic activity is conducted on a large scale, regulate in detail: their nonprofit statutes require a proportion of independent directors, they devote real budgets to supervision, and their fundraising rules require registration not only of corporations formed in the state but of any corporation soliciting there. Such states are the exception, and even where a specific problem such as fundraising is regulated, governance generally is not.

For this reason the IRS's discipline under the Internal Revenue Code is often said to matter more — some speak of the "federalisation of the duty of loyalty" — even though that discipline is disclosure-based and imposes no legal requirements on director independence or compensation. The mismatch between the agency's statutory purpose, which is revenue collection, and its de facto governance role has long been noted.

Recently the IRS has become less active in supervising charities. Among the reasons usually cited is the 2013 controversy in which the agency was accused of delaying approval of conservative Tea Party-affiliated organizations and was severely criticised by congressional Republicans. In response the IRS simplified the process, introducing Form 1023-EZ to allow small organizations to apply online with an attestation rather than proof and without attaching their constitutional documents. Reports of abuse followed. Organizations were formed under names closely resembling those of the American Cancer Society and United Way and used to defraud donors. In the summer of 2022 the Ways and Means Oversight Subcommittee of the House took the matter up and published a letter to the Commissioner seeking an explanation; the Treasury Inspector General for Tax Administration expressed concern about Form 1023-EZ; and the Nonprofit Sector Strength and Partnership Act introduced in the House in 2022 contains a provision urging its withdrawal.

As the IRS has retreated, the states have in some respects become more active. In 2015 all fifty states and the District of Columbia joined the Federal Trade Commission in an action against Cancer Fund of America Inc., dissolved for fraud after its controllers were found to have distributed charitable assets to relatives and friends; the New York Attorney General dissolved the Trump Foundation in 2019 for the private diversion of charitable assets to election purposes. These are, however, as much political as institutional developments, and do not reflect a general strengthening of state nonprofit law or of state budgets.

6.6 Growth and Governance

Growth and governance are, in Japan as in the United States, the two wheels of the cart. Arranging the organizations the mission visited along a trajectory of growth brings out something the regulatory literature tends to miss: for those actually running nonprofit organizations, governance is felt most acutely not in relation to the state regulator or the IRS but in relation to the people who supply the money — grantmaking foundations and government funders. That corresponds neatly to the public support requirement, which asks that a third of income come from the public or from government.

The clearest example is government funding. Smaller bodies look to states and municipalities; larger and internationally active ones add federal grants. Government money brings audit requirements, and federal money brings rigorous governance obligations. Peace Winds America, engaged in international disaster relief, explained that because its work touches inter-governmental coordination and diplomatic relations it faces strict audit requirements, and that the resulting information becomes public through the Federal Audit Clearinghouse database.

The pandemic was a hard environment, and the organizations that agreed to see the mission were, by definition, survivors. VISIONS reported that several charities serving blind people in and around New York had ceased to operate; VISIONS itself secured government contracts, built its endowment and maintained multiple funders, and was able to recruit skilled staff who had lost their positions elsewhere. Organizations that secure governance and grow expand; those that fail dissolve. There is a hardness in the American nonprofit sector, and it is also the source of its dynamism.

That growth pattern is not, however, the only American model. Ikebana International Chapter No. 1, the Westminster Neighborhood Association and Friends of Georgetown Waterfront Park keep their books on online accounting software, disclose through Form 990-EZ at modest cost, and conduct activity and governance on a scale that suits them. Grass-roots organizations of this kind are the traditional American image of charity. Robert Putnam argued in "Bowling Alone" (2000) that such organizations had declined sharply and that social capital had been lost across the twentieth century; the polarisation of American society and the entrenchment of inequality have provoked criticism of a philanthropy in which the very wealthy exercise great influence. Whether the American nonprofit organization is best understood on the Putnam model of grass-roots association or on a Schumpeterian model of disruption and innovation was a question the mission heard debated; Independent Sector described its own efforts to give greater weight to grass-roots organizations. The argument will continue.

7. Regulators, Intermediaries and Nonprofits

Yoshiharu Shiraishi

7.1 A Comparison with the United Kingdom

It is useful to begin with the findings of JACO's 2019 mission to the United Kingdom. The Charity Commission for England and Wales and the Office for Civil Society, then within the Department for Digital, Culture, Media and Sport, interact frequently with intermediary bodies and with charities themselves, work to understand conditions on the ground, and take the policy and regulatory measures that follow. Officials of the Commission and of the Office attend the annual conference and other events of the National Council for Voluntary Organisations (NCVO), using them to gauge the state of the sector and to identify needs for support and for legal change. When aggressive fundraising aimed at elderly donors became a public issue in 2015, the Minister for Civil Society asked NCVO to consider remedies, and the outcome was the establishment in July 2016 of the Fundraising Regulator, an independent body composed of people from the charity world. Government and intermediaries there depend on one another much as regulator and sector do.

Because that traffic is so open, the 2019 mission was able to interview the Charity Commission and the Office for Civil Society directly. The 2022 mission considered approaching the IRS but found outreach to the agency extremely difficult — even local intermediary bodies described the relationship as hard to build — and no interview took place. Nor did the mission encounter any organization that maintained a relationship with the IRS or a state regulator. The contrast with the United Kingdom is marked.

7.2 Nonprofits and the Regulators

For most organizations the relationship with the IRS or the state authority is one-directional: comply with the requirements. Relations with other parts of government — as distinct from the regulator — are quite different, and often cooperative in matters of policy, funding and contracted services.

City Wildlife, which rescues and rehabilitates injured wildlife in the District of Columbia, has no relationship with the regulator, but the District government understands the value of its work and provides an annual subsidy of around $200,000 ($205,000 in 2021). The organization finds the quarterly programme reports burdensome, though the content changes little enough from quarter to quarter to make them manageable. It also lobbies the District government, with partner organizations, in support of the Migratory Local Wildlife Protection Act of 2022.

The International Center for Not-for-Profit Law, a global organization concerned with the legal environment for civil society, philanthropy and civic participation — and interested, incidentally, in the relationship between Japan's stagnant numbers and its institutional environment — has no cooperative relationship with the IRS or the states beyond registration and annual filing. With the Department of the Treasury and the Department of Justice, however, its relations are close. The United States has a range of counter-terrorism sanctions, anti-money-laundering rules and democracy-related statutes affecting nonprofit organizations, and ICNL works with the Treasury to ensure that these do not obstruct charitable funding, humanitarian relief and development assistance; the day after the mission's interview it was to attend a meeting with the Office of Foreign Assets Control on the effect of United States sanctions on humanitarian aid to Afghanistan. It has also testified in Congress, at the request of the Department of Justice, on the Foreign Agents Registration Act of 1938 — enacted to counter Nazi propaganda and long unamended — to ensure that modernisation does not unintentionally restrict legitimate cross-border charitable activity.

The US-Japan Council likewise files its annual return and no more so far as the regulators are concerned, but maintains good relations with the Japanese and American foreign ministries through the two embassies and runs exchange programmes jointly with them. World Food Program USA operates in a field — global hunger — that both parties and the federal government have supported for decades; about $5 billion of the federal budget was directed to World Food Programme operations in 2022.

7.3 Nonprofits and Intermediary Organizations

Many small organizations are unaware that intermediary bodies exist, and some that are aware cannot afford the subscription, so membership tends to consist of medium and large organizations. Most intermediaries, however, make a range of services and programmes available to non-members as well, so the relationship between intermediaries and the sector at large is an open one.

ICNL works with the Council on Foundations, the intermediary for grantmaking foundations, on a variety of projects, and with InterAction, the intermediary for international development organizations, on international work. It belongs to Independent Sector but finds little occasion to collaborate, that body's focus being domestic. The US-Japan Council is a member of Independent Sector, and its late president Irene Hirano Inouye served on the Independent Sector board, so relations were particularly close until a few years ago; the Council continues to attend events and to support advocacy. World Food Program USA works directly with the United Nations and its partners, has no intermediary affiliation and is not a member of any: one function of an intermediary is to gather voices nationally and carry them to government, and World Food Program USA has its own channels.

The Council on Foundations was itself founded to protect the interests of community foundations too small to retain a lobbyist and to carry their voices to the federal government. When making representations federally it works with Independent Sector and the National Council of Nonprofits on domestic questions and with InterAction on international ones. Internally it maintains a public policy committee, working groups on particular questions and other specialist committees, drawing members into its work so that the conclusions feed its advocacy; members unable to attend can submit views by e-mail.

