



U.S. SENATE COMMITTEE ON

Finance

SENATOR CHUCK GRASSLEY, OF IOWA - CHAIRMAN

<http://finance.senate.gov>

MEMORANDUM

TO: Reporters and Editor
RE: Red Cross governance reforms
DA: Monday, Oct. 30, 2006

Sen. Chuck Grassley, Chairman of the Committee on Finance, issued a comment on the announcement today by the Board of Governors of the American Red Cross regarding changes it plans to make to modernize its governance structure and better support the charitable mission of the Red Cross.

Sen. Grassley began his scrutiny of the Red Cross in the months following the 9-11 terrorist attacks when questions were raised about how the organization was using donations made to assist with recovery efforts. As chairman of the Senate Committee responsible for tax policy, Sen. Grassley has continued to conduct a broad-based review of the non-profit sector and has won approval of legislative reforms aimed at certain abuses. He continues to examine where policy changes may be needed to improve the governance of such tax-exempt organizations by their boards of directors.

Grassley comment —

“I’m pleased with the vote by the board of the Red Cross to make real changes to the governance at the American Red Cross. The board has followed the recommendations of the Independent Governance Advisory Panel to make the changes necessary that will help ensure that the Red Cross has the necessary leadership and governance to succeed. Certain incidents have shaken public confidence in the Red Cross, and the Red Cross needs to go the extra mile with governance reforms to ensure public confidence.

“My work on oversight of nonprofit organizations has made it clear that getting the governance right is critical if a charity is going to succeed in its mission. It’s good news that the Red Cross’ board recognized that a Band-aid won’t do, and that the American people expect the best from an organization that so many have supported with time and money.

“The Red Cross also has taken good steps to support whistleblowers who are speaking out at problems they are seeing at the Red Cross. Encouraging and acting on the reporting of whistleblowers will make the Red Cross a stronger institution. Going forward, I want to make certain that the Red Cross also has in place reforms that will contribute to greater transparency and openness to the Congress and the public. The Red Cross and Congress should give strong consideration to creating an ombudsman at the organization.

“I look forward to meeting with the Chairman of the Red Cross, Bonnie McElveen-Hunter, as well as Karen Williams, the Chairman of the Independent Governance Advisory Panel, on November 15 to go over the details of the governance changes. My hope is that we can move quickly and have Congress act to pass the necessary statutory changes to change the governance and board of the Red Cross in keeping with the board’s actions.”

The text of Sen. Grassley’s Feb. 27, 2006, and Dec. 29, 2005, letters to the Red Cross Board of Governors follows here for your reference.

February 27, 2006

Ms. Bonnie McElveen-Hunter
Chairman, Board of Governors
American Red Cross
430 17th St., NW
Washington, D.C. 20006

Dear Ms. McElveen-Hunter:

I am writing in response to your invitation to serve as the keynote speaker for your corporate governance summit, “Enhancing Board Effectiveness”. Because Congress is not scheduled to be in session during that week, I will have to decline your invitation. I am encouraged that the Red Cross is holding this summit as a first step in reviewing its governance structure and practices and it is my hope that the Red Cross board recognizes that “business as usual” cannot continue.

I would appreciate a full report on the findings of the summit. I am particularly interested in recommendations provided by the outside governance experts who have agreed to assist the Red Cross in its review. I look forward to hearing how you plan to proceed following the summit and what further actions you will be considering as you take an in-depth look at the Red Cross’ operations and practices. It will be instructive to take a look at how other organizations have worked with independent experts to strengthen their governance structures and their effectiveness. It is my understanding that such an in-depth review of the Red Cross has not taken place in well over fifty years and is therefore most timely.

I am also writing at this time to provide you with an early impression of the material you provided in response to my December 29, 2005, letter and to request additional information. In response to my letter, my office has received an enormous number of phone calls, letters and other material from Red Cross volunteers, employees and former employees, and I have met personally with some to hear their stories. These individuals who have come forward all share the same goal that drives my oversight – to ensure that we have a Red Cross that is as efficient and successful as possible. The information from these Red Cross volunteers and employees along with the responses I have received from the Red Cross make it clear that there is much work to be done to ensure that the Red Cross is most effective in responding to the next Katrina.

