

WISE GIVING™

GUIDE

BBB WISE GIVING ALLIANCE : SUMMER/FALL 2013



CROWDFUNDING for Charitable Causes





A Publication of the
BBB Wise Giving Alliance

The *Wise Giving Guide* is published three times a year to help donors make more informed giving decisions. This guide includes a compilation of the latest evaluation conclusions completed by the BBB Wise Giving Alliance.

If you would like to see a particular topic discussed in this guide, please email suggestions to give@council.bbb.org or write to us at the address below.

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president's MESSAGE

Increasingly technology impacts our lives, particularly in how we communicate with each other. On a personal level, my children are more likely to respond to a text message than a phone call. Also, a growing number of physicians are sending patient medication orders directly to the pharmacy via secured email. Say goodbye to prescription pads and your doctor's indecipherable handwriting.

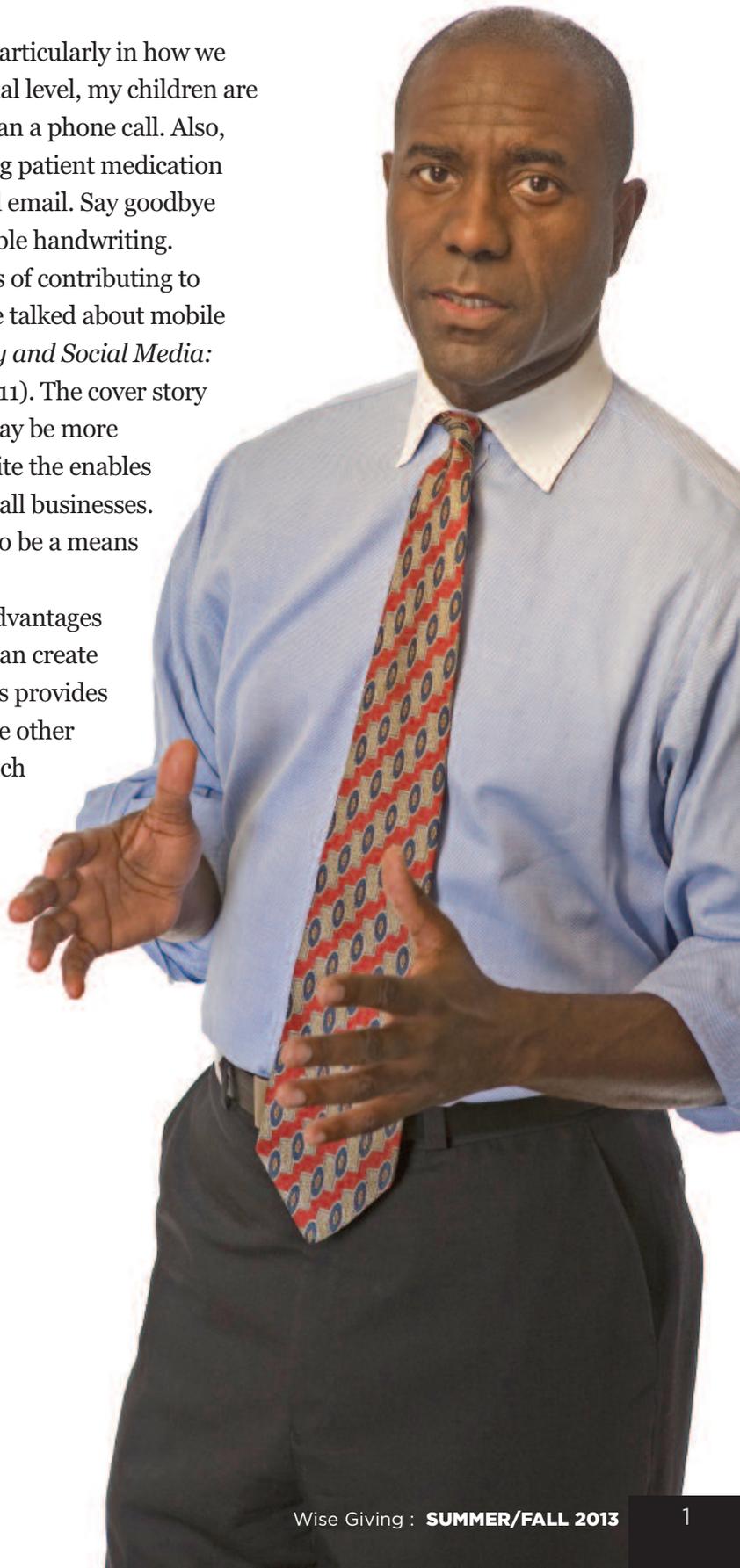
So, it should come as no surprise that new ways of contributing to charitable causes are also gaining in popularity. We talked about mobile giving and social media in a previous issue (*Charity and Social Media: Finding What Fits*. Wise Giving Guide: Holiday 2011). The cover story of this issue is about crowdfunding. Some of you may be more familiar with the business use of this term—a website that enables you to help individuals raise capital for start-up small businesses. As you will read in this issue, crowdfunding can also be a means to give to charity.