7.4 Intermediaries and Government

The relationship between intermediaries and the regulators is not close. Relations with other parts of the federal government, on questions of policy, are much closer — with the Treasury, the Department of Health and Human Services, the Federal Emergency Management Agency and Congress, according to the issue. Where a matter affects the sector, the federal government turns to the intermediaries as opinion partners, and the dependence runs both ways.

Independent Sector once had a contact officer at the IRS. That officer moved on, and the search for a successor has been unsuccessful, apparently because of staff shortages at the agency. Even when a contact existed there was a certain distance, and a close relationship is not to be expected. Unlike Japan, there is no officer assigned to each corporation and no on-site inspection, so the agency cannot be looked to for advice; contact is confined to the moment of filing, and there is even less contact with the states. With the rest of government the position is quite different. Relations with the Treasury are excellent: tax questions are discussed, along with the effect on nonprofit organizations of the new arrangements introduced by the 2017 tax reform. Relations with members of Congress are good, and the organization reaches out actively to the tax-writing committees. It is now working to strengthen the relationship between the sector and government and to make it permanent by legislation, on the view that many policy makers have no experience of charitable work and do not understand the sector — some believing that nonprofit work is done entirely by volunteers. When an issue affects the sector, the agencies, the Treasury and Congress turn to Independent Sector as an opinion partner.

On state regulation, Independent Sector has been pressing a specific reform that is now close to resolution. An organization wishing to fundraise outside its state of incorporation must at present register in every state in which it solicits, which is a heavy burden. To reduce both compliance and administrative cost, state regulators have launched a Single Portal Initiative allowing an organization to satisfy the registration requirements of every state through one online portal; legislation was expected in 2023, after which a consortium of state regulators would operate the system. The Council on

Foundations, for its part, maintains a government relations team that meets frequently with the Treasury, the Department of Health and Human Services, FEMA and representatives of the administration; its role is to supply information about the sector, to convey the views of community foundations and small organizations to the federal government, to bridge the foundation community and government, and to connect its 850 member organizations with federal agencies. It files an annual submission on tax questions with the Treasury.

7.5 Collaboration among Nonprofits

Organizations in the field each hold their own expertise, and the view is widely held that high-quality work requires several kinds of expertise brought together. In advocacy the same logic applies with added force — the louder the voice, the greater the influence — so joint submissions signed by many organizations are the norm. Collaboration is treated as ordinary practice.

City Wildlife described a dense network of environmental organizations in Washington, D.C. whose particular concerns differ but whose direction and interests coincide: bodies concerned with watershed protection, with rare species, with animal welfare all share an interest in conserving the natural environment and improving urban biodiversity, and cooperate when the occasion arises. Its campaign for the Migratory Local Wildlife Protection Act produced a statement of support signed by twenty-two organizations, which carried great weight; conversely, when other organizations ask City Wildlife to sign, it signs. Collaboration between organizations and between groups of organizations is treated as routine business. World Food Program USA works closely with the United Nations to understand the state of global hunger and the effective means of ending it, and domestically has formed a coalition with nonprofit and international development organizations working on hunger, maintaining its influence by advocating the World Food Programme’s work through that coalition at home and abroad.

8. Nonprofit Responses to COVID-19

Masayuki Tamaruya

8.1 The Impact of the Pandemic

The pandemic that reached the United States early in 2020 affected American nonprofit organizations profoundly and in two directions at once. It generated enormous demand for charitable work: businesses closed or contracted, people lost their jobs and fell behind on rent, and need rose sharply, above all in anti-poverty work. Hate crimes against Asian Americans multiplied, and the Black Lives Matter movement that followed the killing of George Floyd confronted organizations working on racial justice and civil rights with very large tasks. At the same time it magnified operational and financial difficulty, and organizations in culture and the arts, education, welfare and health care that depended on in-person activity and the earned income it generated were hit hardest.

Culture and the arts suffered most: the sector draws nearly 60 per cent of its income from ticket sales, and lockdowns closed theatres and museums. Employment in theatre and music halved, unemployment among stage actors reached 52.3 per cent in the third quarter of 2020, and the revenue of tax-exempt theatrical organizations fell 54 per cent. Universities closed campuses and moved teaching online, and many faced sharp revenue losses; the image of the richly endowed American university applies only to a small elite, and even there much of the endowment is restricted. In social welfare, where the private sector accounts for some 60 per cent of employment as a legacy of contracting out, many of the nonprofit organizations involved are small, exhaust their funds quickly in a crisis and hold few reserves.

Even a museum of MoMA's size was tested. New York's lockdown began at the end of February 2020 and the museum did not reopen until 27 August; a revenue shortfall of $150 million was projected by the middle of the year. MoMA holds an endowment of $3.6 billion, but endowment funds are generally restricted and the scope for diverting them to operating costs is limited. The museum avoided laying off employees but terminated the contracts of eighty-five freelance curators in April; the director's large salary was reported, and in April 2021 there was a demonstration protesting at the influence of wealthy patrons.

Employment and economic effects

Research by the Center for Civil Society Studies at Johns Hopkins University estimated that in the first three months of the pandemic — March to May 2020 — the nonprofit sector lost more than 1.64 million jobs, some 13.2 per cent of sector employment. Some 40.6 per cent of those jobs returned over the following three months, but recovery from September 2020 through 2021 was slow, and by the end of 2021 only 72.1 per cent of the lost jobs had been recovered. When the mission visited in the summer of 2022 the country had moved further toward normality than Japan, and few people wore masks in the street; but recovery in the nonprofit sector was said to lag behind that of business.

The difficulty was not uniform. Urban Institute research shared with the mission by George Mason University showed full-time employment in the charitable sector little changed from pre-pandemic levels while part-time employment and volunteering were severely affected. Part-time employment fell 7 per cent between 2019 and 2020 — 1 per cent in urban areas, 12 per cent in suburban and 18 per cent in rural. Regular volunteering fell 23 per cent in urban areas, 24 per cent in suburban and 41 per cent in rural, and episodic volunteering by 42, 35 and 58 per cent respectively. Earned income fell by a median 30 per cent, but scarcely at all among organizations with assets above $10 million; it fell 20 per cent for those between $1 million and $10 million, 38 per cent between $500,000 and $1 million, 25 per cent between $100,000 and $500,000 and 33 per cent below $100,000. Small and medium-sized organizations, in short, were hit hardest. By field, earned income fell by a median 50 per cent in the arts, 17 per cent in education and in human services, 25 per cent in other categories and not at all in health.

8.2 Responses on the Ground

Organizations improvised. Theatres moved ticketing online, indoor spaces were reconfigured for distancing, performances moved outdoors. Across many fields the response was digital: online exhibitions, streamed performances, classes moved online, IT support supplied to low-income households, and administrative work shifted to remote working. The shift carried technical and financial costs, and while it opened the possibility of reaching more distant audiences it also severed connections with people unable to use the technology. The Urban Institute survey found that 72 per cent of organizations had moved existing services to remote or online delivery and 71 per cent had added new ones — but 64 per cent had suspended or discontinued services, 47 per cent had reduced the numbers they served and 41 per cent had scaled back programmes.

Philanthropy responded. Very large gifts from wealthy individuals conscious of the crisis made news: MacKenzie Scott gave $5.8 billion to a large number of charities in 2020, Independent Sector among them, and the fact that she attached no restrictions whatever was widely and warmly noted in the sector — it came up in the mission’s interview at Independent Sector. Foundations moved emergency funds to organizations affected by the pandemic and to those serving vulnerable people: the Robin Hood Foundation, which supports anti-poverty work in New York, announced that in the nineteen weeks from the stay-at-home order of 20 March it had distributed $35.5 million to 432 front-line nonprofit organizations, and after the death of George Floyd its chief executive Wes Moore launched a new initiative, supported by Goldman Sachs and JP Morgan, to fund nonprofit organizations led entirely by people of colour.

Restrictions on gifts were a problem before the pandemic. A use restriction imposed by a donor binds the recipient legally: where a donor gives a collection to a museum on terms that it be kept together, the museum must bear the cost of conservation indefinitely, cannot in principle sell part of the collection to meet that cost, and must go to court if it reaches an impasse. During the pandemic a private initiative to waive such restrictions spread. The Ford Foundation and the Council on Foundations published a "Call to Action: Philanthropy’s Commitment During COVID-19", inviting other foundations and philanthropists to join. Signatories undertake to loosen or remove restrictions on current grants, converting project-specific grants into unrestricted support, accelerating payment schedules and not holding grantees responsible for delayed events and projects; to make future grants as unrestricted as possible so that grantees can respond flexibly; to postpone reporting, site visits and other requirements during the crisis; to communicate regularly with grantees, listen to their needs, support their advocacy for policy improvement and share crisis responses. By the end of 2022 the call had 806 signatory foundations.