As you know, the staff of the Finance Committee has scheduled a round table discussion for March 3rd to take a look at some of these issues. I am sure you will find the discussion helpful as you engage in your own review. My goal is to strengthen your work and governance structure. To better inform the public as well as decision-makers, I am releasing today some of the material the Red Cross has provided in response to my letter. A significant portion of material has been marked confidential by

the Red Cross. My staff will be discussing this matter further with your counsel. I strongly encourage the Red Cross to be as open and transparent as possible. This is particularly important in light of its designation by Congress to be the lead disaster relief organization for the country and in light of the fact that it has board members who are appointed by the President but also depends on the public for the majority of its support.

I am heartened that you recognize the seriousness of these matters in your January 31, 2006, letter in which you state that it is “. . . [E]ssential for the Red Cross to learn from these prior challenges and to make necessary changes. . . . Not only are we open to a critical review of how we provide our services, but we also welcome a critical review of our governance structure.” Given the Red Cross’ congressional charter, Congress, the Administration and the Red Cross must all look at substantive changes in certain areas, including, but not limited to, governance structure, the scope of work, and cultural problems of the Red Cross. I am concerned the Red Cross appears at times to be more interested in image than results and wants to shut out those volunteers and employees who want to improve the Red Cross.

1. Governance

I have found again and again in my oversight work that many organizations can trace their problems to board governance. This is true whether it be non-profit or for-profit. The Commissioner of the IRS, Mark Everson, came to a similar conclusion in a March 30, 2005, letter to me:

“Lax attitudes towards governance. An independent, empowered, and active board of directors is the key to insuring that a tax-exempt organization serves public purposes and does not misuse or squander the resources in its trust. Unfortunately, the nonprofit community has not been immune from recent trends toward bad corporate practices. Like their for-profit brethren, some charitable boards appear to be lax in certain areas. Many of the situations in which we have found otherwise law-abiding organizations to be off-track stem from the failure of fiduciaries to appropriately manage the organization.”

One example of the impact of governance on the work of the Red Cross was provided to me by an individual who was a former CEO of a state Red Cross organization for several years. This person stated that the Red Cross structure limits accountability and control and that limitation directly relates to the Red Cross failing to be successful in performing its mission.

There are three areas related to governance that are of concern to me at this stage of my review: a) lack of participation of board members; b) size of the board; and, c) independence of the board.

a. Participation

I am troubled by the number of the board of governors, particularly government-appointed board members, who rarely attend board meetings and often send representatives who do little more than sit in a chair. This nonattendance by government appointees is regardless of administration – an example of bipartisanship the American people could do without. In addition, some of these government officials have a direct conflict with the two hats they wear. For example, the Secretary of Health and Human Services who sits on the Red Cross board also oversees the Food and Drug Administration, which has been engaged in significant oversight of the Red Cross on blood issues.

I believe that presidential appointees can add much value to the work of the Red Cross. However,

these appointees must be willing and able to do the heavy lifting that should be expected from the board of a multi-billion dollar organization. Moreover, at a time when we have very real governance problems in the charitable sector, the federal government should be leading by example by naming active and engaged board members.

The effective lack of participation of so many of the board members is highlighted in the exit of your most recent President and CEO, Ms. Marsha Evans. As your outside counsel briefed my staff on this entire matter, the plans and actions that resulted in Ms. Evans' departure were initiated by a small group of members of the executive committee. These board members had already retained an outside employment lawyer to handle the severance negotiations with Ms. Evans prior to the December 5th meeting. It was only after this meeting, at which Ms. Evans' resigned, that the rest of the board members, including the other members of the executive committee, were informed of what had taken place.