One aspect of crowdfunding that brings both advantages and challenges is the relative ease with which one can create a fund raising campaign. During an emergency, this provides a way to give immediate financial assistance. On the other hand, speed and ease also can limit the ability of such websites to adequately vet fund raising appeals.

BBB Wise Giving Alliance believes that each type of fund raising can open up opportunities for those who seek to take advantage of American generosity. We hope the article's advice about how best to use crowdfunding will help you avoid potential problems and enable you to make more informed judgments about this giving alternative.



H. Art Taylor, *President*



CROWDFUNDING for Charitable Causes

Beginnings

It started with rock and roll fans. In 1997, devotees of the British rock band Marillion raised \$60,000 on the Internet to provide funds for a reunion tour in the United States. This collection of small gifts from a large group of individuals to support a project, person or organization began the now popular fund raising activity known today as “crowdfunding.” After the successful efforts of Marillion’s supporters, others helped move the crowdfunding concept along in their own way. Within a few years, activities were spreading in a number of directions including both for-profit and charitable objectives.

In April 2000, a New York City high school history teacher created a website where teachers can post specific classroom project needs. Donations in any amount were accepted. The initial offering had just 10 posted items. Since then, DonorsChoose.org has cumulatively raised over \$185 million and funded 367,000 school projects (field trips, art supplies, books, etc.) for all school grades.

How did crowdfunding grow in popularity as a charity fund raising alternative? What are the tax deductibility implications? And, how can donors avoid questionable crowdfunding campaigns?

Two years later, the GlobalGiving Foundation began a website that enabled donors to fund grassroots projects and organizations around the world that are working to address a variety of needs such as education, housing and job skills. The GlobalGiving website states, in part, that it *“enables you to fund the underdog. [GlobalGiving] give[s] access to new sources of funds to creative ideas and projects that might never be funded through traditional structures...and philanthropy*

approaches.” To date, they helped raise \$89 million for over 8,000 projects.

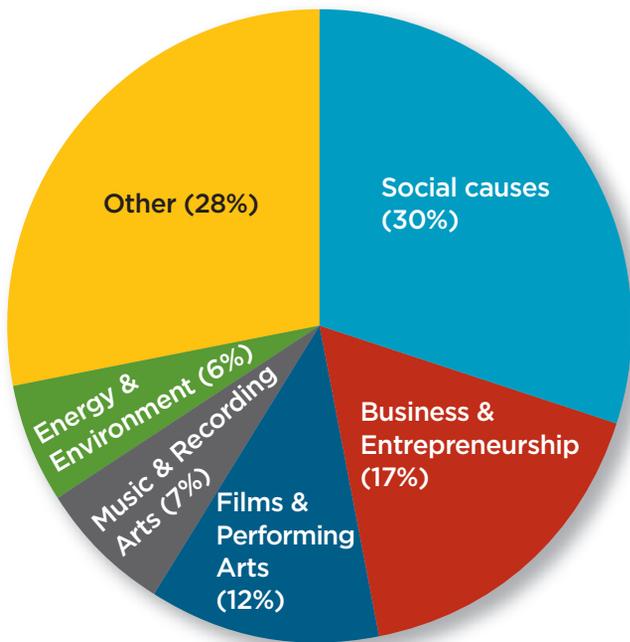
According to the website ArtistShare.org, it *“...created the Internet’s first fan funding platform for artists, launching its initial project in October 2003.”* In exchange for funding musical works, such as producing a CD for a jazz artist, funders are promised rewards such as copies of the recording, recognition on the jacket cover, and/or personal updates from the artist.