American grantmakers are said to be readier than Japanese ones to fund operating as well as programme costs. Even so, the crisis demonstrated that programme-restricted grants can impede the continuity of a grantee’s work, and prompted a re-recognition of the value of less restricted operating support. Japan might usefully raise its own awareness of the value of unrestricted gifts and grants for the continuity and expansion of public interest corporations. At present a gift whose use is specifically designated is treated as designated net assets and so escapes the financial criteria, while an undesignated gift counts as ordinary revenue and is caught by the revenue-expenditure balance requirement. If that treatment is discouraging flexible giving, the time to reconsider it has come.

8.3 Institutional Support Measures

(1) State level

On donor restrictions, the legislative movement predates the pandemic. The Uniform Prudent Management of Institutional Funds Act (UPMIFA), published in 2006, relaxed the procedure for modifying gift restrictions. Previously, where a charitable purpose or use restriction had become unlawful, impracticable or impossible to achieve, relief could be obtained only through court proceedings under the cy pres doctrine. Under UPMIFA a restriction may be released or modified without court proceedings if the donor consents; where the donor does not consent, cy pres is extended to cases where the restriction has become wasteful as well; restrictions on management and investment may be modified under the doctrine of equitable deviation where circumstances unanticipated by the donor prevent the purpose being served; and a small old fund — twenty years and $25,000 are the illustrative figures — may be modified on notice to the attorney general alone, where litigation would cost more than the fund is worth. UPMIFA has been adopted in every state except Pennsylvania and in the District of Columbia, and the Restatement adopts the same rules.

Guidance addressed specifically to pandemic-related financial distress built on that legislative base rather than going beyond it — state nonprofit authorities were, if anything, cautious about going further. The mission found no guidance from the District of Columbia or New York, but the Massachusetts Attorney General's Office published in August 2020 a document entitled "Guidance from the Attorney General on Endowment Funds of Charities Facing Financial Distress from COVID-19". Before touching endowment, it recommends considering (1) raising new unrestricted funds, (2) federal and state support such as the CARES Act, the Small Business Recovery Loan Fund or the Economic Injury Disaster Loan Program, (3) COVID relief funds or grants from private foundations, and (4) commercial bank borrowing or refinancing. If those are unavailable, the charity should consider asking donors to release spending restrictions, or temporarily varying the endowment spending rate for the year alone. Only when those possibilities are exhausted should court modification be sought. The Attorney General's Office must be notified before proceedings begin, and it undertakes to review the petition and give feedback, supply the necessary forms and, where needed, help arrange an expedited hearing.

(2) Federal level

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) passed Congress and was signed on 27 March 2020. Within it, the measure most often mentioned to the mission was the Paycheck Protection Program (PPP), administered by the Small Business Administration, under which businesses and organizations with fewer than 500 employees affected by the pandemic could borrow to maintain operations, with the proceeds restricted to payroll, interest, rent and utilities. PPP ran in two rounds, and loans meeting certain conditions were forgiven.

Nonprofit organizations, including 501(c)(3) organizations and veterans' organizations, were eligible, and an estimated 97.7 per cent of all nonprofit organizations with employees could apply. Friends of the Children NY and VISIONS both told the mission that PPP allowed them to maintain employment and to stabilise their finances. The Urban Institute survey found 66 per cent of respondents had used PPP, but take-up varied sharply with size: above 80 per cent among organizations with annual expenditure over $500,000, 64 per cent between $100,000 and $500,000, and only 37 per cent below $100,000.

Live performance was affected particularly severely, and many theatres, having closed and been unable to retain employees, could not use PPP. The Save Our Stages Act, passed with bipartisan support in December 2020, created the Shuttered Venue Operators Grant, under which live venues and performing arts organizations could receive up to 45 per cent of 2019 gross revenue, capped at $10 million; a delayed and faulty website caused substantial payment delays and attracted criticism, and the programme closed in August 2021.

One lesson the sector drew from the pandemic was that its channels to federal policy makers were inadequate — the difficulties over PPP being the clearest illustration, given how important that support was to a sector composed largely of small entities. The Nonprofit Sector Strength and Partnership Act of 2022, supported by Independent Sector, would establish an office for partnership with the nonprofit sector in the White House, an inter-agency council, and an advisory board of sector representatives reporting to Congress; it includes the procedure for the single national online portal for fundraising registration, requires the Treasury, the Department of Labor and other agencies to review the law and administration of volunteering and giving, and proposes the withdrawal of Form 1023-EZ. Whether it will pass is uncertain; anticipating that, Independent Sector has published a draft executive order to substantially the same effect.

8.4 Discussion

The impact of the pandemic in the United States was severe and uneven. Rural organizations dependent on volunteers and individual gifts suffered more. Organizations that were larger, with diversified income and the capacity to make effective use of foundation and government support, survived. Speaking to organizations in the field, the mission heard again and again that other bodies doing the same work in the same neighbourhood had been forced to stop, while the organization in front of us had used private grants and public support to secure its financial base and was expanding its programmes. Both the hardness and the strength of the American nonprofit sector were on display.

American charity regulation disperses public authority, and the responses to the pandemic were correspondingly various at both federal and state level. Federal measures such as PPP supported small nonprofit organizations in the same way as small businesses, from the standpoint of maintaining employment — a reflection of how important a nonprofit employer is in the United States, and equally of the fact that the great majority of nonprofit organizations are small. States provided subsidies and also governance support, though wholesale governance exceptions were not common; the focus fell rather on the pre-existing trend toward relaxing donor use restrictions.

There is much here for Japan. Japanese public interest corporations face stricter financial regulation than their American counterparts. The requirement that revenue and expenditure balance, and the restriction on idle assets, narrowed the scope for accumulating capital over the medium and long term, weakened corporations' financial resilience and removed the margin needed to absorb a shock of this size. That an unrestricted gift is caught by the revenue-expenditure requirement in Japanese law runs directly counter to the American movement to expand and use unrestricted giving. And where a Japanese corporation wishes to provide emergency assistance, the need to change its programmes is frequently a procedural obstacle. The time has come to take stock of how the Public Interest Corporation Commission and the Cabinet Office responded to the pandemic and what should be learned from it. Greater latitude in the financial criteria, governance, and a legal framework allowing private charitable and mutual assistance to operate freely and without inhibition in a disaster of this magnitude all deserve examination. In the United States, though the outcome is uncertain, legislation has been proposed to expand communication between the charitable sector and the federal government. Japan too might consider how to expand the opportunities for dialogue between the Commission and the private sector.

Part 2: Report on the U.S. Field Research Mission

The mission met thirty-three organizations between 6 September and 11 October 2022. This part condenses the field reports of the Japanese edition, retaining for each organization what bears on the themes of the study: how small and medium-sized bodies are formed and financed, what they must file, what assurance they obtain, and how they experienced the pandemic. Interviews conducted online are marked as such.

Washington, D.C. and Virginia

1. City Wildlife, Inc.

6 Sep 2022 · Washington, D.C. · Jim Monsma (Executive Director), Anne Lewis · citywildlife.org · Ryota Kaneko and Yoshiharu Shiraishi

A nonprofit rescuing and rehabilitating injured wildlife in the District of Columbia and running education and community programmes. Founded in 2008, it operated without a facility for five years and opened its rehabilitation centre in 2013. The annual budget is about $580,000, of which some $200,000 is District subsidy; the organization takes pride in raising more privately than it receives from government.

Gifts in kind are frequent and are capitalised at $500 or more. The director keeps the books in QuickBooks, an accountant reviews them monthly, and a separate firm audits the statements — not because the law requires it but because foundation grant applications generally do. She stressed trust: the paperwork is laborious but indispensable, particularly in a field where some organizations accept gifts and fail to use them properly. Giving patterns differ by age — cheques by post from older donors, Facebook and GoFundMe from younger ones. Because a crowdfunding appeal's total is unknown in advance, appeals are worded to allow any excess to be applied elsewhere, so the proceeds are treated as net assets without donor restrictions. Reserves are held against emergencies with no regulatory limit, though she noted that donors reading the published balance sheet would ask questions if a large fund sat unused; under GAAP a restriction may be released after about five years. District grants up to $200,000 require no programme report, which is one reason the figure recurs; contracts are quite different — a neighbouring nonprofit running the animal control service under contract has every dollar restricted, faces exacting performance requirements and must be audited.