The critical function of a board is to decide whether to hire or fire the CEO. The fact, as my staff understands from the briefing provided by Red Cross' outside counsel, that Ms. Evans' departure took place without any formal action or decision by the entire board is extraordinarily troubling. In addition, I am at a loss to understand how all of this was decided without any written documentation. It appears that this most vital of all decisions – the removal of the President of a multi-billion dollar organization -- was done with only a small number of board members and without a single piece of paper.

Please confirm that there are no records, such as memos, emails, videoconferences or other similar records of these events -- or otherwise provide such records. I ask that you provide a detailed explanation of the events, actions and decisions that led to the December 5th meeting with Ms. Evans as well as a narrative discussing when and how board members were informed both before and after December 5th.

In contrast to the lack of board participation with respect to Ms. Evans' departure, I am receiving reports of overly intrusive participation by some board members, i.e., board members who cross the line and get involved in the day-to-day management of the Red Cross, which should be the responsibility of the CEO. I am concerned that the CEO is unable to make reforms or changes because an individual or subgroup is "protected" by a board member. Please explain what actions you will take to ensure that the CEO is empowered to do what is necessary to insure the effectiveness of the organization.

b. Board Size

The response from the Red Cross to my letter entitled, "The Governance Structure of the American Red Cross", which points to other organizations with large boards, does not provide a convincing defense of the current 50 person board. Note that The Nature Conservancy's governance review, prompted by the Finance Committee's investigation, came to a very different conclusion about big boards. That review recognized that when everyone is in charge, no one is in charge. As a result, The Nature Conservancy is reducing its board from 41 to at least 18 in the near future.

I am pleased that the Red Cross has been able to retain the key author of The Nature Conservancy review for its own review of governance and can only commend his observations:

Generally, the non-profit sector, like the commercial sector, has come to recognize that smaller

boards – which meet more frequently and have standing committees focused on particular issues relevant to the organization – are more effective than overly large boards which meet infrequently, often by telephone, and whose members sometimes regard board service as an honorary function.

...

One of the challenges at the time was to develop an approach which would marry the institutional history of TNC's Board of Governors with a modern perspective on board structure. Historically, like many other large, non-profit organizations, TNC had a large Board of approximately 40 members. Many of the Governors had long personal histories of involvement in TNC programs and strong commitments to TNC's mission. TNC rightfully sought to encourage the continued involvement of these individuals. At the same time, a 40-member Board could not govern effectively, no matter how qualified the members were; there were simply too many of them to operate as a modern, hands-on board. (Emphasis added – Progress Report on The Nature Conservancy, April 19, 2005).

The American people have a right to expect that the Red Cross will engage in best practices in board governance and not rely on what sounds like an “everyone else is doing it” defense. I am encouraged that you share my general point given your January 31, 2006, letter to me stating: “We want to model the best corporate governance practices found in the charitable and for-profit sectors.” There is no daylight between us in that common goal.

c. Independence

An issue for organizations such as the Red Cross, United Way, YMCA and others, is ensuring the proper balance between the field and headquarters. There have unfortunately been very real problems at the chapter level of the Red Cross. To be effective, the Red Cross must vigorously oversee chapters and discipline chapters as well as ensure that national standards are in place and met by the chapters. I have concerns that this is not happening to the degree it should because of the chapters' involvement in governance. I understand that a majority of the national board is comprised of representatives from the chapters. I encourage you to consider the issues of independence that such a structure creates and whether the chapters' involvement serves to “protect” individuals or chapters as discussed above. In addition, while the focus of this letter is on the national governing board, given material I have received from volunteers and employees, I believe it would be beneficial for your experts to also look at governance of the chapters and best practices for the chapters as well.

2. Scope of Work

The statute governing the Red Cross' charter discusses the Red Cross' responsibilities with respect to the International Red Cross, military authorities on certain matters, and, most importantly, disaster relief and prevention. As I look at the work of the Red Cross, I am concerned that many times the work of the Red Cross is far removed or only tangentially related to the core areas that Congress defined as its purpose. It is vital in today's world that the Red Cross be most successful with its core responsibilities – particularly disaster relief and prevention. I encourage your review to look at not only how the Red Cross is operating but also what it is doing. Defining what the Red Cross should be doing will go far in helping to determine how the Red Cross should be governed.

