

Jason Clemens, Lawrence J. McQuillan, Ph.D., K. Lloyd Billingsley, and Adam Frey

# BURDENING



# FOUNDATIONS

Economic Costs of Assembly Bill 624



# BURDENING FOUNDATIONS

## Economic Costs of Assembly Bill 624

Jason Clemens

Lawrence J. McQuillan, Ph.D.

K. Lloyd Billingsley

Adam Frey

Burdening Foundations:  
Economic Costs of Assembly Bill 624

Jason Clemens, Lawrence J. McQuillan, Ph.D, K. Lloyd Billingsley, and Adam Frey

June 2008

Pacific Research Institute  
755 Sansome Street, Suite 450  
San Francisco, CA 94111  
Tel: 415-989-0833/ 800-276-7600  
Fax: 415-989-2411  
Email: [info@pacificresearch.org](mailto:info@pacificresearch.org)  
[www.pacificresearch.org](http://www.pacificresearch.org)

Additional print copies of this study may be purchased by contacting us at the address above, or download the PDF version at [www.pacificresearch.org](http://www.pacificresearch.org).

Nothing contained in this report is to be construed as necessarily reflecting the views of the Pacific Research Institute or as an attempt to thwart or aid the passage of any legislation.

©2008 Pacific Research Institute. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopy, recording, or otherwise, without prior written consent of the publisher.

# Contents

Executive Summary .....	2	<i>Are Foundations “Subsidized Industries”?</i> .....	19
Introduction.....	5	<i>Diverting Attention from Quality</i> .....	20
I. Overview of AB 624: Imposing New Reporting Requirements on Foundations .....	6	<i>Reducing the Importance of Mission</i> .....	20
II. Economic Costs of AB 624 .....	7	<i>Dubious Diversity Goal</i> .....	20
<i>Compliance Costs</i> .....	7	IV. Conclusion: The Consequences of AB 624 .....	21
<i>Primary Diversity Report</i> .....	8	V. References .....	22
<i>Foundations</i> .....	8	About the Authors .....	24
<i>Charities</i> .....	10	Acknowledgements .....	26
<i>Business Contracts</i> .....	11	About the Pacific Research Institute .....	27
<i>Secondary Foundation Diversity Reports</i> .....	12	Endnotes.....	28
<i>Total Compliance Costs of AB 624</i> .....	13	Tables	
<i>Administrative Costs</i> .....	14	Table 1: Compliance Costs for Primary Diversity Reports Associated with AB 624 .....	9
<i>Total Compliance and Administrative Costs of AB 624</i> .....	14	Table 2: Compliance Costs for Foundation Diversity Reports .....	13
<i>Impact on Costs of Reducing the \$250 Million Threshold</i> .....	16	Table 3: Total Compliance Costs of AB 624.....	13
III. Non-Economic Issues of AB 624 .....	18	Table 4: Total Compliance and Administrative Costs of AB 624.....	15
<i>Questionable Constitutionality</i> .....	18	Table 5: California Foundations by Asset Size .....	16
<i>Violating the Spirit of Proposition 209</i> .....	18		

# Executive Summary

California legislators are considering imposing new racial and gender reporting requirements on foundations as well as the charities that receive grants from them and the businesses that work with them. This study focuses on the economic costs anticipated as a result of Assembly Bill 624.

## I. Economic Costs of Assembly Bill 624

### *Compliance Costs of AB 624*

Compliance costs are the expenses incurred by individuals and organizations to comply with government regulation. Complying with AB 624 requires a two-stage process. First, foundations, charities (grant recipients), and businesses (which contract with foundations) would have to collect and report racial and gender information on their organizations. Foundations would also have to accumulate the information received from charities and businesses and report it.

### *Foundations*

The estimated average time for foundations to gather the required information is 39.5 hours, which includes developing an employee questionnaire, distributing it, having board member and staff complete it, follow-up, entering the results into a database, and analyzing the data. The total time costs required to complete the primary report is estimated at \$54,879 for the 57 California foundations with assets of more than \$250 million. In addition to time costs, a portion of overhead expenses must be included in a complete compliance cost estimate. The total compliance costs for the 57 foundations in California with assets greater than \$250 million including overhead is estimated at \$74,636.

### *Charities*

AB 624 is aimed at foundations, but interestingly, the bulk of the compliance burden falls on the recipient charities. Like foundations, charities would be required to survey staff and board members to obtain the necessary diversity data. The estimated average time burden for charities to gather the required internal diversity information is 31.3 hours. The time estimate is calculated based on the average number of staff and board members of grant receiving charities.

In addition, charities would need to collect and report diversity information of its clientele (individual and families served) to determine the number and percent that belong to specific "under-represented" communities. Written questionnaires and/or observational identification (visual surveys) would be required to collect the necessary information. The estimated average time burden for charities to gather the required external diversity information is 88.5 hours.

The total time costs of collecting and reporting the required data (internal and external) is estimated at \$40.2 million (including overhead) for the 10,141 charities that received grants from one or more of the 57 California foundations covered by AB 624.

#### *Business Contracts*

AB 624 would also require foundations to disclose information on the number and percentage of contracts awarded to businesses owned by African Americans, Asian Americans, Pacific Islanders, Caucasians, Latinos, Native Americans, and Alaskan Natives. To obtain this information, foundations would require business owners to disclose their ethnicity. The estimated average time burden for business owners to disclose their ethnicity is 0.5 hours. An estimated 4,009 vendors received one or more contracts from California foundations with assets greater than \$250 million. The estimated total time cost borne by businesses is \$60,269 (including overhead).

These estimates are extremely conservative and in many cases purposefully excluded information that would have increased the estimate of the compliance costs.

#### *Additional Report*

Foundations would also be required to accumulate and consolidate the information received from charities and businesses and the foundation's own primary data. The estimated average time burden for foundations to gather and report this information is 77.8 hours. This results in a compliance cost of \$146,824 including overhead.

### *Total Compliance Costs of AB 624*

The total cost to foundations, grant recipients, and business of complying with AB 624 is estimated at \$40.5 million.

### *Administrative Costs*

Administrative costs are incurred by governments to enforce regulation. Although AB 624 excludes mention of oversight or monitoring, however future amendments could bring about such activity. Administrative costs emanating from AB 624, though not required by the bill in its current form, are estimated at \$6.9 million.

The total costs of complying with and administrating AB 624 amounts to \$47.4 million.