2. US-Japan Council

6 Sep 2022 · Washington, D.C. · Terri Swetnam (COO), Sonoko T. Plummer, Shane Graves · usjapancouncil.org · Seiya Wakisaka

Founded by Japanese Americans to strengthen the bilateral relationship by developing and connecting leaders. Revenue is $5–6 million, mid-range among the organizations visited but substantial by Japanese standards.

Ms Swetnam, with more than thirty years in the sector, was unequivocal that disclosure of compensation is essential: it helps prospective donors and partners understand potential conflicts of interest, and seeing where money goes lets people judge whether an organization is well run. On reserves she described a spectrum: large organizations adopt formal policies with drawdown procedures; smaller ones are beginning to, knowing funders expect it, and typically start by aiming at three months of operating expenses. A reserve policy normally addresses permitted risk levels, the associated investment policy and who manages the funds.

3. Independent Sector

6 Sep 2022 · Washington, D.C. · Jeff Moore (Chief Strategy Officer), Lindsay Marcal, Stuart Hewitt · independentsector.org · Yoshiharu Shiraishi

The leading national intermediary, with some 500 member organizations deeply involved in its programmes, working also with the wider sector. Its Sector Health programme, begun three years earlier, diagnoses the sector through four elements — financial health, workforce health, governance and trust, and research and advocacy — and publishes an annual report used by policy makers, funders and other intermediaries. Edelman's national survey ranks the sector among the most trusted in the country, with community-rooted organizations trusted more than large ones: proximity matters.

There is no regulation of reserves; holding them is regarded as a plain responsibility, and restrictions exist only as between funder and grantee. Since the pandemic the Council on Foundations has led a campaign for unrestricted giving, and much money shifted toward flexible support; Independent Sector itself received a very large unrestricted grant from MacKenzie Scott, to be spent over three years. Directors may be paid, but transparency and clear justification are required; the general practice is reimbursement of expenses without compensation.

4. Ikebana International, Washington D.C. Chapter No. 1

6 Sep 2022 · Washington, D.C. · Avis Black (President) · iichapter1.com · Yuko Uehara

Ikebana International was founded in 1956 under the motto "Friendship through Flowers", and has about 170 chapters and 7,600 members. The Washington chapter was the first established outside Tokyo and is the largest, with about 270 members.

The chapter is a 501(c)(7) social and recreational club; the link among Ikebana International bodies is loose and each operates independently. Annual revenue is about $75,000 and Form 990-EZ is filed each year. The accounts are very simple, there is no borrowing, the financial report is prepared by member volunteers and there is no external audit; the president considered that for organizations of this size the arrangement presents no difficulty, and that with ten board meetings a year the organization's soundness is maintained. Her two years in office coincided with the pandemic. An organization built on events might have been expected to suffer, but with volunteer help the chapter moved quickly to Zoom and its membership rose; in-person events resumed in 2022. Where directors meet often enough to know what is happening, self-regulation can work well without professional accounting staff or an external audit.

5. Friends of World Food Program USA

6 Sep 2022 · Washington, D.C. · Claudio Silva (COO and CFO) · wfpusa.org · Seiya Wakisaka

World Food Program USA works with American policy makers, companies, foundations and individuals to support the mission of the United Nations World Food Programme, the world's largest humanitarian organization and the 2020 Nobel Peace laureate. Mr Silva is a qualified accountant who previously worked in audit.

On the value of Form 990 to donors he pointed to the balance sheet information on assets, liabilities, net assets and restrictions, from which a reader can judge whether the organization has the liquidity to meet its long-term needs; and to the expense information, which shows not only what was spent on salaries, consultants and rent but how much went to programmes, fundraising and management, so that a donor can see what proportion of each dollar served the charitable purpose. That ratio, he said, is a genuinely important statistic. The form also identifies board members and their compensation, the policies that may constitute best practice, and the nature of board oversight, together with how funds are used and to whom they are given, including lobbying expenditure. It is, he concluded, the best source the American public has on how nonprofit organizations use their resources.

6. Center for Values in International Development

7 Sep 2022 · Washington, D.C. · Dr Chloe Schwenke (President and Founder) · centerforvalues.international · Ryota Kaneko

A small organization of practitioners and ethicists working to make secular, universal moral values explicit in international relief and development policy, programming, advocacy, monitoring and evaluation. Its beneficiaries are diverse — LGBTQ people, racial minorities, marginalised people in developing countries — and what distinguishes it is that it approaches their dignity through ethics rather than through any single issue. At the time of the interview it was twenty-eight months old.

Dr Schwenke secured a large foundation grant soon after founding the organization. The funder then asked her to raise money from other foundations as well, which proved extremely difficult without existing connections; she took training from a fundraising consultant — which foundations exist, how to attract their interest, how to write applications, how to build relationships — and subsequently succeeded. For specialist work on values, general crowdfunding platforms are unsuitable; LinkedIn proves more useful.

7. Peace Winds America

7 Sep 2022 · Washington, D.C. · Wayne Nissly (CEO), Abie Alexander (Senior Finance Manager), Randy Martin (Board Chair), Sarah Maraschky · peacewindsamerica.org · Seiya Wakisaka

An international NGO responding to natural and man-made crises worldwide. Peace Winds Japan was founded in 1996 and Peace Winds America began operating in 2008; since 2016 the two have worked as partners. Mr Alexander has more than thirty years in nonprofit finance in the United States and abroad.

Only accrual accounting is acceptable under GAAP and federal standards; some very small organizations use cash accounting, but it is not recommended. He noted the 2018 reduction of net asset classes from three to two, and the difference between FASB-based audited statements and the statements within Form 990 — the audited statements, for instance, do not list the five highest-paid individuals. The federal government treats items below $5,000 as supplies rather than fixed assets, which differs from Japanese practice. On audit he distinguished the organization-wide audit, the programme-specific audit and donor-specific audits: below $750,000 of federal funds with a single project a programme-specific audit suffices, but with multiple projects or $750,000 or more an organization-wide audit is required. He emphasised the public availability of Form 990: when one nonprofit considers partnering with another, the first step is to examine the other's return and confirm that their goals align.

He set out four steps to forming a 501(c)(3) organization: incorporate in a state, the documents differing by state; file Form 1023 with the IRS, the longest step, within twenty-seven months to avoid complications; obtain an employer identification number; and register with the state as a tax-exempt body. Federal recognition, once granted, need not be renewed and is not reviewed annually, though the IRS may revoke it, whereas state registration is annual.

8. Candid (online)

7 Sep 2022 · online · Arif Ekram (Manager of Global Partnerships), Grace Sato · candid.org · Tomohito Nakajima

Formed in February 2019 by the merger of GuideStar, which provided information on organizations recognised as public charities, and the Foundation Center, which provided information on grantmaking foundations and their grants; Candid is itself a 501(c)(3) organization. The merger brought information about the supply of philanthropic money and about the organizations that use it into a single source. In 2020 it reported revenue of $42,877,589 and expenditure of $39,439,944, with 251 staff and 22 directors.

On the purpose of disclosure, Mr Ekram gave the historical account reproduced in Chapter 3: the McCarthy-era Cox Committee hearings, the sector's realisation that it was being scrutinised because it was not transparent, and the Tax Reform Act of 1969 that followed. Transparency, he said, underlies everything; without it there is no efficiency, and without efficiency no success.

9. The George Washington University (site visit)

7 Sep 2022 · Washington, D.C. · gwu.edu · Yuko Uehara and Ryota Kaneko

Founded in 1821 as a private university in the capital open to all. Unable to interview an educational 501(c)(3) organization directly, the mission visited to observe how an American university raises funds. At the university's Textile Museum, admission free, plaques at the entrance record the donors who funded the building and, separately, those giving above a threshold each year, with a donation box beside them; on the main campus the paving is inscribed with graduation years and individual names, and the shop sells a wide range of GW-branded goods. The care taken over brand, and over the pride of being a graduate, is evident everywhere.

10. International Society for Third Sector Research (online)

8 Sep 2022 · online · Dr Megan Haddock (Director of Programs) · istr.org · Masayuki Tamaruya

Founded in 1992 to promote research and education on civil society, philanthropy and the nonprofit sector. Dr Haddock worked under Professor Lester Salamon at the Center for Civil Society Studies at Johns Hopkins University before moving to the ISTR West Coast office in 2016. Professor Salamon, who died in 2021, pursued the question of what the third sector is: registered nonprofit organizations at the centre, cooperatives and mutuals overlapping on one side, social ventures overlapping the for-profit boundary, volunteering below and government above.