As part of this review, I think it important that the Red Cross consider its role in disaster relief as regards to other charitable organizations that respond to disasters. Red Cross is presently the lead responder for disaster, but the reality is that the Red Cross cannot be all things in response to

disaster. For the Red Cross to succeed in its mission of disaster relief, it must work in concert with the entire charitable community. I have been concerned about comments I've received from local charities in the Katrina area that have expressed frustration about their relationship with the Red Cross. I would appreciate your thoughts on this matter and the Red Cross' role of coordination and sharing of support and material with other charities responding to disaster – particularly local charities that may not have a national presence but are often the ones best placed to effectively assist the community.

3. Culture

In my twenty plus years of conducting oversight I have rarely had as significant a response from the public as I have had from my December 29th letter to the Red Cross. Many of the phone calls and letters came from volunteers and current and former employees. The vast majority spoke with admiration for the goals of the Red Cross but tempered that by first-hand observations that the Red Cross is failing in practice to meet its stated purpose. These letters spoke to problems not just related to Katrina but also September 11 and previous Red Cross efforts.

I recognize that the Red Cross cannot be perfect and I appreciate your recognition that the Red Cross must learn from its experiences. That is why I am particularly troubled that several volunteers have told me that when they tried to raise concerns or issues about possible misuse of donated funds and property – including suspected criminal activity – the volunteers were ignored, told to leave or otherwise made to feel like the skunk at the picnic. This type of culture, a culture that discourages people from coming forward, management that does not want to hear the bad news, and is more concerned about good press than good results, is a theme that I am hearing too often from Red Cross volunteers. I cannot emphasize enough how important it is to correct this culture – perceived or real. I have seen similar mindsets at government agencies that I have conducted oversight on, such as the FBI. Such a culture greatly undermines the effectiveness of the organization.

I bring to your attention two examples of what I have stated above. The first is Ms. Christee Lesch of Iowa who, along with several other volunteers, submitted a report on their experience with Katrina. After congressional inquiries, these volunteers did finally meet with Red Cross officials, whom they understood to be designated to receive such reports and commentary. I would ask for a response to their report and their experience in trying to speak out about problems and also would ask for copies of similar reports that the Red Cross has received from volunteers in the last year. I am particularly interested in understanding how the current governance structure, with so much representation by the chapters, affects the ability of such field reports to make into the hands of truly independent overseers at national Red Cross.

The second example is from a report dated December 5, 2005, prepared by an attorney volunteer for the Red Cross entitled: “Alleged Criminal and Staff Misconduct in DR 865-06/Harvey Group.” This report was provided to Frank Favilla, Ethics and Compliance NHQ. As the title implies, it raises serious matters relating to the Katrina disaster relief. I would ask for a response to this report – particularly what happened to the allegations raised, and the proposals for additional investigation – and also would ask for all reports received (or completed by) in the last five years from both the Safety and Security office as well as the office of Ethics and Compliance.

Thank you for your time and courtesy on this important matter. I would ask that I receive the material within 30 days. Again, please accept my appreciation for your invitation and I look forward to meeting with you in the near future to discuss the progress made on the issues we both recognize as

requiring attention for the Red Cross' success in the future.

Cordially yours,

Charles E. Grassley
Chairman

cc: Senator Baucus

December 29, 2005

Ms. Bonnie McElveen-Hunter
Chairman
The American Red Cross
17th & D St., NW
Washington, D.C. 20006

Dear Ms. McElveen-Hunter:

The Finance Committee has taken a strong interest in the work of the Red Cross since questions were raised about the work of the Red Cross following the 9/11 tragedy. Given that the Red Cross is a tax-exempt organization, chartered by Congress and most importantly – is designated by the federal government to play a vital role in response to disasters -- it is the duty of Congress to engage in oversight to ensure that the Red Cross is performing its role effectively.