### *Moving Beyond 0.6 percent?*

A legitimate concern for foundations with assets less than \$250 million is the possibility that the state would reduce the threshold over time. As currently written, AB 624 applies to only 0.6 percent of California foundations. To capture approximately 50 percent of foundations, the asset threshold would need to be \$500,000. A rough estimate of the compliance and administrative costs of AB 624 amended to require adherence by all foundations with assets greater than \$500,000 would be \$89.0 million.

## II. Non-Economic Issues of AB 624

In addition to the economic costs, there are a number of non-economic issues or problems with AB 624. Concerns range from legal issues, such as the constitutionality of the bill, to the incongruity between the measure and Proposition 209, to the underlying premise that foundations are “public” entities, to potential reductions in the focus on an organization’s mission. All have been raised as legitimate points of concern.

## Conclusion

AB 624 will impose serious compliance costs on foundations, charities, and the businesses they work with. These are resources that could have been used to support the many good works undertaken and completed by charities across California – from providing shelter to the homeless, to food for the hungry, to education for the poor, to assistance for those in difficult circumstances, to support for the elderly. The benefits of the bill in no way come close to offsetting these serious and disconcerting costs.

# Introduction

As California goes, so goes the nation. California is now leading the movement to impose new reporting requirements on foundations as well as the charities that receive grants from them and the businesses that work with them. The implementation of AB 624 could have national consequences as its framework is already being discussed in Washington, D.C. It is therefore critical that the costs associated with the proposed reporting requirements be understood in advance. This study begins with a brief overview of the bill. It then provides an estimate of the main economic costs associated with AB 624. Section three of this study discusses some of the many non-economic problems with the bill. The study ends with a brief conclusion.

# I. Overview of AB 624: Imposing New Reporting Requirements on Foundations

Assembly Bill 624<sup>1</sup> would require foundations (including private, corporate, and public operating foundations) located in California with assets of more than \$250 million to collect and make available race and gender information on their board of directors and staff.<sup>2</sup> Specifically, the bill would require foundations to report the number and percentage of board members and staff that are African American, Asian American, Pacific Islander, Caucasian, Latino, Native American and Alaskan Native as well as the numerical and percentage breakdown of men and women.<sup>3</sup>

The bill would also require covered foundations to report similar information for the recipients of grants (charities) as well as business contracts. For example, foundations would have to provide information on the race and gender composition of the communities served by their grants as well as the income profiles for the communities in which grants were issued. AB 624 would require information on both the number of grants and the dollar value of grants for all recipient charities. In addition, foundations would have to provide information on the number and value of grants awarded to charities by the race and gender composition of their board of directors and staff. In other words, any charities that receive grants from covered foundations would have to collect, organize, and disseminate the same information as the foundation for their board and staff.

The information mandated in AB 624 would have to be posted on the foundation's website and included in a "Diversity" section in their annual report.

It is important to note, however, that the bill does not impose any specific requirements for board composition by either race or gender. Indeed, Assemblyman Joe Coto (D-San Jose), primary sponsor, describes the measure as a simple attempt to get foundations to disclose key data related to diversity on a regular basis. In addition, the bill seems to lack any penalty or oversight/auditing mechanisms.

## II. Economic Costs of AB 624

There are a number of direct and indirect costs emanating from the regulations associated with AB 624. This section estimates compliance and administrative costs that would be incurred by foundations, charities, businesses, and government should Assembly Bill 624 become law.<sup>4</sup>

### Compliance Costs

Compliance costs are the expenses incurred by individuals and organizations to comply with government regulation. With respect to AB 624, these include the time and expenses incurred to collect, maintain, and report data required by the bill.

As discussed in the overview section, if AB 624 becomes law, foundations with assets greater than \$250 million would be required to collect and report racial and gender information from its staff and board of directors; from charities to which it awards grants; and from businesses with which it contracts.<sup>5</sup>

Complying with AB 624 would result in a two-stage process. First, foundations, charities (grant recipients), and businesses (which contract with foundations) would need to collect and report racial and gender information on their organizations. Charities and businesses would complete and submit their reports to the respective foundations. We have referred to this document as the *Primary Diversity Report* throughout the study.

In addition to the direct information mandated for foundations, they would also have to accumulate and consolidate the information received from charities and businesses. This diversity information would be compiled into a second report, which we have referred to as the *Secondary Diversity Report*. AB 624 requires consolidation of both reports into an overall Diversity Report for the foundation.

This section presents compliance cost estimates expected for foundations, charities, and businesses.

## Primary Diversity Report

### *Foundations*

As discussed in the overview, AB 624 requires foundations with assets of more than \$250 million to disclose data regarding the racial and gender composition of its staff and board of directors. Specifically, foundations would be required to report the number and percentage of board members and staff that are African American, Asian American, Pacific Islander, Caucasian, Latino, Native American, and Alaskan Native; and the number and percentage of board members and staff by gender.

To comply with AB 624, foundations would be required to collect and report employee and board member ethnicity and gender information. Specifically, foundations would be required to survey staff and board members to obtain the necessary information.<sup>6</sup> It is likely that AB 624 would require employers to allow individuals to self-identify their ethnicity. For example, all businesses (unless specifically exempt) that contract with the federal government are required to file an EEO-1 report with the U.S. Equal Employment Opportunity Commission (EEOC) to disclose the composition of the business's employees based on race or ethnicity and gender. The EEOC requires that businesses provide their employees with the opportunity to self-identify their race.

The estimated average time burden for foundations to gather the required information is 39.5 hours. This time burden applies to foundations with assets more than \$250 million and was estimated using specific data on California foundations. Specifically, the 57 California foundations with assets greater than \$250 million had an average of 10 board members and 42 employees (Foundation Search America). This estimate includes the time to: develop an employee questionnaire (16 hours), distribute questionnaires to employees and board members (4.3 hours),<sup>7</sup> complete questionnaire by employees and board members (13 hours),<sup>8</sup> follow-up with employees and board members (0.9 hours),<sup>9</sup> enter questionnaire results into a database (4.3 hours),<sup>10</sup> and to analyze the data and compute the aggregate information needed (1 hour).