On financial regulation her answer was categorical. Nothing corresponding to the Japanese requirement that revenue and expenditure balance exists in the United States, apart from the 5 per cent payout rule for private foundations. Regulating nonprofit spending would intrude on autonomous management and would meet strong resistance; as policy it is unwise, because pressing organizations to spend leads them to consume resources without adequately considering the need. That said, the reluctance of well-endowed private foundations to spend even 5 per cent is a live issue; the Bill & Melinda Gates Foundation has stated it will exhaust its assets within fifty years.

11. National Archives Museum (site visit)

8 Sep 2022 · Washington, D.C. · archives.gov · Yuko Uehara

The mission had intended to visit the Smithsonian National Air and Space Museum, which proved closed for a $250 million renovation begun in 2018 — for which online donations were still being solicited, about 94 per cent of the target having been raised — and went instead to the National Archives Museum, whose rotunda displays the Declaration of Independence, the Constitution and the Bill of Rights, with an original copy of Magna Carta of 1297 at the entrance.

12. George Mason University

8 Sep 2022 · Arlington, Virginia · Dr Stefan Toepler, Dr Alan J. Abramson, Dr Mirae Kim · gmu.edu · Ryota Kaneko

Virginia's largest state university. The area around Washington, D.C. is a centre of nonprofit research, and several of the researchers had studied under Professor Salamon.

The mission was shown results from an online study of nonprofit giving during the pandemic. Five findings stood out: individual giving is indispensable; giving grew between 2015 and 2019 but reversed for many organizations in 2020; organizations led by people of colour show a long-term disparity in giving trends; before 2020 rural community organizations saw smaller increases than others, whereas in 2020 urban organizations saw the larger decreases; and earned income fell markedly in 2020, particularly in the arts, while volunteering also declined.

Such studies are possible because Form 990 data are readily available. Professor Toepler, who is German, observed that comparable work is difficult in Germany because financial disclosure by nonprofit organizations is limited, and that even where a study is possible international comparison is not — a point applying equally to Japan. He also noted the limits of the American data: clear errors are frequent in Form 990 filings, and publication lags make timely analysis difficult.

13. International Center for Not-for-Profit Law

8 Sep 2022 · Washington, D.C. · Douglas Rutzen (President and CEO), Cathy Shea, Julie Hunter, Lily Liu · icnl.org · Masayuki Tamaruya

Founded in 1992 and focused on the legal environment for civil society worldwide, working with civil society, governments and the international community on legal and institutional reform.

On Form 990: introduced in 1941 at about two pages, it has grown in length and complexity, though small charities may file the simpler versions. ICNL engages an accountant to prepare its return, employing in-house accounting expertise being difficult. The complexity is real, but the disclosure has value and there is no strong criticism of the present position. The 2007 amendment emphasised governance disclosure; there was debate about whether a tax authority should engage with governance at all, but the answer lies ultimately in self-regulation and good practice. Most organizations care how they appear through Form 990, and the good practices published by Independent Sector had real impact. There are limits — reports of $2 million and $4 million salaries for university coaches suggest as much — but journalists use the data regularly, and investigative reporting frequently prompts state investigations.

14. Home Roots Foundation

9 Sep 2022 · Washington, D.C. · Joseph Loubens Paul (President) · homerootsfoundation.org · Seiya Wakisaka

Established in 2003, dormant after the financial crisis of 2008, and revived in 2018 following a visit to Haiti. Because 80 to 90 per cent of Haitian schools are private, the foundation first focused on school fees for children; its second line of work is economic support for women.

Funds came initially from acquaintances; from 2021 it began raising money from foundations, obtaining a grant from a women's foundation and writing to others to build support gradually, and it runs a project on the GlobalGiving platform. Funders require a report on what was done, how the money was spent and what resulted; what interests them is impact. The foundation files Form 990-N, which the president described as a very simple document — just the address and the name — noting that the IRS does not go into detail with a small organization receiving little. Some grantmakers nonetheless require the full Form 990: a body from which he sought a living fund for women had done precisely that. The accounts are kept in Excel, with QuickBooks in prospect when funds allow. There is no audit, though a woman who had given several thousand dollars had asked whether the accounts were audited and he felt the need for one. During the years of dormancy the foundation continued to file Form 990-N with zero income, to stay registered and avoid the automatic revocation that follows three years of non-filing.

15. Council on Foundations (online)

11 Sep 2022 · online · Brian Kastner (Director of Engagement) · cof.org · Tomohito Nakajima

The intermediary whose members are the foundations that fund American nonprofit organizations. Founded in Chicago in 1949, incorporated in New York in 1957 and renamed in 1964. Membership comprises community foundations, private and corporate grantmakers, grantmaking public charities, non-US and tribal grantmakers and non-grantmaking supporting members: 804 in 2021, 135 more than the year before. Revenue in 2020 was $12,198,284, of which dues at $6,082,879 were nearly half.

Asked about the position that Form 990-N filers need file no Schedule A and need not meet the public support test while receiving the same tax benefits, Mr Kastner confirmed the reading, adding that the purpose of the graduated forms is to make the regime workable for the largest possible number of organizations. On start-up support he described fiscal sponsorship, by which an organization holding tax-exempt status treats another group's activity as part of its own and passes on funds raised — in effect a nonprofit start-up model, which he understood to be distinctively American and to give community foundations a role in nurturing the organizations their communities need.

16. Outdoor Alliance

9 Sep 2022 · Washington, D.C. · Adam Cramer (CEO), Logan Knowles (Development and Operations Manager) · outdooralliance.org · Yuko Uehara

Founded in 2014, a coalition of ten national organizations including American Whitewater and the International Mountain Bicycling Association, and the only body in the country aggregating the voices of outdoor recreationists to protect public lands. Revenue in 2020 was $1,269,294, mainly foundation grants, with corporations about 30 per cent and individual giving about 10 per cent from some 3,000 donors; it receives no government money and has seven staff. Its annual report records 46,661 advocacy messages to legislators and sixty-one meetings with legislators in a year.

The founder is himself a kayaker and mountain biker and the operations manager a former kayak instructor: they work in the field of their own enthusiasm. They were noticeably respectful of both the policy support the United States gives nonprofit organizations and the obligations it imposes — on the disclosure of salaries they regarded it as a plain responsibility and indeed as fair. The reserve policy took considerable time and had recently been completed, setting aside resources against risk so that unexpected costs can be met flexibly. Form 1023 was prepared by a lawyer at formation and the annual statements by an accountant, and the organization is audited; using professionals also makes Form 990 efficient to produce. Staff meetings are almost entirely online, so work can be done from anywhere.

17. Westminster Neighborhood Association

9 Sep 2022 · Washington, D.C. · Lynn Johnson · wnadc.org · Ryota Kaneko

A community organization of 165 households, running events, organising projects and working to improve local life — something like an incorporated neighbourhood association in Japanese terms. It has no office; the interview took place at the president's home.

The account of its founding was a lesson in recent American history. The president, a white man from North Dakota who drove a taxi in Washington to save for law school and became a lawyer, bought a cheap house in the 1980s in what was then an almost entirely Black neighbourhood with very poor public safety. Drugs were widespread, people were leaving, empty houses stood everywhere, drug users occupied them and fires started by open flame were frequent while the fire service was of little help. Out of the work of putting out fires and clearing empty houses, he and an accountant living in the same community founded the organization. Incorporation was possible only because he was a lawyer and his friend an accountant; such organizations are said to be unusual even within the District.

The effort succeeded: property prices rose in the 2000s, affluent young white residents moved in and public safety improved greatly, though the president spoke with real regret of the destruction of the traditional Black community that accompanied it. Improved safety has had a paradoxical effect: residents are less interested, turnover is high, and finding a successor is difficult. Members pay $15 a year, so income is very limited and the annual Form 990 is extremely simple. Asked how the mission had found the organization, the president was astonished to learn that it had been located through Form 990. The mission joined, at $15 a head.

18. Friends of Georgetown Waterfront Park

9 Sep 2022 · Washington, D.C. · Meg Hardon (President) · georgetownwaterfrontpark.org · Ryota Kaneko

Formed to raise awareness of Georgetown Waterfront Park, a national park on the bank of the Potomac, and to support its planting, its fountain and the maintenance of its natural environment. The park belongs to the federal government, but public funds are limited, so private gifts pay for the improvements.

