Self-Auditing—A Futile Endeavor or a Credible Safeguard against Scandal for New York Nonprofits?

By Sarah S. Miller

After several financial improprieties were exposed at national and New York-based nonprofit organizations, New York Attorney General Elliot Spitzer encouraged legislation mandating that nonprofit organizations establish audit committees. It is the expectation that the audit committees would act as a self-monitoring mechanism and deter any potentially inappropriate financial transactions from taking place that could violate the integrity of the organizations.

Recent events such as the Statue of Liberty Foundation paying its executives excessive amounts of money while the Statue of Liberty remained unopened and the unethical financial transactions by the former leader of the United Way of the National Capital Area added to the public's faltering confidence in nonprofit accounting procedures. The exorbitant compensation given to Richard Grasso, the former chief executive officer of the New York Stock Exchange, a registered nonprofit organization, was the latest transaction that spurred the New York state Attorney General to propose new mandates in auditing procedures for nonprofits. The proposed changes were brought to the chairs of the Corporations, Authorities, and Commissions Committee in both the New York State Senate and Assembly. The chair of the committee in the Senate, Vincent L. Leibell III, and the chair of the committee in the Assembly, Richard L. Brodsky, sponsored the attorney general's proposed bill, SR 4836.

SR 4836 would require nonprofit corporations with at least $3 million in assets or those that receive more than $1 million in annual revenue to create an audit committee. The president or chief executive officer, and the treasurer or chief financial officer, would have to sign the annual report and verify the financial information presented. The legislation, as it stands, is for the most part positive, but its effectiveness and enforceability remain uncertain should the bill pass the New York Legislature and become law.

The proposed legislation places increased responsibility on nonprofit board members to be knowledgeable about the organization's financial transactions and controls. In particular, the members chosen for the audit committee need to be aware of an organization's staff compensation, paid professional services and other financial matters. Such requirements appear to be good, basic board practices that should already be in place.

But all too often, boards are unaware of their organization's financial situation and transactions. Members may serve on a board because they feel the organization's mission is worthwhile for the community, without paying attention to the board's internal activities that could potentially take away from that mission. A mandate for the establishment of an audit committee emphasizes the vital role board members can play in ensuring the longevity and good reputation of an organization through sound financial practices. Fiscal accountability is vital to a strong organization if it is to operate effectively and efficiently to meet its target goals. Strengthening the internal controls of the organization would strengthen the organization as a whole and instill confidence in the organization's charitable mission.

Other states have introduced legislation similar to SR4836, with varying requirements for nonprofit corporations. The proposed legislation in New York could benefit from incorporating some of those requirements, including rotating audit committee members every three to five years and barring chief executive officers and chief financial officers from serving on the committee. While chief executive officers and chief financial officers should approve audit committee reports, barring them from sitting on the committees would serve as a check and balance to prevent any inappropriate financial transactions from taking place at the executive level.

Some critics may argue that such legislation would place additional stress on nonprofit organizations that already have stretched resources and are held accountable to other standards. The establishment of audit committees, however, should not require any large additional outlay of resources. In addition, the pro-

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and feedback are needed before this process can move from discussion to action. Considering the remarkable diversity of the organizations in the nonprofit and philanthropic sectors, it is impossible for lawmakers to translate the wide-ranging needs, concerns and priorities of these organizations into policy with which everyone agrees. Most policy decisions—i.e., lawmaking and rulemaking—produce winners and losers.

Of course, it's not politically palatable for lawmakers to appear to be punishing nonprofits and foundations—especially in an election year. Most members of the media and public assume that these organizations are do-gooders, and imagine that the groups are run by individuals with halos on their heads and wings on their backs. Most of us who work within the sector know that these notions are simply untrue, and that tax status does not determine whether an organization is run and managed in an ethical and law-abiding manner. The easy thing for Congress to do at this point is to jump on the "self-regulation" bandwagon, which would make the leaders of the trade groups that represent the sector quite happy.

But it's not the right thing to do. The abuses in both nonprofits and foundations that caught the Senate's eye are real. More importantly, they violate the public's trust and, in some cases, state and federal laws. They've taken place because savvy people know that the ability of the Internal Revenue Service and state governments to regulate these organizations is laughable. Congress has effectively defunded the IRS's oversight function, and some state governments do not have enough funding to devote even one full-time employee to tax-exempt oversight.

Policymakers face a stark choice. They can continue to allow leaders of national, multimillion-dollar organizations to weaken efforts to strengthen government oversight of foundations and nonprofits. Or they can reassert the government's right and duty to police the nonprofit and philanthropic sectors and the sectors' control of trillions of tax-exempt, quasi-public dollars. It's not an exaggeration to say that the path taken will impact the lives of millions of the nation's most disadvantaged people and communities, as well as show just how responsible—or dysfunctional—Congress has become.

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posed legislation in New York is directed at nonprofit corporations of a certain size—those with at least $3 million in assets or that receive more than $1 million in annual revenue. In nonprofit organizations of that size, any additional outlay of time, energy or funds would be minimal compared with the potential benefits of establishing an audit committee. An audit committee would safeguard an organization from inappropriate financial transactions that could potentially hurt the integrity of the organization's mission and its fiscal health and sustainability.

If the proposed legislation is to be effective, it must also be enforceable. While the mandate alone should help to at least partially restore the public's confidence in New York's charitable sector, few nonprofit corporations may actually follow through with the new law if they believe it will not be enforced. It is highly possible that this will be the case, as the New York State Charities Bureau, like most state-level nonprofit regulatory agencies, is severely understaffed and lacking in resources comparable with the number of charitable corporations it is required to monitor. William Josephson, the assistant attorney general for oversight of charities in New York, operates on a shoestring budget and outdated resources.

If the attorney general's proposals regarding the financial accountability of nonprofit corporations are to be taken seriously, additional resources will be needed to bolster the efficacy of the Charities Bureau and instill public confidence in its watchdog capabilities.

Of course, the attorney general's recent actions to bring attention to nonprofit organizations' financial accounting practices may quickly dissipate if the legislation is not passed. As it currently stands, the legislation is still in the Corporations, Authorities, and Commissions Committee of both the New York State Senate and Assembly. It is unlikely, however, that the bill will move forward this year.

If the bill is to gain any momentum, it would most likely be at next year's general legislative session, where it would have to be reintroduced. Perhaps by that time, additional discussion among other charity watchdog groups and nonprofit corporations themselves can enhance the proposed legislation to ensure its efficacy in strengthening the integrity of nonprofit fiscal accountability and accounting practices in New York state.

Sarah S. Miller is an independent nonprofit consultant.