The response to Katrina and the recent resignation of the President and CEO of the Red Cross have understandably raised questions about the Red Cross. Specifically whether the current board and governance structure meets the high level of competence and engagement that Congress and the public should expect from an organization that carries such serious responsibilities.

To assist in my review of these matters, I would ask for the following information:

A. Board Governance

- 1) Please provide copies of all board minutes, including board minutes of any subgroup (such as the executive committee) of the board, for the last five years. Please provide a list of all material provided to board members for the last five years.
- 2) Please indicate for all board meetings and subgroup meetings of the board the attendance – who attended the entire meeting, who attended part of the meeting, who was absent – for the last five years. Please indicate what board members are elected by chartered units, members-at-large and Presidential appointees. In addition, for Presidential appointees please provide the attendance information for the last ten years.
- 3) Please provide copies of all communications between board members and the President and CEO

for the last five years. This would include e-mails, faxes, memorandums, etc.

4) Please provide a detailed discussion of your office – the number of staff that report to you, their duties and salaries. Please compare this to your predecessor. Please provide the number of hours per week that you spend performing your duties as Chairman and provide a detailed discussion of your work and duties as Chairman. Please provide a copy of an organization chart for the Red Cross including reporting chains (including contacts and reporting chains from chapters up into headquarters).

5) When did the board last do a self-evaluation of the board's work and performance? Please provide a copy of that evaluation. When does the board intend to do another evaluation?

6) When has the board last conducted an evaluation of the effectiveness of the American Red Cross operations? Please provide a copy of the evaluation. When does the board intend to do another evaluation?

7) It is my understanding that when Ms. Marty Evans, the former President and CEO of the Red Cross, first took her position at the Red Cross she sought to initiate a series of reforms in governance. Please discuss these reforms and the board's response to these efforts by Ms. Evans. Please provide a copy of Ms. Evans memorandum to you "Guiding Principles for a Successful Board-Management Partnership." Please provide a copy of any response you, your staff, or other board members made to this memorandum.

8) A Red Cross spokesman states that Ms. Evans's departure was due to coordination and communication issues with the board. The American public deserves more than a papering over of the reasons for her departure. If coordination and communication is at issue, then please provide a detailed discussion of what exactly were these issues. Please provide all written memos, communications, email, etc. that support these concerns cited by the Red Cross spokesman that justify this explanation of Ms. Evans's departure.

9) Please provide a copy of all internal audits (both completed and in draft form) for the last five years.

10) Please provide a discussion of whether you believe the current governance and board structure is appropriate and adequate – including any proposed changes to the law.

11) Please provide me a detailed discussion of how the board will proceed in finding a new President and CEO of the Red Cross and the qualifications that the board is seeking. Please advise who is serving on the search committee.

B. Response to Disaster

1) I have heard from charities and colleagues that a top concern has been the Red Cross' poor working relationship with leaders of local charities. However, these concerns were not made of other major charities, such as the Salvation Army. I would appreciate your response to this concern, and if you agree, what the Red Cross will do to address this matter in the future.

2) The Red Cross is the lead charity for disaster relief. However, it is understandable that there are

times when the Red Cross cannot reach certain populations that are in need of assistance. Often, it is local charities that fulfill this mission of disaster relief – responding to the needs of populations that the Red Cross is unable or incapable of assisting. Given the Red Cross’ national presence and Congressional charter, what do you believe is the appropriate response of the Red Cross to such local charities that are providing disaster relief to families that the Red Cross is not in a position to provide relief? Under what circumstances will the Red Cross provide financial and material support to such local charities?

3) It is my understanding from press reports that the Red Cross received donations of \$568 million for tsunami recovery and has spent \$167.6 million. Please explain what the Red Cross plans to do with the remaining funds – specifically the purpose for which these funds will be spent; when the funds will be spent; and, finally, how these expenditures are in keeping with the Red Cross’ role and mission. My understanding is that the Red Cross has a 5-year plan for Tsunami relief – please explain (and give examples) how this is in keeping with past Red Cross practice as I understand of responding to only the immediate aftermath of an emergency or disaster.