Table 1: Compliance Costs for Primary Diversity Reports associated with AB 624 (\$2007)

<b>Foundations</b>	
Time costs:	
Time required to complete Primary Diversity Report (hours)	39.5
Average hourly wage	\$24.36
Number of foundations (assets greater than \$250 million)	57
Total Time Cost	\$54,879
Imputed Overhead (36%)	\$19,757
<b>Compliance Costs of Primary Diversity Reports for Foundations</b>	<b>\$74,636</b>
<b>Recipient Charities</b>	
Time costs:	
Time required to complete Primary Diversity Report (hours)	119.8
Average hourly wage	\$24.36
Discrete number of charities receiving grants from foundations with assets greater than \$250 million	10,141
Total Time Cost	\$29,586,244
Imputed Overhead (36%)	\$10,651,048
<b>Compliance Costs of Primary Diversity Reports for Charities</b>	<b>\$40,237,291</b>
<b>Business Contracts</b>	
Time costs:	
Time required to complete Primary Diversity Report (hours)	0.5
Average hourly wage	\$22.11
Discrete number of businesses receiving contracts from foundations	4,009
Total Time Cost	\$44,315
Imputed Overhead (36%)	\$15,954
<b>Compliance Costs of Primary Diversity Reports for Business Contracts</b>	<b>\$60,269</b>

NOTES: The estimate 2007 average hourly wage in the non-profit sector in California (\$24.36) is based on the U.S. Department of Labor's 2006 *National Compensation Survey and May 2007 State Occupational Employment and Wage Estimates, California*. A ratio of California to U.S. mean hourly wages (1.13) is applied to U.S. mean hourly wages in the non-profit sector (\$20.92) in 2006. Wage data is increased by the 2007 inflation rate in California (3.3%). The average hour wage used to calculate the compliance costs of business contracts (\$22.11) is taken directly from U.S. Department of Labor, Bureau of Labor Statistics (2008a).

SOURCES:

Erard, Brian (1997). Fraser Institute (2007). Foundation Search America [www.foundationsearch.com](http://www.foundationsearch.com)

Urban Institute (2008).

U.S. Department of Labor, Bureau of Labor Statistics (2007).

U.S. Department of Labor, Bureau of Labor Statistics (2008a).

U.S. Department of Labor, Bureau of Labor Statistics (2008b).

The total time costs of collecting the information required to complete the primary report is estimated at \$54,879 for the 57 California foundations with assets of more than \$250 million (table 1).<sup>11</sup>

In addition to time costs (human-capital resources), a portion of overhead expenses including rent, utilities, computer equipment, and supplies must be included in a complete and accurate compliance cost estimate. Specifically, an overhead charge of 36 percent is applied to the total time cost estimate (table 1).<sup>12</sup>

The total compliance costs of the *Primary Diversity Reports* for the 57 foundations in California targeted by AB 624 is estimated at \$74,636.

### *Charities*

Interestingly, the bulk of the compliance burden of AB 624 falls on the recipient charities rather than the foundations at which it is aimed. AB 624 would require foundations with assets greater than \$250 million to disclose data on grant making activities. As discussed in the overview, foundations would be required to report the number of grants and grant dollars awarded to organizations specifically serving ethnic, lesbian, gay, bisexual and transgender, disabled, and other underrepresented communities; the number of grants and grant dollars awarded to organizations where 50 percent or more of the board members are ethnic minorities; the number of grants and grant dollars awarded to organizations where 50 percent or more of the full-time equivalent staff are ethnic minorities; and the number of grants and grant dollars awarded to predominantly low-income communities.

To comply with this aspect of AB 624, foundations would require grant recipients (charities) to provide the required diversity information.<sup>13</sup> Put differently, a significant portion of the compliance burden would fall on the charities that would be required to collect racial and gender information and report it to foundations.

Much like foundations, charities would be required to survey staff and board members to obtain the necessary diversity data. The estimated average time burden for charities to gather the required internal diversity information is 31.3 hours. The time estimate is calculated based on the average number of staff and board members of grant receiving charities. Charities were assumed to have the same average number of board members as the foundations (10). The estimated average number of employees per charity (19) was calculated based on median staff to revenue ratio (.0015 percent) from an extensive database of charities.<sup>14</sup> The ratio is applied to average revenue for public charities in the United States (\$1,274,189 for 2006) obtained from the National Center for Charitable Statistics maintained by the Urban Institute.

The estimate includes the time to: develop an employee questionnaire (16 hours), distribute questionnaires to employees and board members (4.0 hours), complete questionnaire by employees and board members (7.4 hours),

follow-up with employees and board members (0.5 hours), enter questionnaire results into a database (2.5 hours), and analyze the data and compute the aggregate information needed (1 hour).

In addition, charities would need to collect, track, and report diversity information of its clientele (individual and families served) to determine the number and percent that belong to specific “under-represented” communities. Written questionnaires and/or observational identification (visual surveys) would be required to collect the necessary information. For example, soup kitchens would likely rely on observational identification of clients whereas charities that provide counseling services, crisis intervention, or substance abuse treatment would likely rely on self-identification through questionnaires.<sup>15</sup> The estimated average time burden for charities to gather the required external diversity information is 88.5 hours.<sup>16</sup>

The total time costs of collecting and reporting the required data (internal and external) is estimated at \$29.6 million for the 10,141 charities that received grants from one or more of the 57 California foundations with assets more than \$250 million (table 1).<sup>17</sup>

Applying the 36 percent overhead charge to the time costs results in a total compliance cost estimate of \$40.2 million. In other words, U.S. charities receiving grants from California foundations with assets greater than \$250 million would incur approximately \$40 million in expenses to comply with AB 624.

### *Business Contracts*

AB 624 would also require foundations with assets of more than \$250 million to disclose information on the number and percentage of contracts awarded to businesses owned by African Americans, Asian Americans, Pacific Islanders, Caucasians, Latinos, Native Americans, and Alaskan Natives (see Overview). To obtain this information, foundations would require business owners to disclose their ethnicity.<sup>18</sup>

The estimated average time burden for business owners to disclose their ethnicity through a *Primary Diversity Report* is 0.5 hours. An estimated 4,009 vendors received one or more contracts from California foundations with assets more than \$250 million.<sup>19</sup> The estimated total time cost borne by businesses is \$44,315. Applying the 36 percent overhead charge to the time costs results in a total compliance cost estimate of \$60,269.