The organization has no office of its own. Most gifts come from Georgetown residents and small businesses; very large and corporate gifts are limited. Where many organizations pay professional fundraisers, this one works essentially on a voluntary basis and employs none; directors are unpaid, many serving for long periods, there are no paid staff, and beyond park improvement the only expense is the fee to the accountant who prepares Form 990. That almost no cost is incurred and that the directors are unpaid contribute to the confidence donors place in the organization, and that record of private fundraising has in turn helped it obtain federal grants through matching programmes. Incorporated in the 1990s, it found formation not especially difficult, and everyone present emphasised that annual compliance takes little effort. The early years brought disagreements, budget overruns and delays, but the liveliness of the park now persuades them they were right; during the pandemic it served as a place of rest where distancing was possible. The chief difficulty is that public interest fades once the work is complete. Offered a cash donation, the organization explained that it does not accept cash and directed the mission to its online giving page.

19. Garfield Terrace Senior Citizens Resident Council

9 Sep 2022 · Washington, D.C. · Connell Wise · Yuko Uehara

Recognised by the IRS in 2019 and filing Form 990-N, a small organization whose mission is to provide secure housing for the most vulnerable — people with disabilities, veterans and older people. It grew out of something resembling a residents' council concerned with the maintenance of a housing development, and works to make that community function well. Despite its size the team spans generations and includes engineers, artists, gardeners and carpenters. It was renamed My Seniors Keeper Foundation in 2022.

Mr Wise is also founder and managing principal of a for-profit firm offering business technology support, entrepreneurship training, policy research and international trade services, with offices in Florida, Hong Kong and Mauritius. He holds doctorates in theology and church administration and in business administration and a master's in industrial and organizational psychology, describes himself as a business psychologist, and supports people with disabilities, people on low incomes and veterans in starting businesses; the Council is both his client and a beneficiary of that support. Its work is funded mainly by government money and corporate grants, and gives residents opportunities to meet and to build skills for employment, with particular emphasis on work older people can continue to do — agriculture, carried on with partner organizations, among them. The board has six members and most of the work is done by volunteers. The organization currently files Form 990-N and expects to move to Form 990-EZ as revenue grows; Mr Wise, familiar with accounting, intends to prepare the returns himself.

20. Old Town Alexandria (site visit)

10 Sep 2022 · City of Alexandria, Virginia · the whole mission

American weekends bring charity events, and Alexandria, about ten kilometres south of central Washington, is well known for them; events run along the main street connecting Market Square — one of the oldest markets in the country, dating from 1753 — with the waterfront.

At the farmers' market a Boy Scouts troop was selling popcorn: of a $20 purchase, $13 goes to the troop, and the proportion is stated for each item. Along the streets, paper tags reading "Thank you for your support" hung on front doors, left by door-to-door canvassers for the Alexandria City High School band; the fundraiser is run by Band Boosters, a 501(c)(3) organization formed by parents, which files Form 990-EZ with income of $82,682, of which $74,488 is contributions. There is something heartening in the sight of parents and students raising money for a school band, and something reassuring in the fact that a 501(c)(3) organization is used for it and that it files and discloses properly. Throughout the old town, plaques mark buildings certified as historic by the Historic Alexandria Foundation — a programme begun in the 1960s when federal urban renewal threatened downtown Alexandria, which marked buildings at risk of demolition and helped raise public awareness of those that survived.

New York

21. Cooper Hewitt, Smithsonian Design Museum (site visit)

11 Sep 2022 · New York · Nykia Omphroy · cooperhewitt.org · Yoshiharu Shiraishi

The only museum in the United States devoted to historic and contemporary design, with a permanent collection of more than 210,000 objects spanning thirty centuries. The building is the mansion Andrew Carnegie built in 1899 to raise his daughter Margaret, with sixty-four rooms — the first steel-framed house in the United States, the first in New York with an Otis passenger lift, and an early adopter of central heating. After his retirement in 1901 Carnegie gave some $350 million to education, cultural institutions and the cause of world peace, and built a network of more than 1,500 free public libraries across the country.

22. New York Mycological Society, Inc. (online)

12 Sep 2022 · online · Sigrid Jakob (President) · newyorkmyc.org · Yuko Uehara

A 501(c)(3) organization founded in 1962 to promote knowledge, appreciation and conservation of fungi, on the view that more knowledgeable people mean better science and better conservation. Anyone interested may take part without prior knowledge; activities are mushroom walks almost every weekend whatever the weather, a Zoom identification session every Monday evening, lectures by specialists from February to June, and workshops on skills from identification to DNA barcoding.

The society has legal personality, which many comparable mycological groups do not, and files Form 990-N. It has about 1,300 members and annual income of around $30,000, mainly from the $20 subscription; membership roughly doubled from about 700 during the pandemic as events moved smoothly to Zoom. Asked what problems it faced in law, taxation and accounting, the president said there were none: the organization is run very simply and concentrates on the study of fungi. There has never been an external audit, and the accounting and annual filings are prepared without charge by members who are accountants.

23. Museum of Modern Art

12 Sep 2022 · New York · Jay Levenson (Director of the International Program) · moma.org · Masayuki Tamaruya

Founded in 1929 by three women, one of them the wife of John D. Rockefeller Jr. Historically close to the Rockefeller family, it is privately funded and takes no government money at present, though its branch MoMA PS1 in Queens receives support from the City of New York. Contemporary art invites controversy: private money is easier to raise, and political interference is to be avoided. Of a $175 million budget, roughly a third comes from admissions and the shop, a third from gifts and a third from the endowment — possible in a city with New York's concentration of wealth. Attendance is normally about three million a year, half foreign visitors; the pandemic reduced it to two million.

The museum is governed by a self-perpetuating board. Many trustees are wealthy collectors expected to contribute substantially. Curatorial departments are organised by medium, each with an acquisitions committee of trustees and other collectors whose dues and gifts fund acquisitions; curators propose acquisitions at two meetings a year and obtain the committee's approval, briefing members in advance so that proposals almost always carry, though a strongly avant-garde proposal may require persuasion. On diversity, the recent effort has been to bring onto boards women, minorities and others previously unrepresented, and the same applies to curators, which has in turn made it easier to collect a wider range of work.

24. Friends of the Children NY

12 Sep 2022 · New York · Gary Clemons (Executive Director), Wendy James · friendsnewyork.org · Masayuki Tamaruya

The New York chapter of Friends of the Children, begun in Portland, Oregon in 1993 to break the intergenerational cycle of poverty through mentoring by paid professionals — not volunteers — supporting children facing socio-economic obstacles from kindergarten to the age of twelve. The model has spread to fifteen locations and was brought to New York in 2001.

When Mr Clemons became executive director the budget was about $1.6 million; four years later it was about $4.4 million. The board he inherited was one whose members took part in running the organization, so expertise did not develop and performance did not improve. Programme delivery was handed to full-time staff, finance to the national organization and human resources outsourced, while directors concentrated on fundraising; both the work and the organization then grew.

Income is deliberately diversified: state grants, foundation grants and individual gifts, with the national organization pursuing federal funds and chapters pursuing local sources. For the largest individual gifts the organization uses trustees' networks: each of the twenty-six directors undertakes to introduce three to five donors a year and, by giving personally or introducing others, to bring in at least $10,000. City support is pursued by identifying New York's problems — mental health, violence, homelessness — and considering whether the model matches; foundations are approached the same way, from their mission statements. One gala at $10,000 a table for 500 people raised $1.3 million. Crowdfunding run by younger members raised $75,000 alongside a five-kilometre race. Rather than hiring outside fundraisers the organization employs a development director and three staff. At the same time money must reach the work: one mentor is employed for every eight children and one manager for every six mentors.

25. International Institute for Community Solutions, Inc.

12 Sep 2022 · New York · Lisette Nieves (President), Aldrin Bonilla (Vice President), Alyson Rich · fcny.org · Ryota Kaneko

An intermediary for nonprofit organizations, chiefly in New York City, providing back-office support, unemployment insurance and retirement plan support, and zero-interest, low-fee short-term lending. Comparable organizations are rare elsewhere, which says something about the size and depth of New York’s nonprofit sector, where nonprofit organizations generate $8 billion of GDP and employ 9 per cent of the workforce.

The institute sets no lower limit on the size of organizations it supports. Small and medium-sized bodies cannot readily establish unemployment insurance or retirement plans of their own, and cannot easily borrow from banks. American nonprofit organizations compete for staff with businesses, and better insurance and retirement arrangements help them recruit: the service is therefore not merely a substitute for back-office work but a strengthening of organizational capacity. Small organizations also find access to government agencies difficult and grants slow to arrive, so demand for short-term working capital is high; the loss rate on lending is below 1 per cent. Asked whether it uses SROI or social impact measures in lending decisions, the institute said it does not: creditworthiness is judged through long relationships and dialogue with directors. Asked whether its lending crowds out commercial banks, it answered that its loans are short-term, low-interest and bundled with other support, and are therefore not products banks offer. Having adopted a range of IT systems before the pandemic, its own staff moved to remote working comparatively early.