4) Please state the amount raised from Katrina and also the purpose for which these funds will be spent; when the funds will be spent; and, finally, how these expenditures are in keeping with the Red Cross’ role and mission.

5) When you ask for funds for a specific purpose, how do you protect that designated account? Please provide a list of all your designated accounts – both fund balance and purpose. Do you use such designated funds for any other purpose? If so, please explain and provide details.

C. Compensation

1) Please provide copies of Ms. Evans’ employment contract, deferred compensation and severance plans and any other compensation arrangements, including expense reimbursements. Please provide a copy of Ms. Evans’ severance package or proposed severance package.

2) For the past three years for individuals listed in Part V of Form 990 "List of Officers, Directors, Trustees and Key Employees," and Part I "Compensation of the Five Highest Paid employees Other Than Officers, Directors and Trustees", please answer the following:

a. Explain how you established the amount of compensation and benefits.

b. Describe the nature of the components for each amount reported under compensation; contributions to employee benefit plans & deferred compensation; and, expense account and other allowances.

c. Describe the duties and responsibilities that each individual performed for the Red Cross.

d. Do the amounts reported represent the total economic benefits each individual received from the Red Cross for the year? If no, please explain what other benefits were received, including the fair market value of those benefits.

e. Did the Red Cross establish the rebuttable presumption under section 53.4958-6 of the Foundation and Similar Excise Taxes Treasury Regulations as to the compensation and

benefits reported for any of the individuals? If yes, please provide copies of all supporting documentation.

f. If the answer is no to "e" for any of the individuals, do you have documentation supporting the reasonableness of the compensation and benefits reported? If yes, please provide a copy of this documentation.

g. Did the Red Cross board approve the amount of compensation and benefits reported? If yes, please provide a copy of the approval for each individual.

h. Did the Red Cross have an employment contract or any other compensatory agreement with any of the individuals? If yes, please provide a copy of the contract or agreement.

i. Does the amount of compensation and benefits reported agree with the amount reported on each individual's Form W-2 or Form 1099? If no, please explain the difference.

j. Did any of these individuals use any property that the Red Cross owned or leased (such as an automobile, aircraft, real estate, credit card, etc.) for any purpose other than to further the organization's exempt purposes? If yes, did the Red Cross include the value of this usage in the amount of compensation and benefits reported? Was the value included on the individual's Form W-2 or Form 1099? If your answer to either of these questions is "No" please explain.

3) Please provide copies of all correspondence between the Red Cross or its chapters and the IRS for the last three years.

D. Internal Revenue Service Filings

1) Please provide a copy of the Red Cross' most recent 990.

2) Your Form 990 2003 indicates \$60 million in government grants. Please provide a detailed list of all grants and contracts (including reimbursement contracts) that the Red Cross has received from the Federal, state and local government since July 1, 2003. Specifically, the amount, the purpose of the funds and who granted/awarded the funds.

3) Please provide copies of Form 990-Ts for the last five years.

4) Part IX lists Pathogen Removal and Diagnostic Technologies. Please provide a detailed discussion of this entity, a copy of all organizing documents, and tax returns for the last five years. For the last five years has any Red Cross employee, board member, etc. receive any compensation from this organization?

5) The 2003 Form 990 includes Form 5471 – Information Return of U.S. Persons with Respect to Certain Foreign Corporations. It lists holdings with Boardman Indemnity, LTD based in Bermuda. Please explain why the Red Cross made this decision and please provide copies of all letters, analysis and memos that discuss this decision, particularly to house this wholly owned insurance subsidiary in Bermuda. In addition, does this company provide services only to Red Cross and its affiliates.

6) Please provide for the last three years the amount of money that the Red Cross spends on government relations and public relations. Please provide copies of all contracts that the Red Cross has entered into for public relations.

Thank you for your time and assistance. Please provide the answers to these questions by January 30, 2006.

Cordially yours,

Charles E. Grassley
Chairman

cc: Senator Baucus
Senator Lott
Chairman Thomas
Congressman McCrery
Congressman Thompson