Some nonprofits are juicy targets for unscrupulous advisers

by Lynn O'Shaughnessy

Just about every time I visit the grocery store, I am reminded this is the season of giving. Standing next to a big red kettle swinging from an old chain, a bell ringer from the Salvation Army wishes everyone a merry Christmas, even those who ignore his ringing entreaties to help.

Charities excel in cajoling us into reaching into our wallets to help the less fortunate, whether it's families trapped in the Darfur chaos or a brave child fighting a terminal diagnosis in an oncology ward. But charities also have an obligation to invest their hard-earned donations wisely. And I've seen no evidence that many nonprofits know how to invest even as well as my 14-year-old son.

As an occasional contributor to the Chronicle of Philanthropy, I've run across stunning examples of investment mismanagement. One board, for instance, directed $500,000 into a noninterest-bearing account because they thought a charity's money couldn't generate interest.

An outside expert from BoardSource, which is devoted to helping nonprofits function better, convinced the board that generating a profit from their donations was not only legal, but an excellent goal.

When she paid a visit a few months later, however, the board had executed a hazardous U-turn and was talking about throwing a lot of cash at small speculative stocks.

Meanwhile, a well-known charity in San Diego, which once had $150 million in assets, stupidly gambled it all on tech stocks and lost big-time. I'm sure its benefactors would have been livid if they knew how quickly their donations had shrunk to roughly $50 million.

It's not hard to appreciate why so many charities fail to invest wisely. Often, nonprofits are created by passionate people who want to rescue rain forests, fight illiteracy or save blighted neighborhoods, but they've never even heard of modern portfolio theory. Many charitable boards wouldn't know where to begin to fashion investment portfolios that appropriately balance the financial risks they are willing to assume with the financial rewards they hope to gain.

For many board members, a charity's biggest risk is failing to raise enough money to meet their fundraising goals. Potentially losing this cash through boneheaded financial moves isn't something they dwell upon.

Seeking outside help may seem like the obvious answer for charities, but there are hidden hazards in following that course. Sandra Champion, who is principal of Champion Partners, a consulting firm in Savannah, Ga., that advises nonprofits on financial practices, says cultures clash when charitable-minded people meet in a conference room with financial experts.

Board members may be unwilling to admit they don't understand financial jargon, and experts may be unable to parse the concepts into understandable language. Champion once watched a board member lose it because he was so frustrated by the stilted language that the adviser embraced.

"A board member," she recalls, "got so angry that he turned red in the face and stood up and pounded the table at the jargon the adviser was using."

But if deciphering opaque terms was the extent of the problem, charities would be in far better financial shape. One of the biggest perils they face, however, is trusting people they shouldn't.

Many so-called financial experts, who want to sell investment products, see charities as irresistible suckers. Charities have cash and don't possess investment moxie, so it's easy to push ridiculous investments on them that would trigger peals of laughter from sophisticated institutional investors.

In one case shared by Scott Simon, an investment adviser at Prudent Investor Advisors in Camarillo, a stockbroker from a well-known brokerage firm portrayed himself as an institutional adviser and persuaded a charity with more than $50 million to buy a complicated investment that was expensive and hard to ditch.

The board members were apparently impressed that the guy worked with institutional clients, but the broker never would have tried to pull this nonsense on knowledgeable investors.

Simon, who is one of the true good guys in the investment world, is currently working with a couple of nonprofit trustees who are disgusted by their board's willingness to be hornswoggled by a fast-talking broker. Like so many board members around the country, Simon says, "These folks have no idea what questions to ask."

Unfortunately, plenty of affable stockbrokers, insurance agents, bankers and others - who are intent on selling their wares - have focused on charities because of the low-hanging fruit. These folks get involved in charitable causes or their firms donate money just so they can ingratiate themselves with the power brokers and possibly earn spots on the boards. Once they secure their board positions, they may try to take over the investing duties while pocketing commissions.

But even when a board isn't guilty of such an appalling conflict of interest, there are plenty of other ways for it to screw up. One sin is failing to develop an investment policy statement, which is the crucial blueprint that directs how a charity's money should be prudently invested.

When the Association of Small Foundations polled its members, 48 percent of foundations didn't possess one of these statements. Board members also routinely don't realize what their responsibilities as fiduciaries are.

One way for board members to determine whether they are following the investment standards of care is to get a copy of a slim publication titled "Prudent Practices for Investment Stewards," which can be obtained through the Foundation for Fiduciary Studies in Sewickley, Pa. (www.fi360.com).

What can donors do about the lame investing practices of too many charities? Start asking questions. Those who depend upon your kindness are counting on you.