New York University Stern School of Business
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Not-for-Profit Organizations in Economic Uncertainty

February 2, 2010

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Seymour Jones (NYU) moderated a panel of experts from the not-for-profit organizations (NPO's) sector, legal and accounting professions, and academia to discuss key issues related to NPO's, and in particular the problems facing Boards of Directors and management in times of economic uncertainty and distress. Professor Jones asked the experts to share their views on how to survive and maintain their posture during economic downturns, recognizing that NPO's are particularly vulnerable in times of financial distress. He strongly believes that it is the duty of the Board of Directors, and not the government, that has the responsibility for monitoring and controlling executive compensation.

Mark Lilling provided participants with statistics underscoring the important role of the NPO industry. In 2008, NPO's had revenues of $94 billion, assets of $218 billion, and represented 9% of the workforce in the U.S. Similar to other industries, the Board and officers of NPO's must understand their fiduciary responsibilities, and the responsibility of ensuring that the mission of the organization is carried out. The Board must receive assurance that government auditing standards[1] and NYS attorney general requirements are being met. He discussed the difficulties of NPO's valuation of securities, especially those that are non-marketable and alternative investments.

Mark Lilling addressed new audit areas for Boards of Directors and officers to be alert for, including the audit requirements related to NPO pension plans. Deferred compensation and salary deferral plans for NPO's are regulated by IRS Section 403(b) and have the same attributes as the popular 401(k) Salary Reduction Plans for commercial entities. Audited financial statements for 401(k) plans with over 100 participants have always been required and now the comparable 403B plans will have to be audited for plans effective in 2010. Mr. Lilling urged all Boards which are responsible employees pensions to have their plans audited and for all NPO's to be audited annually.

Joel M. Levy (YAI, National Institute for People with Disabilities) stated that to survive and thrive, quick action is necessary. However, it is important not to panic, and hastily put into place cost-cutting measures that may erode customer service. The focus should be to keep on doing, and improving upon, what the organization does best. Protect the core and the infrastructure required to support it. Increase fund raising by investing resources to expand databases. Strategies employed by NPO's during difficult times have

[1] Applicable to organizations that receive grants from the government.

been finding none-cash solutions, including recruiting volunteers and goods and services from business entities. Contacting donors personally; inviting them to their facility; creating income-generating activities and town-hall style meetings that include and expand their donor base. Tough times can be a catalyst for finding new opportunities, improving internal operations, and increasing staff recognition and incentives. The Board must be both informed and involved in the planning process. Transparency and building trust should start within your organization, and will ultimately reflect upon your donors.

John Biggs'[2] (Executive in Residence NYU) prestigious career spans many decades in positions involving fiduciary responsibilities as CEO, chairman, board member and trustee in NPO's, for profits, and academic and research institutions. Mr. Biggs is a strong proponent of efficient "*spending rules*" that assure that endowments will be there for future generations. Washington University successfully implemented a *spending rule* that Mr. Biggs helped design. The university did not suffer severe cutbacks, nor were there reductions in faculty or programs during periods of economic distress. The goal set for endowment spending was to increase it every year by at least the rate of inflation. The rule provided for a spending corridor with boundaries set by average market values (maximum) and actual rates of return (minimum). Most states have adopted the UPMIFA[3] regulation that prohibits endowment spending when the market value is below the initial value. This Act is in keeping with the fundamental fiduciary responsibility of a trustee, which is to assure the future of the endowment.

Christine Petrovits (NYU) represented the academic sector. Her scholarly research provides evidence that in periods of economic stress there is significant pressure to cut spending on overhead. Her findings support a decision rule based on overall effectiveness rather than classification as program or administrative. The benefits of investing in a strong internal control system include lowering the costs of debt, audit fees, and fraud. There is a high correlation between effective internal controls and both public and governmental support. Findings also support expanding grants to include funds for core operating support. Professor Petrovits suggests that Watchdogs should replace efficiency ratios, which lead to fraudulent reporting, with information from IRS reports that require reporting fraud, and disclosures[4] of internal control required by the OMB.

Her suggestion of peer review was met with opposing views: Donor lists are a valuable proprietary resource. Additionally, audits of accounting internal controls, based on generally accepted standards, are sufficiently complex. Peer review of organizational structures that vary dramatically would not be effective.

Christopher J. Sues (Pryor Cashman LLP) discussed the contentious issue of executive compensation. In New York, if an independent Board approves a

[2] Former Chairman TIAA-CREF
[3] The Uniform Prudent Management of Institutional Funds Act has not yet been adopted by New York State.
[4] OMB Form 133 requires internal control disclosures pertaining to compliance requirements for Federal programs.

compensation package after having an expert independent comparability study performed, the compensation determination is considered valid subject to a rebuttable presumption (i.e., it is very difficult for the IRS or other parties to successfully challenge the determination). To avoid problems, he suggests that organizations implement and document comparability studies. Separately, the required disclosure of the percentage of union dues paid for compensation is being scrutinized, and he predicts that any current flagrant abuses will be curtailed.

Joel Schleifer (Perlman Schleifer & Perrone, CPA's) suggests expanding the annual audit required for government-grant programs to the entire organization. Audits protect the taxpayer, and increasing internal control will not only reduce audit fees, but also improve overall efficiency. Organizations should be aware that the government frowns on surplus. He also suggests brainstorming sessions and documentation thereof.

Miklos Vasarhelyi (Rutgers) is a strong proponent of passing legislation that requires audits of NPO's. The public should be made aware of the fact that the size of some NPO's is equivalent to a Fortune 50 company, and yet their governance is pathetic. Some Boards are comprised of cronies who receive no salary, have no time to spare, and simply show up for required meetings. There are far too many sham foundations. Procedures must be put into place to test if the organization is carrying out their mission efficiently. What percentage of donations is allocated to salaries? What percentage of donations finds its way to providing services? SOX for NPO's? An affirmative "yes"! Professor Vasarhelyi strongly believes it would make society work better.

In keeping with Professor Vasarhelyi's philosophy, Martha Garner (PWC) noted that the SEC is considering the regulation of tax-exempt bonds issued by NPO's. They argue that their strong inter-relationship with capital markets requires the same registration and disclosure as for profits.

"Tis better to give than to receive"—but charitable donations provide an opportunity to do both. A comment was made that NPO's should simply be called "tax-free" organizations. In response to what might be considered a cynical comment, it was noted that NPO's are in fact providing services that would otherwise have to be provided by the government at a much higher cost. The taxpayers and beneficiaries of charitable institutions are ultimately better off.

Professor Jones suggested that charitable organizations be wary of "image donations", as they are retractable by trustees in bankruptcy. Should donors go through a vetting process? Hindsight is always 20/20, and every huge scandal is followed by an aftermath of costly, non-optimal rules and regulations hastily enacted to appease the concerned public. In general, background checks would not only be costly, they would be futile[5]. The "*shades*" do not come off the perpetrators until the sun goes down.

[5] Some Boards have vetting procedures for extra-ordinary gifts.

The participants were deeply divided on the issue of government intervention in donor-sponsored programs. Everyone agreed that donors should receive reliable and transparent information to determine if their donations are being used efficiently and for the intended purpose. However, many believe that government has encroached on too many areas of our lives. Can the Board and the Trustees be trusted? Who should make this decision? The government? The donors? The jury is still out.