Crowdfunding evolved and grew over the past decade with new platforms coming into existence such as: Indiegogo (2008), GiveForward (2008), FundRazr (2008), KickStarter (2009), Crowdrise (2009) and GoFundMe (2010). While some platforms have consistently focused on a specific objective, others have morphed to diversify. Indiegogo, for example initially channeled funds for independent film projects and later expanded to fund “anyone, anywhere, to raise money for anything.” Others continue to be focused on a specific objective such as “fundraising online to help with medical bills (GiveForward). Balancing an inclusive approach with the need to direct assistance in a targeted way, the KickStarter platform states it provides a place to raise funds for projects involving *“art, comics, dance, design, fashion, film, food, games, music, photography, publishing, technology and theater”* but does *not* allow charity, cause, or “fund my life” projects. For purposes of this overview, this article will focus on crowdfunding for charitable activities and attempt to explain: How does it work? How did crowdfunding grow in popularity as a charity fund raising alternative? What are the tax deductibility implications? And, how can donors avoid questionable crowdfunding campaigns?

Referencing the right “crowd”

You know this subject has hit the mainstream because similar terms are emerging that include the word “crowd” but refer to different circumstances. Here is quick fix on some of the main players:

- **Crowdsourcing** involves soliciting ideas, services or contributions from an online population. This term has been attributed to a June 2006 article by Jeff Howe in



Most Active Crowdfunding Categories of 2012

Source: Massolution.com, 2013CF — *The Crowdfunding Industry Report*

Wired magazine, “The Rise of Crowdsourcing.” The subheading explained it: “Remember outsourcing? Sending jobs to India and China is so 2003. The new pool of cheap labor: everyday people using their spare cycles to create content, solve problems, even do corporate R&D.” The example cited in that article to illustrate the use of cheap service provision online was a website that offers stock photographs on just about any subject at very inexpensive prices. The photos are provided by a large pool of photographers who sign up with the site to sell their wares. Going to a professional photographer might cost a few hundred dollars, but

stock photo websites might offer you a shot for a few bucks.

- Apparently, **crowdfunding** is a subset of the online crowdsourcing universe that involves collecting money to help start a business, fund a charity, or provide financial assistance to a person in need (such as a disaster victim.)
- And now comes: **crowdvoting**. As described on the idealware.org website, crowdvoting involves seeking out the opinions or feedback of the online community so as to “increase awareness of [a] cause and draw in new audiences for [the] message.” A cited example involved a museum that called for people to submit photographs for an on-line contest. Photos were placed online and the most popular ones were later featured in an exhibit.

Growth

From its musical beginnings in 1997, crowdfunding has grown exponentially. According to *Massolution.com* which produces a *Crowdfunding Industry Report*, in 2010 there were 283 crowdfunding platforms worldwide that cumulatively raised \$1.5 billion. Two years later, there were 536 platforms raising funds for over 1 million projects and campaigns that generated \$2.7 billion worldwide. The cumulative total for 2013 is predicted to reach \$5 billion.

The *Industry Report* also indicates which categories of projects dominated the crowdfunding spaces. (See pie chart.) Although these stats show a mix of business and charity focused activities, the category “social causes” was the top type of crowdfunding projects.



A July 2013 article in the *Washington Post* stated that the crowdfunding site KickStarter raised more arts funding than the National Endowment for the Arts (NEA), “...people have been saying that KickStarter funds more art-related projects than the NEA. And it’s true! For 2012, the NEA had a total federal appropriation of \$146 million, of which 80 percent went towards grants. Kickstarter funded roughly \$323.6 million of art-related projects if you include all design and video-related projects, which make up \$200 million of the total.” (Boyle, Katherine. “Yes, Kickstarter raises more money for artists than the NEA. Here’s why that’s not really surprising” *Washington Post* 7 Jul. 2013)

Universities are also beginning to look at crowdfunding opportunities. *USA Today* reports that “...several university crowdfunding initiatives, featuring faculty and student-led projects, have been

institutions who would have a difficult time receiving funds from big granting agencies.” (Ingeno, Lauren. “Academic researchers using crowdfunding platforms.” *InsideHigherEd.com* 6 Jun. 2013)

In its first year of operation starting in August 2008, GiveForward raised about \$225,000 for various medical-related needs. Five years later, the cumulative amount raised by this crowdfunding platform was over \$57 million. As stated on its website, projects funded include general medical expenses, cancer treatment, transplants, funeral costs and disaster relief.