26. VISIONS

13 Sep 2022 · New York · Nancy D. Miller (Executive Director and CEO), Mike Cush (Chief Program Officer) · visionsvcb.org · Yuko Uehara

Founded in 1926 by six women, a 501(c)(3) organization helping blind and visually impaired people to live independent and active lives and educating the public about their abilities and needs. In 2021 it served 7,075 people. Total revenue was about $18 million in 2020 and about $27 million in 2021, and the organization is proud that 88 per cent of funds raised go to programmes and only 12 per cent to administration and support.

It works only in New York City and its suburbs, addressing the problem that only about 40 per cent of visually impaired people seeking work obtain paid employment, and the need for independence training: only about 3 per cent of visually impaired people are connected to an organization such as VISIONS, so 97 per cent receive no such training. It employs a little over 100 staff, about sixty-eight full-time, of whom about 30 per cent are themselves blind or visually impaired, with some 500 volunteers. About half its funding is governmental, under contracts with the State and City of New York; most of the remainder is investment income from an endowment that stood at about $8 million in 1984 and is now about $100 million — a structure only a ninety-five-year-old organization could have. It files Form 990 annually and is externally audited.

The pandemic hit hard, and the organization used the Paycheck Protection Program and similar support to keep operating. Applying required staff with the financial knowledge to handle a loan application, and neighbouring organizations unable to secure such help made deep cuts or closed: all four long-established agencies in the area that had served blind people for more than fifty years closed. Taking the view that trained people are an organization’s greatest asset, VISIONS hired several of those who had been trained at those agencies and lost their positions.

27. Médecins Sans Frontières – USA

13 Sep 2022 · New York · Cameron Wrigley (Director of Finance), Claire Bruten-Paul (Deputy Director of Finance) · doctorswithoutborders.org · Seiya Wakisaka

Médecins Sans Frontières was founded in France in 1971 as a private, nonprofit medical and humanitarian organization delivering emergency medical assistance independently, neutrally and impartially. The national organizations are independent but cooperate; MSF-USA is the movement's largest source of funds, accounting for 30 per cent of its total income and more than twice the size of the second largest, Germany.

On donated legal services: against total revenue of $650 million, MSF-USA recognises $1.3 million of pro bono legal advice, on the basis of formal letters from the firms stating hours worked at their own rates, which the organization retains. On examination by the authorities: unlike Japan, where an agency checks the equivalent filings every few years as a matter of course, there is no periodic examination in the United States. An examination happens only if the authorities want one and may happen at any time, so records must be kept for a long period; so far as those interviewed knew, MSF-USA has never been examined. On gifts in kind: the balance sheet carries substantial securities, many of them donated, which the organization converts in accordance with its investment policy. There is no in-house investment team; management is outsourced. The policy is conservative, and because reputation must be protected the organization specifies what it does not wish to be invested in — alcohol, coal, air pollutants and anything connected with weapons.

28. American Geographical Society of New York

13 Sep 2022 · New York · John Konarski (CEO), James Mallinson (Manager, Operations and Events) · americangeo.org · Masayuki Tamaruya

A learned society founded in 1851, the first professional body of geographers in the United States. After the First World War it was much larger, drawing the maps for the delimitation of European borders in place of the federal government; when map-making for government moved in-house after the war, the society contracted.

By the 2000s the cost of running an organization — accounting, human resources, pensions, tax filings — made it preferable to use the Fund for the City of New York, and the society began outsourcing to FCNY in 2014. It pays 9 per cent of income, $50,000 to $55,000, where employing someone able to do the work would cost $120,000 to $130,000. The endowment cannot lawfully be transferred, so it is managed outside FCNY and the society continues to exist as a 501(c)(3) organization filing CHAR500 in New York and Form 990 federally. When the pandemic showed that months of remote working posed no problem, it gave up its office; its symposium moved online, which proved laborious and harder to attract sponsorship for.

29. Japanese Medical Support Network-USA

13 Sep 2022 · New York · Yoshio Kano (Director, Accounting) · jamsnet.org · Seiya Wakisaka

JAMSNET was founded in January 2006, with the cooperation of the Consulate-General of Japan in New York and the support of Japanese companies, as a network for the exchange of information among medical, welfare, educational and psychological support groups for Japanese nationals in the New York area; it was recognised as a 501(c)(3) organization in 2011. Mr Kano, posted to New York in 1973 and later a consultant, has prepared all its filings to the IRS and the state.

What was most emphasised is that the IRS is exceptionally sensitive to the possibility that nonprofit funds are used for money laundering. Having been badly burned in the past when funds reached criminal and terrorist organizations, it now restricts grant recipients in principle to 501(c)(3) organizations. When large sums were sent to Japanese NPOs after the Great East Japan Earthquake, the procedure was exacting: a proposal stating the intended use; a signed agreement undertaking that the money would be used for no other purpose; only then permission to remit; and thereafter, until the money was exhausted, an activity report and an account every six months, copies of which must be kept securely against IRS examination. Vague payments described as honoraria, and the handing of cash to individuals, are not accepted; only fees for professional services are recognised, and event accounts must record the time, the place, the person and the activity.

30. Okinawa Institute of Science and Technology Foundation, Inc.

13 Sep 2022 · Irvington, New York · David Janes (President and CEO) · oistfoundation.org · Ryota Kaneko

A foundation established in New York in 2019 in support of the Okinawa Institute of Science and Technology Graduate University, an interdisciplinary graduate university created at the initiative of the Japanese government to gather outstanding researchers, build a world-class research base and contribute to global science. The university seeks to expand further, but government support has limits, and the foundation exists to strengthen it in people and in funds. Mr Janes, who once studied in Japan and worked for many years at the US-Japan Foundation, is its only full-time employee in the United States.

Japanese universities often maintain American branches, but few are 501(c)(3) organizations; several, International Christian University among them, raise funds through such a foundation, though only a handful with high name recognition and many alumni raise substantial sums. OIST has few graduates and little recognition, so fundraising was expected to be difficult; nonetheless, with support from the Okinawan diaspora community and from the United States government, income reached $436,000 last year. Mr Janes travels to Washington and to Hawaii to build recognition and networks; much of that opportunity was lost to the pandemic, and network-building continued online, though ready access to New York, Washington, San Francisco and Seattle remains essential — a headquarters in a small Midwestern town would not be realistic.

Online Interviews after the Mission’s Return

31. NY de Volunteer (online)

29 Sep 2022 · online · Shizuko Kitagawa (President) · nydv.org · Seiya Wakisaka

An organization promoting Japan-United States cultural exchange through volunteer and social contribution programmes, with the object of developing people with the global outlook to understand one another’s diversity. It connects Japanese students with students at New York universities, runs global study tours, operates a language exchange programme and introduces Japanese culture to children and students in New York.

The organization filed Form 990-EZ for 2019 and has since moved to the full Form 990. The full form requires considerably more detail, but neither IRS nor state regulation causes stress and the financial reporting is straightforward. No other financial report is required, so no FASB-based statements are prepared, no funder has required a special format, and there is no audit. Obtaining 501(c)(3) status brings not only tax relief but the ability to apply for grants at all. There is no regulation of retained funds; revenue from the global study tours is the main source of income, and although the tours could not run for two years, the accumulated reserve allowed the organization to continue. Form 990 requires the three-way functional split of expenses. Allocating expense to programmes matters whether or not the IRS requires it, because it matters for grant applications, and staff report which programme their spending served; costs common to programmes, formerly treated as management cost, are now allocated to programmes, while fundraising expense scarcely arises and is not at present separated. The organization uses QuickBooks Online — commercial software, but American nonprofit accounting differs so little from business accounting that no inconvenience arises. It does not classify by donor restriction, and not every American organization does.

32. Friends of Mitchell Park, Inc. (online)

6 Oct 2022 · online · Robert Nevitt (President) · mitchellparkdc.org · Tomohito Nakajima

A nonprofit maintaining Mitchell Park, a park owned by the District of Columbia in a residential neighbourhood, and running activities for local residents. It is a 501(c)(3) organization and a nonprofit corporation under District law. Its Form 990-EZ for 2020 records income of $40,602 and expenditure of $67,960, the income almost entirely donations.