The total compliance cost estimate for business contracts is likely a gross underestimation as it excludes corporations. For example, all foundations in California contract with corporations for their gas and electricity. If the stipulation in AB 624 regarding “business contracts” is extended to include public and private corporations, the compliance estimate would increase significantly. For example, Pacific Gas and Electric (PG&E) – the biggest gas and electric company in California - had 88,752 shareholders as of December 2007.<sup>20</sup>

Surveying PG&E shareholders to determine the percentage belonging to the various ethnic categories would translate into an estimated annual cost of more than \$980,000<sup>21</sup> – for just one company. Add to that financial institutions, telecommunication companies, supply companies, etc., and the potential compliance costs are enormous.

There is also a second potential cost equally as important to understand in terms of a potential effect on businesses. Businesses may simply refuse to exchange with foundations covered by the reporting guidelines due to the costs. That is, if the costs are deemed prohibitive, a number of businesses may simply decide that they cannot afford to conduct business with a small number of foundations.

## Secondary Foundation Diversity Reports

To comply with AB 624, foundations would also be required to accumulate and consolidate the information received from *Primary Diversity Reports* submitted by charities and businesses and the foundation's own primary data. The information would be compiled into a *Foundation Diversity Report* (secondary report).

In total, foundations would be required to submit 14 aggregated pieces of information:

- racial composition of its staff and board of directors (number and percentage)
- gender composition of its staff and board of directors (number and percentage)
- business contracts awarded to businesses with ethnic minority owner (number and percentage)
- grants awarded to organizations specifically serving underrepresented communities (number and dollar amount)
- grant awarded to organizations where 50 percent or more of the board members are ethnic minorities (number and dollar amount)
- grant awarded to organizations where 50 percent or more of the full-time equivalent staff are ethnic minorities (number and dollar amount)
- grant awarded to predominantly low-income communities (number and dollar amount)

The estimated average time burden for foundations to gather and report this information is 77.8 hours.<sup>22</sup> This estimate includes the time to: develop the *Primary Diversity Reports* that grant applicants would be required to complete (16 hours), compile reports from grant recipients and enter responses into a database (44.1),<sup>23</sup> develop the *Primary Diversity Report* for business contracts to complete (4.0 hours),<sup>24</sup> compile reports from business contracts and enter the responses into a database (7.6 hours),<sup>25</sup> analyze the data and compute the aggregate information (3 hours) and complete *Foundation Diversity Report* (3 hours).

Table 2: Compliance Costs for Foundation Diversity Reports (\$2007)

<b>Time Costs</b>	
Time required to complete Secondary Diversity Report (hours)	77.8
Average hourly wage	\$24.36
Number of foundations (assets greater than \$250 million)	57
Total Time Cost	\$107,959
Imputed Overhead (36%)	\$ 38,865
<b>Compliance Costs of Foundation Diversity Reports</b>	<b>\$146,824</b>

SOURCES: see sources listed in table 1; calculations by the authors

The total time costs of collecting the required information and completing the Foundation Diversity Report is estimated at \$107,959 for the 57 California foundations targeted by AB 624 (table 2). Applying the 36 percent overhead charge to the time costs results in a total compliance cost of \$146,824.

## Total Compliance Costs of AB 624

The data and calculations in tables 1 and 2 are combined to determine the total compliance costs of AB 624 (table 3). The total cost to foundations, grant recipients, and business of complying with AB 624 is estimated at \$40.5 million in 2007 dollars.<sup>26</sup> In other words, approximately \$40 million would be diverted from the valuable and limited resources available to charities to expenses associated with AB 624 compliance.

Table 3: Total Compliance Costs of AB 624 (\$2007)

<b>Compliance Costs</b>	
Foundations	\$ 221,460
Recipient Charities	40,237,291
Business Contracts	60,269
<b>Total Compliance Costs of AB 624</b>	<b>\$40,519,020</b>

SOURCES: see table 1 and table 2; calculations by the authors

## Administrative Costs

Administrative costs are incurred by governments to enforce regulation.<sup>27</sup> AB 624 does not currently include any mention of oversight or monitoring requirements by government, but the prospect of amendment should not escape consideration. If legislators include oversight/auditing/enforcement requirements, this would involve certain costs worthy of calculation. Core administrative activities pertaining to AB 624 would likely include auditing foundation websites and annual reports to ensure required racial and gender information is disclosed, auditing foundations to assess the procedures used to collect and maintain diversity information, auditing charities and businesses that receive grants or contract with foundations to assess the procedures, imposing and collecting penalties for non-compliance, and providing an appeal process for disputed penalties.

Literature on the tax compliance and administrative costs can be used to estimate the administrative costs associated with AB 624, although these are not required by the bill in its current form. Evans (2003) in a review of studies (international and U.S. specific) finds that tax administrative costs are estimated at 17 to 50 percent of compliance costs. Vaillancourt and Clemens (2008) estimate administrative costs at between 17 and 23 percent for Canada's tax system. Using the lower estimate of 17 percent, administrative costs of AB 624 are estimated at \$6.9 million (table 4).

## Total Compliance and Administrative Costs of AB 624

Table 4 presents the total compliance and administrative costs that would be incurred by foundations, charitable organizations, businesses, and governments should Assembly Bill 624 become law. The total costs of complying with and administering AB 624 amounts to \$47.4 million. That is, foundations, charities, businesses and California taxpayers will expend nearly \$50 million to force California foundations with assets of more than \$250 million to collect and disclose racial and gender information.

Table 4: Total Compliance and Administrative Costs of AB 624 (\$2007)

Compliance Costs	
Foundations	\$ 221,460
Recipient Charities	40,237,291
Business Contracts	60,269
Total Compliance Costs Of AB 624	40,519,020
Administrative Costs	6,888,233
<b>Total Compliance and Administrative Costs</b>	<b>\$ 47,407,254</b>

## NOTES:

Administrative costs are calculated as 17 per cent of total compliance costs based on the lower-bound found in research of tax compliance and administration.

## SOURCES:

Table 1 and table 2;

Evans, Chris (2003). Vaillancourt, Francois and Jason Clemens (2008).

Calculations by the authors

## Impact on Costs of Reducing the \$250 Million Threshold

A legitimate concern for foundations with assets less than \$250 million is the possibility that the asset threshold would be reduced over time. Table 5 presents the number of California foundations by asset size. As currently written, AB 624 applies to only 0.6 percent of California foundations. To capture approximately 50 percent of foundations, the asset threshold would need to be \$500,000. Put differently, if California foundations with assets of more than \$500,000 were required to collect and disclose diversity data, nearly 46.7 percent of all foundations would be covered under AB 624.