In the past year, crowdfunding received significant attention for channeling funds to the victims of Hurricane Sandy and the horrible shootings at a Newtown, Connecticut, school. Similarly, crowdfunding for the victims of the April 15, 2013 Boston Marathon bombing responded quickly. Within ten days various crowdfunding projects had collected over \$2.5 million for the victims of this tragedy.

How does crowdfunding work?

Crowdfunding platforms differ in how they are administered but there are some elements that are common to most sites. The following features cover projects that seek to help charitable causes or to help individuals. Projects intended to help start a business can trigger government regulatory requirements in some circumstances and are not covered in this article. In reviewing the following descriptions, do not assume that all platforms will operate as shown in these examples.

1. Restrictions on types of projects

As mentioned earlier, there are platforms that have a theme like musical projects or medical needs while others will permit funding to be sought for just about anything. Here are some actual examples of crowdfunding projects sponsored by individuals:

- Help a person in need buy a car in Los Angeles.
- Fund a trip to Taiwan so a woman can teach English for two years.
- Assist a homeless vet seeking an apartment.
- Help fund someone’s funeral.

The examples cited above are quite diverse in terms of the subject of the specified need or project. While many projects on crowdfunding websites are not affiliated with any charitable organization, some

implemented across the nation within the past year. The University of Virginia in Charlottesville, Va., launched its first crowdfunding site [in May 2013] in a six-month pilot initiative.” (Craven, Julia. “Universities explore crowdfunding, social media to raise money.” *USA Today* 23 May 2013)

Young academic researchers also are joining the crowdfunding club. As reported in *InsideHigherEd.com* News, a crowd-funding site known as iAMScientist seeks “...to help young researchers from less-prestigious



are connected to charities and will specify this in either the title and/or the project description. Here are some examples:

- *The [ABC]...Rehabilitation Society is...in the process of acquiring a property to house up to 30 homeless and near-homeless women suffering from alcoholism and addiction. This house requires renovation and improvements so that we can adequately meet our clients' needs.*
- *[MNO] aims to help hundreds of students like [John] find work by teaching English...the school is often without electricity.... A generator will...allow the school to expand.*
- *Please help the [XYZ] Little League, 2013...Regional Champions, with expenses incurred during their exciting, once in a lifetime, journey to the Little League World Series!*

2. The presentation

The individual or organization raising money posts a photo along with a description of why visitors should fund their project or need. Usually detailed background is provided. Crowdfunding sites also encourage the posting of videos featuring the individual and/or organization receiving funds. Platforms usually require that someone seeking to start a campaign have both a Facebook and PayPal account.

3. Target goals

Crowdfunding sites usually ask participants to set a goal of how much money they seek to raise. The fund goals vary from a few hundred dollars to \$10,000 or

more. While one may encounter a large six figure target, this is uncommon. Crowdfunding industry statistics report an average of \$7,000 raised for successful projects involving either individual, charity or business goals (i.e., those that reached or exceeded their target goal). According to several web news reports, the largest crowdfunding amount raised to date is \$15 million for the development of a science fiction video game (Star Citizen) which is still collecting funds as of August 5, 2013. While this project clearly has a business objective, the amount raised demonstrates the financial potential for large charitable activity under the right circumstances.

4. Time limits

Many crowdfunding sites provide an option to limit the campaign length from 1 to 60 days. If a campaign participant selects the time limit option, the funds will usually only be made available once the target amount is reached by that date. If the target amount is not reached, some sites will automatically refund the donations to the supporters. Other platforms may give supporters the option of applying funds to an alternative project. One of the advantages of a time limited campaign is that it may inspire visitors to make a gift decision sooner and/or to revisit the site to make an additional gift so that the project doesn't miss the target goal by the deadline.

Crowdfunding platforms help donors make an emotional connection to the cause by providing a collection of stories, many of them heartbreaking, creating a bridge between the donor and the individual requesting help.

5. Charges and fees

Crowdfunding platforms typically charge fundraisers anywhere from 4% to 20% of the total amount donated. Sometimes the credit card or PayPal processing fee (which can be around 3%) is not included in this amount and will also need to be added to calculate the total fee involved. Charges can also vary within an individual crowdfunding website. For example, if the

campaign is for a fixed amount and funds are only released if the target goal is reached, then the crowdfunding site may charge a lower fee. Donors should keep in mind, however, that the crowdfunding site with the lowest fees is not necessarily the most well managed. For example, some crowdfunding sites engage in significant vetting of the projects posted to ensure they will be carried out properly and fall within the intended objectives of the platform (for example, education or overseas development projects).