The work began with two mothers living nearby who saw the park deteriorating. In 1998 they gathered neighbours who cared about it and proposed to the authorities how it might be used; the District refurbished the park and reopened it in 2004. Since then the organization has worked with the DC Department of Parks and Recreation to maintain the planting and to run community-building events. It has eleven directors, all unpaid.

33. Environmental Protection Network (online)

11 Oct 2022 · online · Michelle Roos (Executive Director) · environmentalprotectionnetwork.org · Yoshiharu Shiraishi

A small organization with five staff and 2020 revenue of $652,849. Having launched a project in 2022 and recruited four more people, it now operates with nine and expects a budget above $1 million in 2023. Ninety-nine per cent of income is gifts, including membership dues, and grants. The staff are scientists and lawyers who served in the federal government, and its roughly 550 volunteers are former officials of the Environmental Protection Agency who carry out its environmental analysis. Half its work concerns national regulation and half supporting communities with local problems, and cooperation with the many environmental organizations of differing specialisms is essential.

She prepares and files Form 990 herself each year, which is a source of stress for someone trained in environmental science, and has an accountant check the return before filing. Audit fees she considers high, and no funder has ever required an audit; the organization was audited once, in 2018, at a cost of $18,000. Compensation above $100,000 must be disclosed, and she is content with her own as published: the purpose is to let donors confirm that their money goes to the work they wished to support. All its funding comes from grantmaking bodies, most of it as unrestricted general support grants, and most funders prefer not to tie organizations down with administrative burden.

Part 3: Conclusions

Findings and Implications for the Japanese System

The mission set out to learn how the American system of nonprofit law, taxation and accounting affects small and medium-sized organizations, and how it has allowed the sector to expand while Japan's has stood still. Five findings emerge, and each carries a question for Japanese policy.

1. Proportionality is applied consistently, not selectively

The most conspicuous feature of the American arrangement is that the burden imposed on an organization scales with its size, and does so at every stage. At formation, an organization expecting gross receipts of $50,000 or less files a three-page Form 1023-EZ for $265 rather than a forty-page Form 1023 for $600. Annually, it files a Form 990-N asking eight questions, at an estimated cost of $20 and five hours, rather than a Form 990 costing an estimated $2,600 and 107 hours. On assurance, it falls below every federal and state threshold and need obtain none. Under state corporate law it may operate with three directors, three officers and no membership structure.

What is decisive is that the graduation applies to the burden and not to the benefit. A Form 990-N filer receives exactly the same tax treatment as a Form 990 filer, and its donors receive exactly the same deduction. It does not file Schedule A and is not required to satisfy the public support test. The system does not ask a small organization to prove that it deserves to be treated like a large one; it assumes that it does, and reserves detailed scrutiny for the organizations where the consequences of misuse would be greatest.

Japan applies the same criteria and demands the same documents whatever the size of the organization, on the reasoning that the tax benefit is the same. The American answer is that a benefit granted equally does not require a burden imposed equally, because the risk is not equal. Introducing genuine graduation into the Japanese authorisation procedure, the periodic filings and the accounting standard — not as a transitional concession but as a permanent feature — is the single change most likely to increase the number of Japanese public interest corporations.

2. Disclosure does the work that supervision does in Japan

Form 990 is filed with a tax authority that does not supervise nonprofit organizations, has no officer assigned to each corporation and conducts no on-site inspection. Yet it does far more governance work than the Japanese periodic filings, for one reason: it is published. Because it is published, GuideStar and Candid aggregate it, Charity Navigator and the Wise Giving Alliance rate on it, journalists investigate with it, foundations screen applicants by it, and nonprofits check prospective partners against it. The 2007 amendment that added governance disclosure worked not by compelling any practice but by making the absence of a practice visible to everyone who matters to the organization.

Japanese public interest corporations file documents of comparable labour that go to the supervising agency and no further. They contain nothing designed to improve the corporation's public standing, because nobody outside the agency reads them, and their content is directed to confirming compliance with the authorisation criteria. Redesigning those filings so that they are useful simultaneously to the regulator, to the citizen and to the corporation's own governance — and publishing them as far as possible — would convert a compliance cost into an asset.

3. Financial judgement is left with the board

American public charities are subject to no requirement that revenue and expenditure balance and no restriction on idle assets. Whether to spend on charitable work or to accumulate and strengthen the financial base is a matter for the fiduciaries, governed by the duties of loyalty and care and by the prudent investor rule. Private foundations alone must distribute 5 per cent of investment assets annually. Asked directly whether a rule resembling the Japanese revenue-expenditure requirement existed, the response at ISTR was that regulating nonprofit spending would be an intrusion into autonomous management, would meet strong resistance, and would in any case be unwise as policy, because pressing organizations to spend leads them to consume resources without adequately considering the need.

The Japanese requirements had a visible cost during the pandemic. By narrowing the scope for accumulating capital over the medium term they weakened corporations' financial resilience and removed the margin needed to absorb a shock. That an unrestricted gift is caught by the revenue-expenditure requirement while a designated gift is not runs directly counter to the American movement — accelerated by the pandemic and formalised in the Council on Foundations' Call to Action — to expand unrestricted giving precisely because it is what allows a grantee to survive a crisis. If that treatment is discouraging flexible giving in Japan, it should be reconsidered.

4. Governance is regulated by disclosure and private codes rather than by formal rules

Neither the Internal Revenue Code nor most state nonprofit statutes regulate the independence of directors. What regulates it is Independent Sector's Principles for Good Governance and Ethical Practice, whose Principle 12 provides that two thirds of the board should be independent and defines what destroys independence — and whose commentary cross-refers to the disclosure of independent directors required by Form 990. The private code supplies the standard; the federal return supplies the visibility; and the code acknowledges that some organizations may have good reason not to meet it.

The American arrangement has costs. Enforcement is uneven; state agencies and the IRS are chronically under-funded; Form 1023-EZ has been abused by organizations adopting names resembling those of well-known charities, to the point that Congress has been asked to withdraw it. A system that keeps entry easy will admit some organizations that should not be admitted. The American answer is that this cost is worth paying for the number of organizations the openness produces, and that the remedy lies in disclosure and in the ecosystem that uses it rather than in raising the barrier at the door.

5. The ecosystem does what no single agency could

The mission could not interview the IRS; outreach to the agency proved extremely difficult, and no organization it met maintained a relationship with the IRS or a state regulator beyond filing. That absence is itself the finding. The functions a Japanese supervising agency performs are distributed in the United States among many hands: intermediary bodies such as Independent Sector, the National Council of Nonprofits and the Council on Foundations, which aggregate the sector's voice and are treated by government as opinion partners; information providers such as Candid, which make the filings usable; rating agencies such as Charity Navigator, which assess organizations on impact and leadership as well as finance and so partially substitute for assurance where assurance is impractical; grantmaking foundations, whose due diligence is often the most exacting governance discipline an organization faces; back-office intermediaries such as the Fund for the City of New York; and fiscal sponsorship, which lets a new initiative operate under an existing organization's exemption while it establishes itself.

None of this was designed as a system, and several parts of it exist because the regulator could not or would not act. But the effect is that a small American organization has somewhere to turn for every function it cannot perform itself. Japan has intermediary bodies and is beginning to develop evaluation and back-office services; the American experience suggests that their growth matters as much to the health of the sector as the reform of the authorisation regime itself.

A closing observation

What the mission encountered most consistently was not a rule but an attitude. Asked whether they objected to the publication of their own compensation, everyone treated it as a matter of course; several described transparency as both a responsibility and a benefit, and expressed pride in a system that requires it. The president of a wildlife rescue organization with a budget of $580,000 volunteered that the paperwork is laborious but indispensable to trust. The president of a mycological society filing Form 990-N returned repeatedly to the importance of being free to concentrate on the mission. The president of a neighbourhood association funded by $15 subscriptions was astonished, and pleased, to learn that a Japanese research mission had found the organization through its Form 990.

These are not the responses of people managed by a regulator. They are the responses of people who understand what the system asks of them, believe the demand to be reasonable, and can see what they receive in return. That is the condition Japanese reform should aim at. The mature culture of giving for which the United States is known rests on institutional foundations deliberately laid — the Tax Reform Act of 1969, the graduated returns, the 2008 governance disclosures — and Japan is free to lay its own. Where the American system keeps the barrier to entry low and raises accountability as an organization grows, Japan sets the barrier high and, having admitted an organization, continues to treat it as an object of supervision. Reversing that order would do more for the increase of public benefit by private hands, which article 1 of the Public Interest Corporation Authorisation Act sets as its purpose, than any further refinement of the criteria.

The Research Mission to the United States

Secretariat, The Japan Association of Charitable Organizations