Table 5: California Foundations by Asset Size

	Number of Foundations	
Less than \$100,000	3,001	31.1 %
\$100,000 - 499,999	2,143	22.2 %
\$500,000 - \$1 million	1,180	12.2 %
\$1 - 5 million	1,997	20.7 %
\$5 - 10 million	486	5.0 %
\$10 - 50 million	596	6.2 %
\$50 - 100 million	103	1.1 %
\$100 - 250 million	79	0.8 %
Greater than \$250 million	57	0.6 %
<b>Total</b>	<b>9,642</b>	<b>100.0 %</b>

NOTE:

Foundations are included if asset data is available for 2005 or beyond; Private, public, community, and company sponsored foundations are included.

SOURCES:

Foundation Search America, [www.foundationsearch.com](http://www.foundationsearch.com);

Calculations by the authors.

The total compliance and administrative costs of AB 624 amended to require adherence by all foundations with assets more than \$500,000 is not easily estimated as the estimated average time burden for foundations, charities and businesses calculated above are based on data (i.e. number of grants, number of recipient charities, average number of employee, board members and business contracts) specific to foundations with assets more than \$250 million.

However, a rough estimate can be computed based on the ratio of total revenue of foundations with assets between \$500,000 and \$250 million to total revenue of foundations with assets of more than \$250 million. Total revenue of foundations with assets between \$500,000 and \$250 million was \$25.1 billion, while total revenue of foundations with assets greater than \$250 million was \$28.6 billion.<sup>28</sup> If the same ratio held true for compliance and administrative costs, the total compliance and administrative costs of AB 624 amended to require adherence by all foundations with assets greater than \$500,000 would amount to \$89.0 million.

# III. Non-Economic Issues of AB 624

In addition to the economic costs delineated above, there are a number of non-economic issues or problems with AB 624. This section summarizes those additional problems.

## *Questionable Constitutionality*

There are serious questions regarding the legality of both collecting and disseminating the race and gender information contained in AB 624. Indeed, the Business Law Section of the State Bar of California concluded that:

These requirements intrude into the personal affairs of the board members and staff of foundations, and extend beyond the foundations to grant recipients, beneficiaries, and businesses that interact with foundations. Such intrusiveness clearly conflicts with California's constitutional and statutory rights of privacy (pg 2).<sup>29</sup>

An additional legal problem with AB 624 is the vagueness of many terms and definitions. This lack of clarity further complicates the measure's legal applicability.<sup>30</sup> For example, there are no clear definitions for different race categorizations, the core aim of the bill. In addition, the following key terms used in the bill are not well defined: business contracts, underserved communities, and low-income, to name but a few.

## *Violating the Spirit of Proposition 209*

California voters were the first in the nation to cast ballots on the issue of race and gender preferences. Proposition 209, the California Civil Rights Initiative, appeared on the November 1996 ballot and was supported by a majority (54 percent) of voters. The measure is now Article 1 Section 31 (a) of the California Constitution and its key provision states:

The State shall not discriminate against, or grant preferential treatment to any, individual or group on the basis of race, sex, color, ethnicity, or national origin in the operation of public employment, public education, or public contracting.

Private foundations are obviously not a division of the government. However, AB 624 departs from the spirit of Proposition 209 by taking the first step necessary toward the imposition of racial and gender quotas: measuring racial and gender composition. It is this latter policy that California voters already rejected for state employment, education, and contracting. The question for supporters of the bill then becomes: why measure and publicize the results if not to achieve some end goal? Clearly, the risk of state-imposed mandates for race and gender representation on boards and in employment increases under the auspices of this initiative.

Assembly Bill 624 is also at odds with a trend away from a government focus on racial and ethnic classification. Since California passed Proposition 209, other states have followed the Golden State's lead. Voters in the states of Washington and Michigan approved similar measures against race and gender preferences.

#### *Are Foundations "Subsidized Industries"?*

"Foundations should be as transparent as any other tax-subsidized industry."<sup>31</sup> That is the premise of AB 624 according to John C. Gamboa, whose Greenlining Institute staff wrote the first draft of the bill.<sup>32</sup> The underlying premise of this statement is incorrect. Preferential tax treatment, or what are often referred to as tax expenditures are not the same as subsidies. Subsidies refer to the direct transfer of monies between two parties. The most common case cited is agriculture: government provides taxpayer resources to farmers in the form of direct payments.

Preferential tax treatment (tax expenditures) are different in that they allow individuals and businesses to retain more of their own income if they pursue certain activities. For example, homeowners are afforded generous tax deductions for mortgage interest and property taxes through the tax code allowing them to keep more of their income. This is a marked difference from a subsidy, which would require the government to pay individuals directly to own homes.

The logic employed by advocates of AB 624 would mean that a portion or perhaps the entirety of any wealth or income derived from a tax-preferred activity was the property of the state. This would mean, for instance, that some portion of

homes owned by the resident would be public rather than private property. This fundamentally challenges the basic concept of private property and should be recognized as seriously flawed.

Heather Higgins of the Philanthropy Roundtable eloquently articulated the problems with this logic in her recent *Wall Street Journal* opinion article:

At a recent hearing, state senators claimed that because of their tax exemptions, taxpayers “subsidize” charities and charitable money is “taxpayer money.” But a tax exemption must not be confused with an actual government appropriation. The benefits arising from various tax exemptions – everything from libraries to child care, art galleries to IRAs – do not mean that the private money involved is suddenly public, giving politicians the right to strong-arm givers, or recipients. Yet such is the direction California is going.<sup>33</sup>

#### *Diverting Attention from Quality*

An obvious effect of AB 624 is to reduce the focus on quality for board and staff recruitment and development or to increase markedly the costs of such activities. Promoting an end goal of having an organization’s board and staff resemble the larger population’s composition either reduces the focus on quality (at the margin) or increases the cost of recruiting board members and staff. Interestingly, Pricewaterhouse Coopers, in its *U.S. Human Effectiveness Report*<sup>34</sup> estimates that, on average, it costs \$4,588 to recruit a staff person. Racial and gender requirements would increase these already substantial costs.