In Better Business Bureau experience, if there is motive and opportunity, fraud can occur no matter what the medium. Whether it is direct mail, telephone appeals, in-person solicitation, websites, emails and now crowdfunding, questionable activities can emerge.

6. Donating and perks

Donors can give as much as they want, \$1, \$5, \$17 or more. Although more common to business projects, some charitable projects may offer perks to donors such as periodic updates on the project, a postcard from the volunteer raising funds for an overseas trip, a t-shirt, and/or special donor recognition when the project is completed. Not all projects offer perks and they may be contingent on the size of the gift made.

Factors in crowdfunding's popularity

While there are many influences that led to the successful growth of crowdfunding platforms, there are three factors that we believe might have helped it along.

One is the ability for crowdfunding to provide immediate assistance. Crowdfunding platforms promote the fact that they provide the templates to enable a participant to set up a crowdfunding project quickly and easily. A fast response can be particularly helpful in gaining attention after a weather disaster or similar emergency event.

Successful fund raising is about stories — providing real world examples of how an individual is affected by a particular problem or issue. Crowdfunding platforms help donors make an emotional connection to the cause by providing a collection of stories, many of them heartbreaking, creating a bridge between the donor and the individual requesting help.

Third, crowdfunding helps provide donors with a sense of impact. They can watch as their contribution is added to increase funds toward the identified target. What is more, they have seen a picture of the individual or family being assisted and have read how the party intends to use collected funds. Charity impact is an area of increasing importance to donors, especially those in the younger generation who want to know more about the results of their generosity.

Can crowdfunding donors get a tax deduction?

For some donors, tax deductibility can be an important consideration. The following provides our views on this subject. Of course, we recommend consulting a tax accountant and/or lawyer for specific deductibility advice.

If a donor contributes to a charitable project that has been posted on a **crowdfunding website that is owned and managed by an organization with Internal Revenue Code section 501(c)(3) charitable tax-exempt status** (for example, GlobalGiving.org and DonorsChoose.org), that should signal a “green light.” That is, donations to the charity should be tax deductible as charitable gifts on your federal income tax return (minus the fair-market-value of any perks received, such as a thank-you teddy bear.)

If a donor contributes to a charitable project that has been posted on a **crowdfunding website that is owned and managed by a for-profit company**, we suggest turning on the “yellow caution light.” Here are two examples. The first may be deductible; the second one is not:

- A for-profit crowdfunding website has a project for disaster relief that is posted by an organization that has 501(c)(3) charitable tax-exempt status. The crowdfunding site has a relationship with a payment platform that will send your donation directly to the charity, and donors automatically receive receipts acknowledging their contributions, directly from the recipient charity. In this scenario, the donation may be deductible.
- A for-profit crowdfunding website lists a project to assist a bird sanctuary run by a conservation



organization. The credit card statement or PayPal confirmation identifies only the for-profit crowdfunding site, with no reference to the downstream recipient conservation project. In this instance, project donors will not be able to confirm that a charity received their contribution.

Without such substantiation of an actual charitable contribution, the payment will not be deductible.

A third scenario that should raise the “red stop light” is that there is little chance for donors to claim deductibility as a charitable gift. We’re referring to crowdfunding projects to help specific named individuals. For example, if an individual posted a crowdfunding project to fund a family reunion, pay for someone’s trip to visit mom on Mother’s Day, or buy a new bicycle for a cycling coach, those types of projects will not be deductible. **That conclusion holds even if someone is raising funds for a specific individual that has been impacted by a disaster or tragedy.** As stated in the April 2012 edition of IRS Publication 526 – *Charitable Contributions*, page 6:

“You cannot deduct contributions to specific individuals, including ...Contributions to individuals who are needy or worthy. You cannot deduct these contributions even if you make them to a qualified organization for the benefit of a specific person. But you can deduct a contribution to a qualified organization that helps needy or worthy individuals if you do not indicate that your contribution is for a specific person.”

Are crowdfunding gifts taxable income for recipients?

The short answer is a solid “maybe.” The below examples reflect our understanding of certain situations but, as in the previous section on deductibility, one should seek an accountant and/or lawyer for definitive guidance.