#### *Reducing the Importance of Mission*

Another critical aspect of the likely effects of AB 624, which has been overlooked completely, is that it lessens the connection to the mission of the foundation or charities by promoting racial and gender diversity as an equal or perhaps even higher goal. This could be one of the most costly aspects of AB 624 since foundations and charities by their very nature are mission-oriented organizations. Lessening the role and influence of the mission would have serious implications for the organizations in both the short and longer run.

#### *Dubious Diversity Goal*

An underlying assumption of AB 624 and similar initiatives across the country is that organizations that do not reflect the racial and gender composition of the country or state as a whole are somehow deficient when it comes to diversity and representation. Put differently, the underpinning of these types of initiatives demand that organizations, like foundations “look” like the population as a whole. This is a rather simplistic way to understand the population as a whole, its diversity, and individual preferences. Individuals naturally cluster with other individuals who have similar preferences, values, and aspirations. These preferences and values can be influenced by one’s racial experiences and gender, but they cannot be tied to them. In other words, one’s race and gender is not an outcome in and of itself.

# IV. Conclusion:

## The Consequences of AB 624

As California goes, so goes the nation. California legislators are considering the imposition of costly and burdensome new racial and gender reporting requirements on foundations as well as the charities that receive grants from them and the businesses that work with them. The total compliance cost to foundations, grant recipients, and businesses of complying with AB 624 is estimated at \$40.5 million. Future amendments to AB 624 could produce additional compliance costs of \$6.9 million, resulting in total costs of \$47.4 million.. These costs cover only the top 0.6 percent of foundations in California and the costs would obviously escalate if more foundations were covered in the future. Indeed, the study estimates costs of \$89.0 million if the top 50 percent of foundations were included.

Regardless of possible expansion, in its current design the bill imposes serious and material costs on foundations and charities. These resources will be consumed at the expense of direct program spending. In other words, the resources to finance the costs associated with complying with AB 624 will come from program spending. That means less money for food banks, shelters, schools, hospitals, and all the good works foundation finance and charities provide in California.

## V. References

Equal Employment Opportunity Commission (2006). Employer Information Report EEO-1 Instruction Booklet. <http://www.eeoc.gov/stats/jobpat/e1instruct.html>

Erard, Brian (1997). The Income Tax Compliance Burden on Canadian Big Business. Working Paper 97-2 (April). Technical Committee on Business Taxation.

Fraser Institute (2007). Donner Canadian Foundation Awards for Excellence in the Delivery of Social Services. Data on median revenue, number of staff and number of clients provided via email correspondence by Niels Veldhuis, director of fiscal studies [niels.veldhuis@fraserinstitute.org](mailto:niels.veldhuis@fraserinstitute.org)

Government Accountability Office (2005). Summary of Estimates of the Costs of the Federal Tax System. (GAO-05-878). Washington, D.C.: GAO.

Hall, Arthur (1993). The High Cost of Tax Compliance for U.S. Business. Special Report 25 (November). Tax Foundation. <http://www.taxfoundation.org/files/6de470dbbb6286da788e6b6f2cc1643a.pdf>

Moody, Scott, Wendy P. Warcholik, and Scott A. Hodge (2005). The Rising Cost of Complying with the Federal Income Tax. Washington, D.C.: Tax Foundation.

Urban Institute (2008). Number of Public Charities by State, 2006. The National Center for Charitable Statistics, Center on Nonprofits and Philanthropy. <http://nccs.urban.org/>

U.S. Department of Labor, Bureau of Labor Statistics (2007). National Compensation Survey: Occupational Earnings in the United States, 2006. <http://www.bls.gov/ncs/ncswage.htm>

U.S. Department of Labor, Bureau of Labor Statistics (2008a). May 2007 State Occupational Employment and Wage Estimates, California. [http://www.bls.gov/oes/current/oes\\_ca.htm](http://www.bls.gov/oes/current/oes_ca.htm)

U.S. Department of Labor, Bureau of Labor Statistics (2008b). Consumer Price Index [http://www.bls.gov/ro9/ro9\\_ca.htm#inflation](http://www.bls.gov/ro9/ro9_ca.htm#inflation)

Vaillancourt, Francois and Jason Clemens (2008). Compliance and Administrative Costs of Taxation in Canada, in *The Impact and Cost of Taxation in Case: the Case for Flat Tax Reform*, ed. Jason Clemens, Vancouver, BC: The Fraser Institute.

# About the Authors

**Jason Clemens** is the Director of Research at the Pacific Research Institute. He also directs the strategic planning and budgeting for the Institute. Prior to joining PRI he held a number of positions at the Canadian-based Fraser Institute over a ten-plus year period, including the director of research quality, resident scholar in fiscal studies, and the director of strategic planning and budgeting. He holds an Honors Bachelors Degree of Commerce and a Masters' Degree in Business Administration from the University of Windsor as well as a Post Baccalaureate Degree in Economics from Simon Fraser University.

He has published more than 50 major studies on a wide range of topics, including taxation, government spending, labor market regulation, banking, welfare reform, productivity, entrepreneurship, public choice economics, and economic prosperity. He has published over 200 shorter articles, which have appeared in such newspapers as the *Wall Street Journal*, *Investor's Business Daily*, *The National Post*, *The Globe & Mail*, and all major daily papers in Canada. Mr. Clemens has been a guest on numerous radio and television programs across the country. He has appeared before committees of both the House of Commons and the Senate (Canada) as an expert witness. In 2006, he received the prestigious Canada's Top 40 Under 40 award presented by Caldwell Partners as well as an Odyssey Award from the University of Windsor.

**Lawrence J. McQuillan** is the director of Business and Economic Studies at the Pacific Research Institute (PRI). Mr. McQuillan earned a Ph.D. in economics from George Mason University in Virginia. He was a research assistant for Nobel laureate James M. Buchanan and received the H. B. Earhart Fellowship for research excellence while attending GMU. Trinity University in San Antonio, Texas, awarded him a B.A. in economics and business administration.

Since joining PRI in 2001, Mr. McQuillan has specialized in tax, budget, regulation, and legal-reform issues. He is coauthor of *Jackpot Justice: The True Cost of America's Tort System* and the *U.S. Tort Liability Index*. He is also coauthor of the *U.S. Economic Freedom Index: 2004 Report*, published in association with Forbes, which ranks the 50 states according to how friendly or unfriendly their state-government policies are toward free enterprise and consumer choice.