What if an individual is raising funds for someone in need such as a victim of a shooting incident? Will the individual owe taxes on the amount raised?

If an individual is raising funds for his/her medical needs as a result of a tragedy, it is likely that the crowdfunding amounts raised would not be taxable to

the individual, as long as the collected funds were **exclusively** used to pay the medical costs of the victim. The rationale for this is that the Gift Tax (see IRS Publication 950 – *Introduction to Estate and Gift Taxes*) has a medical and education exception for gifts received for those purposes. However, it would be wise for the individual to keep paperwork to substantiate how the funds were spent in case he/she is audited.

Suppose Jane Smith is upset about the devastation that a hurricane caused to her community and started a crowdfunding project to help victims. She raises \$10,000 and donates some of it to 501(c)(3) charitable groups involved in relief efforts. She also purchases store gift cards that she hands out to needy people. Is the total \$10,000 amount raised by Jane taxable to her? She can take a deduction on her individual income tax for the contributions she makes to 501(c)(3) charities but her handouts to individuals would not be deductible. It would be the equivalent of giving cash to a homeless person which is not deductible for an individual.

The lesson here is that an individual’s goodwill and the intent to help others won’t be sufficient to offset the potential tax liability from crowdfunding monies received. If a project organizer seeks to avoid this tax consequence, one could seek formal permission from a charity to raise funds on its behalf on a crowdfunding site and donate all of it to the charity.



Crowdfunding cautions and risks

In Better Business Bureau experience, if there is motive and opportunity, fraud can occur no matter what the medium. Whether it is direct mail, telephone appeals, in-person solicitation, websites, emails and now crowdfunding, questionable activities can emerge. While the vast majority of fund raising for charitable causes is honest and forthcoming about the intended use of collected funds, there will be some who seek to take advantage of American generosity.

The BBB in Cincinnati reported that in mid-2007 it encountered a crowdfunding website that marketed its ability to collect small donations for a big impact. The BBB asked the site to substantiate a number of claims including evidence that the projects selected by donors received the funds raised. The site's operators never substantiated the claims. Several years later the site ceased operations.

The Boston Marathon bombing suspect was found hiding in a boat when arrested. The boat was damaged by gunfire. More than one campaign was started to help the boat owner buy a new boat even though the owner had nothing to do with these campaigns.

In June 2013, a business start-up project on Kickstarter had raised \$120,000 for the production of "Kobe Red — 100% Japanese Red Kobe Beef Jerky." Kickstarter shut down the project shortly before the money was to be transferred to the developers after it was discovered to be a scam. While this circumstance involved an alleged start-up business and not a charitable cause, it did bring public attention to the reality that there are some crowdfunding projects that may not be legitimate.

So, how can an informed donor take measures to reduce the risk of getting taken in the crowdfunding environment? Here are some suggestions from the BBB Wise Giving Alliance.

1. Charities can be checked

Crowdfunding websites and projects produced by charitable organizations that have received 501(c)(3) tax-exempt status provide more opportunities for verification. One can visit the charity's website, confirm the charity's registration with state government

...crowdfunding provides benefits to charities beyond the donations raised. These benefits include the potential to: receive increased media coverage, engage current supporters and attract new ones, get corporate attention and sponsorship, and measure public interest in the advertised cause.

agencies, review the charity's financial statements and, of course, go to third-party monitoring organizations such as the BBB Wise Giving Alliance for information on national charities and the Better Business Bureau serving your community to find out about local charities.

2. Give to individuals you know

Charity-themed projects posted by individuals provide more of a challenge in verification. Crowdfunding sites state they help provide some degree of vetting by requiring a Facebook page, PayPal account, and photo if someone seeks to launch a project. However, those gatekeeper requirements alone will not prevent all fraud from taking place. In fairness, sites usually indicate that other measures are taken to keep crowdfunding safe. For example, one site requires participants to receive advice from a fund raising coach who will report suspicious behavior. The specific measures will vary from site to site. Bottom line, it is safest to give to those individuals you personally know who are contacting you to support their specific project.

3. Projects that share updates provide greater transparency

If a project is providing periodic updates of its progress, expenditures and accomplishments, this provides greater assurance that the individual or organization is seeking to responsibly use collected funds.

4. Don't assume your donation is deductible

If you are funding a project that is run by an individual instead of a charity, the funding you provide may not be deductible as a charitable gift for federal income tax purposes. See previous section about tax deductibility.