McQuillan speaks regularly to civic and policy groups across the country and with the national news media. His television appearances include NBC news, CNBC, and CNNfn. He is a frequent guest on nationally syndicated radio talk shows including the Ron Insana Show, Roger Hedgecock Show, and Jerry Doyle Show. He counsels governors, legislators, and advocacy groups across the country; provides legislative testimony; and was a member of Governor Arnold Schwarzenegger's task force on a constitutional spending limit for California.

McQuillan has written more than 125 op-eds in such outlets as the *Wall Street Journal*, *USA Today*, *Forbes*, *Investor's Business Daily*, *National Review*, *Los Angeles Times*, *New York Post*, *San Francisco Chronicle*, *Washington Times*, and *Weekly Standard*. He has written on such topics as tax and spending limits, lawsuit abuse, pensions, workers' compensation, and economic freedom.

**K. Lloyd Billingsley** is the editorial director at PRI. Mr. Billingsley has been widely published on topics including popular culture, defense policy, education reform, and many other current policy issues. Mr. Billingsley is the author of two recent studies, *Net Gains or Net Losses? The Net Neutrality Debate and the Future of the Internet* and *Playing Tag: An RFID Primer*. Mr. Billingsley is the author of *Hollywood Party: How Communism Seduced the American Film Industry in the 1930s and 1940s* and *From Mainline to Sideline: The Social Policy of the National Council of Churches*. His articles have appeared in the *Washington Post*, *Wall Street Journal*, *USA Today*, and many other publications. Before joining PRI, Mr. Billingsley was a journalism fellow at the Center for the Study of Popular Culture in Los Angeles, and he formerly served as a correspondent for *Spectator* magazine and the *Washington Times*.

**Adam Frey** is a General Studies Policy Fellow. Previously, he was a Health Care Studies intern at the Pacific Research Institute where he focused on the Veterans Health Administration. He has written for *Stars and Stripes* and has conducted a variety of research on public policy issues. Prior to joining PRI, Adam earned his BA in Political Science at the University of Vermont and recently completed his Master of Arts in Political Science-Public Policy at the University of Nevada, Reno.

# Acknowledgements

The authors would like to acknowledge Niels Veldhuis, the director of fiscal studies at The Fraser Institute (Canada) for allowing us access to a unique charitable dataset as well as his input and suggestions on a number of areas for the study. The authors would also like to thank one anonymous reviewer who provided valuable suggestions. Any remaining errors or omissions are the sole responsibility of the authors. As the authors of this study have worked independently, their views and conclusions do not necessarily represent those of the board, supporters, or staff of the Pacific Research Institute.

# About the Pacific Research Institute

The Pacific Research Institute (PRI) champions freedom, opportunity, and personal responsibility by advancing free-market policy solutions. It provides practical solutions for the policy issues that impact the daily lives of all Americans, and demonstrates why the free market is more effective than the government at providing the important results we all seek: good schools, quality health care, a clean environment, and a robust economy.

Founded in 1979 and based in San Francisco, PRI is a non-profit, non-partisan organization supported by private contributions. Its activities include publications, public events, media commentary, community leadership, legislative testimony, and academic outreach.

## Education Studies

PRI works to restore to all parents the basic right to choose the best educational opportunities for their children. Through research and grassroots outreach, PRI promotes parental choice in education, high academic standards, teacher quality, charter schools, and school-finance reform.

## Business and Economic Studies

PRI shows how the entrepreneurial spirit—the engine of economic growth and opportunity—is stifled by onerous taxes, regulations, and litigation. It advances policy reforms that promote a robust economy, consumer choice, and innovation.

## Health Care Studies

PRI demonstrates why a single-payer Canadian model would be detrimental to the health care of all Americans. It proposes market-based reforms that would improve affordability, access, quality, and consumer choice.

## Technology Studies

PRI advances policies to defend individual liberty, foster high-tech growth and innovation, and limit regulation.

## Environmental Studies

PRI reveals the dramatic and long-term trend toward a cleaner, healthier environment. It also examines and promotes the essential ingredients for abundant resources and environmental quality: property rights, markets, local action, and private initiative.

# Endnotes

- <sup>1</sup> The bill is formally referred to as the "Foundation Diversity and Transparency Act." It was introduced and sponsored by Joe Coto (D–San Jose) along with Mervyn Dymally and Ted Lieu. It was first introduced in February 2007. It has been amended and passed the House on January 29th, 2008. The Senate has further amended the bill and at this writing it is in the Businesses and Professions Committee for hearings.
- <sup>2</sup> Defined as a full-time equivalent (FTE) staff person.
- <sup>3</sup> Information requirements on sexual orientation have been removed from the bill during the amendment and revision process.
- <sup>4</sup> While administrative costs are incurred by governments directly, California taxpayers ultimately bear the costs.
- <sup>5</sup> According to Foundation Search America ([www.foundationsearch.com](http://www.foundationsearch.com)) there are a total of 57 private, public, community, and company sponsored foundations with assets greater than \$250 million in California.
- <sup>6</sup> For more information see Equal Employment Opportunity Commission (2006)
- <sup>7</sup> Distribution includes mail merge, mailings or hand-delivery of the questionnaires. Distribution is expected to take 5 minutes per questionnaire.
- <sup>8</sup> Each employee and board member is estimated to spend 15 minutes to complete the questionnaire including reviewing instructions, contemplating participation, completing, and submitting the questionnaire.
- <sup>9</sup> The estimate is calculated assuming 20 percent employees and board members would require follow-up at 5 minutes per individual.
- <sup>10</sup> Entry of questionnaires results into a database is estimated at 5 minutes per questionnaire.
- <sup>11</sup> The average hourly wage (\$24.36) for the non-profit sector in California is used to determine the total time costs of complying with AB 624. Given the nature of these foundations (assets more than \$250 million) and the sensitivity of the data, it is likely that a human resource specialist would be tasked with collecting and reporting the required data. The estimated average hourly wages for human resource managers in the United States was \$38.83 in 2006. As such, the estimated time costs presented in table 1 is likely a conservative estimate.
- <sup>12</sup> The 36 percent overhead charge is taken from literature on tax compliance and administration. Hall (1993) estimates that non-personnel expenditures (overhead) amount to 52.7 percent of personnel costs related to tax compliance for Fortune 500 companies. In a study of the top 500 Canadian firms, Erard (1997) estimates non-personnel expenditures at 36.2 percent of personnel costs. The lower estimate provided by Erard is used to calculate estimated overhead expenditures related to compliance with AB 624.
- <sup>13</sup> It is likely foundations would require diversity information from all charities that submit grant applications. The compliance cost estimate presented in this section is based solely on successful applications, which contributes to the conservative nature of the estimate.
- <sup>14</sup> The database is for Canadian charities and is maintained by the Fraser Institute. It covers the years 1997 through to 2007.
- <sup>15</sup> As mentioned in footnote 6, the EEOC requires the option of self-identification. In addition, sexual orientation (one of the data requirements of AB 624) can only be ascertained through self-identification.
- <sup>16</sup> The time estimate is calculated based on an average of 1,596 individuals served per charity which was calculated based on the ratio of staff to clients served (84) obtained from an extensive database of Canadian charities maintained by the Fraser Institute. The estimated time required to survey 1,596 clients through written questionnaires is estimated at 96.8 hours (16 hours for questionnaire design, 79.8 hours or three minutes per client to enter the information into a database, and an hour to analyze the data and compute the aggregate data needed). The estimated time required to survey 1,596 clients through observation (visual survey) is estimated at 21.0 hours (two hours for the design of survey, 16 hours for the implementation of the survey assuming 2 days of visual surveys, two hours to enter the information into a database and an hour to analyze the data and compute the aggregate data needed). The estimated time burden of 88.5 hours is calculated based on the expectation that approximately 89 percent of charities use questionnaires to obtain the required information while the remainder (11 percent) rely on visual surveys. These percentages are again based on data obtained from an extensive database of Canadian charities maintained by the Fraser Institute. Approximately 11 percent of charities in the database provide basic necessities (i.e. soup kitchens and food banks) which would likely rely on visual surveys.

- <sup>17</sup> According to data obtained from Foundation Search American ([www.foundationsearch.com](http://www.foundationsearch.com)), California foundations with assets of more than \$250 million provided approximately 18,241 grants to 10,141 different charities. Grant data for each foundation is for the latest year available (2005 or 2006).
- <sup>18</sup> It is likely foundations would require this information from all businesses that provide cost estimates to foundations. The compliance cost estimate presented in this section is based solely on businesses that successfully receive contracts which contributes to the conservative nature of the estimate.
- <sup>19</sup> An email survey of foundations with assets greater than \$250 million in California revealed an average of 91 independent vendors (individuals, sole proprietorships or partnerships). Inevitably there will be some degree of overlap between the foundations as some vendors will contract with more than one foundation. The estimated number of discrete vendors was obtained by applying the ratio of grant recipients to total grants (77 percent) to the estimated total number of business contracts of the 57 foundation (5,206).
- <sup>20</sup> Obtained through personal correspondences with P.G. & E.; available in their 2007 SEC filing on page 39.
- <sup>21</sup> This estimate assumes an average time burden for shareholders to disclose their ethnicity through a *Primary Diversity Report* is 0.5 hours. The average hourly wages used for this calculation is \$22.11.
- <sup>22</sup> This time burden applies to foundations with assets more than \$250 million and was estimated using specific data on California foundations. Specifically, the 57 foundations with asset over \$250 million in California provided grants to an average of 265 charities and contracted with an average of 91 independent vendors.
- <sup>23</sup> Entry of questionnaires into a database is estimated at 10 minutes per grant recipient.
- <sup>24</sup> The estimate is substantially lower than previous time estimates required to develop questionnaires as the questionnaire provided to business contracts would be similar to that provided to grant applicants.
- <sup>25</sup> Entry of questionnaires into a database is estimated at 5 minutes per questionnaire.
- <sup>26</sup> The estimate is considered conservative for several reasons: see footnotes 11, 13, and 18.
- <sup>27</sup> While administrative costs are incurred by governments directly, the costs are ultimately borne by California taxpayers.
- <sup>28</sup> Aggregated revenue data from Foundation Search America ([www.foundationsearch.com](http://www.foundationsearch.com)) is calculated based on revenue for the latest year available for each foundation (2005, 2006, or 2007).
- <sup>29</sup> Statement of the Nonprofit & Unincorporated Organizations Committee of the State Bar of California, Business Law Section, to the State Bar Office of Governmental Affairs, March 27, 2008, p. 2. <http://calbar.ca.gov/calbar/pdfs/sections/buslaw/nonprofit/2008-03-03.ab624-comment-letter.pdf>
- <sup>30</sup> The Business Law Section of the State Bar of California rendered a similar opinion regarding the ambiguity of the language in AB 624: "Many of the key terms purporting to describe data to be assembled are so vague, undefined or ambiguous as to defy collection." Statement of the Nonprofit & Unincorporated Organizations Committee of the State Bar of California, Business Law Section, to the State Bar Office of Governmental Affairs, March 27, 2008, p. 2. <http://calbar.ca.gov/calbar/pdfs/sections/buslaw/nonprofit/2008-03-03.ab624-comment-letter.pdf>
- <sup>31</sup> John C. Gamboa, "Tax-supported foundations must reveal diversity data," *San Jose Mercury News*, February 29, 2008.
- <sup>32</sup> The co-author of AB 624, Ted Lieu, made similar statement in his testimony to the Businesses and Professions Committee of the California Senate on May 12, 2008: "All of us here as taxpayers subsidize foundations because they are non-profits... We rely on foundations to reallocate and redistribute wealth back to our society."
- <sup>33</sup> Heather R. Higgins, "The 'Diversity' threat to California Charity," *Wall Street Journal*, May 30, 2008, p. A12.
- <sup>34</sup> The Saratoga division of PricewaterhouseCoopers publishes a US Human Capital Effectiveness Report (<http://www.pwc.com/extweb/pwcpublishations.nsf/docid/62650EBBC242A29585257369006D88BDA>). Released in July, this report contains estimates of costs per hire. Data from the 2000 report shows that the total cost per hire for all participants in the survey averaged \$4,588. While the summary indicates there was considerable range of costs, no specific estimates were provided for CEOs or Directors in the summary article ([http://findarticles.com/p/articles/mi\\_mofxs/is\\_1\\_80/ai\\_69294704](http://findarticles.com/p/articles/mi_mofxs/is_1_80/ai_69294704)).



Pacific Research Institute  
755 Sansome Street, Suite 450  
San Francisco, CA 94111  
t: 415.989.0833 | f: 415.989.2411  
[www.pacificresearch.org](http://www.pacificresearch.org)