5. Be especially careful after a disaster or tragedy

Con artists will strike while the emotional iron is hot. As a result, the donating public needs to be especially on guard when reacting to headlines featuring hardship and injuries that disasters and tragedies bring. What's the plan? How are they going to carry it out? What is their connection to the event (are they a victim's relative, friend, neighbor, etc.)? Organizations raising funds should get permission from the families to use either the names of the victims and/or any photographs of them. Some fund raising activities for the victims of the shootings in the Colorado movie theater and in the Newtown, Connecticut school did not do this and were the subject of criticism from victims' families.

6. Read the fine print

Crowdfunding sites will vary in terms of their privacy

policies, under what conditions donations will be refunded if at all, and whether the donor or the project organizer will be charged for site administrative costs and credit card fees.

7. Specialized crowdfunding sites may be more adept

If a crowdfunding site specializes in a particular kind of crowdfunding activity such as medical funding, school projects, overseas development projects, etc., there is a greater likelihood that they will have the experience to spot problems as they emerge. A site that allows any type of crowdfunding activity may result in more challenging oversight hurdles.

Fake or real stories?

As noted earlier, stories of individuals in need provide an emotional connection in crowdfunding and help generate sympathy and donations. But how do you, as a potential donor, know these stories are true? Confirming the veracity of online individual stories can be hard, especially given the volume of stories appearing on crowdfunding platforms today.

Fake claims of suffering from an illness have occurred in various communities across the country. Although the following two examples do not involve crowdfunding, they demonstrate that fundraising deception can occur.

- In 2011, a Virginia woman was accused of fabricating a story that she had cancer and needed help paying bills. Allegedly, she lied to supporters for years. On April 22, 2013, she pled guilty to raising money under false pretense. (Hanover County, Virginia Court Case Number CR12000710-00.)
- On June 6, 2013, the United States Attorney's Office, District of Connecticut, announced that a New York woman pled guilty to engaging in a fraudulent fund raising scheme raising money via Facebook, PayPal, and other means for a funeral fund. She falsely claimed that she was an aunt of one of the 20 children killed in the Sandy Hook Elementary School attack in Newtown.

In addition, questionable crowdfunding projects may be promoted on social networking sites such as Facebook and Twitter. By sharing this information, some people may help spread the word about the project — resulting in a false perception of trust since the distributor is a familiar source.

Even if a story on a crowdfunding or social networking site is absolutely true, ensuring that the collected funds will be used for their intended purpose can be difficult.

One helpful measure would be for the crowdfunding project organizer to direct collected funds to a bank account managed by a third-party. The fund manager could be a CPA, lawyer, or bank executive, as opposed to a family member or related party. Then, when bills for medical treatment or other advertised needs are sent to the family, the third party can facilitate adequate payment allocation. This provides assurance for contributors and is a good way to provide written evidence, in case the family is audited by the IRS, about how these gifts were used.

Future of crowdfunding and charities

One crowdfunding site states that its founders were disappointed that the only way to raise money online was if you were a nonprofit organization so they wanted to create a site where anyone can raise money for anything. This suggests that the motivation for some is to help people work outside organized philanthropy to address needs and community concerns. Of course, that is not the case for all crowdfunding since some platforms are run by charities. This does suggest, however, that there may be competing interests at work that could impact how crowdfunding will develop.

Salvador Briggman, who writes a blog on CrowdCrux.com that provides advice and assistance on crowdfunding campaigns, pointed out in his March 18, 2013 posting that crowdfunding provides benefits to charities beyond the donations raised. These benefits include the potential to: receive increased media coverage, engage current supporters and attract new ones, get corporate attention and sponsorship, and measure public interest in the advertised cause.

No matter what direction or emphasis emerges, there will always be a need to ensure these activities are carried out with transparency and accountability. Many crowdfunding sites emphasize the ability to set up a project in less than a minute and say contributions are safe and secure. Encryption technology can help protect contribution transactions but they don't provide verification that funds will be spent as described. Through audited financial statements, the IRS Form 990, government regulatory efforts, voluntary standards, and other activities, measures have been developed to help protect donors who contribute to organized philanthropy. If crowdfunding is to evolve further, accountability will also need to grow to maintain donor confidence and trust. ■

This cover story was written by BBB WGA staff. Special thanks to Kevin Romero, a 2013 BBB WGA intern, who conducted research for this issue.