



## The New Face of Nonprofit Accountability

Accountability has been a popular buzzword in the nonprofit sector for much of the last decade, but headline-grabbing scandals and changes in the laws and regulations that govern not-for-profit organizations made 2003 a particularly important year. For many charities, understanding the new environment will make all the difference in 2004.

“*The New Face of Nonprofit Accountability – A Briefing for Funders, Board Members and Managers*” was presented on January 22, 2004 by Fiscal Management Associates, LLC (FMA)—a full-service financial management and consulting firm dedicated to supporting nonprofits—in partnership with U.S. Trust. The following is a summary of the information and guidance provided by Hilda H. Polanco, CPA, Managing Director and founder of FMA, at that event.

---

### Accountability: What, Why & Who Cares?

What does it mean to be ‘accountable’? A simple review of the thesaurus gives us the common synonyms ‘responsible’ or ‘answerable’, as well as some other synonyms that make us all a little less comfortable, such as ‘liable’ and ‘blamed’. While many organizations view accountability in terms of reducing the risk of being blamed for something bad, accountability is not simply about assigning blame. Being accountable also means being able to explain one’s actions, positive or negative. Viewed in this light, an accountable charity is one that:

- provides funders with a means to better understand how the money they donate is serving the community;
- allows board members to measure their organization’s effectiveness and convey it to others easily, and
- supports managers in their efforts to monitor performance and instill confidence in their organization.

As such, the steps an organization takes to improve its accountability measures can also help to enhance its management, increase donor confidence, improve board participation and raise its public profile. Generally speaking, accountability is achieved through:

- production of accurate and informative documents, especially financial statements;

- careful monitoring of performance by funders, board members, managers, regulators, watchdogs and the general public; and
- imposition of consequences for mismanagement, fraud and failure to further the organization’s mission.

### Who’s Watching Now: External Forces

A variety of organizations, government agencies and other groups now seek to hold board members and nonprofit managers accountable for the performance and management of their charity and its resources.

#### Charity “Watchdogs” & Reporting Agencies

Often nonprofits themselves, these organizations set guidelines or standards for charitable operations and provide the public with information on a charity’s performance against these standards.

The primary national watchdogs include:

- American Institute of Philanthropy  
[www.charitywatch.org](http://www.charitywatch.org)
- BBB Wise Giving Alliance  
[www.give.org](http://www.give.org)
- Charity Navigator  
[www.charitynavigator.org](http://www.charitynavigator.org)

The New York Philanthropic Advisory Service, a program of the Better Business Bureau serving metropolitan New York, also reviews

state charities. These reports can be accessed through [www.newyork.bbb.org](http://www.newyork.bbb.org).

Guidelines and standards set by these organizations include the following examples:

- Boards should have at least 5 members and meet at least 3 times a year.
- Program expenses should amount to at least 60% of total expenses.
- Fundraising expenses in a given year should not amount to an average of more than 35 cents of each dollar raised.
- Every organization should have an annual report.

Increasingly popular with the public and members of the media, it is a good idea for board members and managers to find out whether their organization has been evaluated by a watchdog organization. Not all of them notify the charities they cover. Funders also may find the information useful.

In addition to the rating agencies, **Guidestar** ([www.guidestar.org](http://www.guidestar.org)), is quickly becoming a major player in the provision of charity information. This website provides access to almost every organization's Form 990, the annual information return filed with the IRS. In addition to these tax forms, Guidestar provides easy-to-read supplemental information on each of the charities listed.

### **Regulators**

The Internal Revenue Service issues tax-exempt status to a not-for-profit organization, and continues to regulate the organization's activities.

In New York, the state regulatory agency is the Charities Bureau of the Attorney General of New York State, which serves as the registration office for charities located in or operating within New York State.

The Charities Bureau has the authority to investigate fraud and mismanagement, and to bring suit against organizations and their officers, directors and employees, if necessary. It also serves as the arbiter in questions of dissolution, use of funds and other issues.

For charities located or operating in New York State, the primary filing is NYS Form CHAR-497, which includes detailed information about fundraising contracts, and generally includes a copy of the organization's audited financial statements and IRS Form 990.

## **Enron and on and on and on ... Regulatory Ramifications of Fraud**

### **Sarbanes-Oxley**

In response to increased financial fraud in publicly owned companies, the Sarbanes-Oxley Act was signed into law to place greater responsibility on the members of corporate boards, increase the disclosures required, and establish guidelines for board structure.

While Sarbanes-Oxley deals primarily with for-profit, publicly held companies, some important provisions may be applied to nonprofit organizations as well: under the new law, it is a crime to alter, cover up, falsify, or destroy any document in order to prevent its use in an official proceeding.

Sarbanes-Oxley also provides protections for whistle-blowers, and criminal penalties for actions taken in retaliation against whistle-blowers.

### **Pending New York State Legislation**

In late January 2003, NYS Attorney General Eliot Spitzer proposed a version of the federal Sarbanes-Oxley law that would apply to New York's nonprofits. Modified after significant input by various industry groups, the current version contains a number of provisions about which funders, board members and managers should be aware:

#### **1. Board Structure**

The pending legislation would require charitable organizations to establish an independent and competent Audit Committee, unless the organization's by-laws prohibit the creation of such a committee.

Organizations with more than 25 board members would be required to appoint an Executive Committee, unless the

organization's by-laws prohibit such a committee.

## 2. *Disclosure & Assertions*

Related Party Transactions, also called "interested transactions", must now be disclosed and Interested Directors are required to proactively establish that they acted in good faith and in the organization's best interest. Any compensation of directors and officers by affiliates must be disclosed. Under the new law, the Attorney General has the right to challenge transactions, even if the board has approved them after full disclosure.

Organizations with revenues in excess of \$1 million or assets in excess of \$3 million are required to provide more extensive certifications regarding the accuracy of financial data. The executive director and chief financial officer can make such certifications.

## 3. *Indemnifications*

The pending legislation would limit the nature and type of indemnifications a nonprofit may provide to members of its board.

The pending law may be adopted in all or part as currently presented. Once passed, regulations codifying the requirements of the law and reconciling various other applicable laws governing nonprofit operations within the state will be issued. In other words all that is written here may change!

### **Recommendations**

In light of Sarbanes-Oxley and the pending state legislation, and simply as best practice, charities would be wise to adopt the following practices:

If you have a Finance/Audit Committee, it should:

- Ensure compliance with federal, state, and other reporting requirements.
- Select audit firm, receive results of audit, review resulting report, and discuss

suggestions for improvement in internal controls.

- Ensure accurate and timely financial information is presented to and understood by the board as a whole.
- Direct and monitor investment performance.
- Review activities to identify threats to tax-exempt status.

### **Newly Introduced Audit Guidelines**

Also in response to private sector fraud and the widespread perception of auditor complicity, the Financial Accounting Standards Board issued *Statement on Auditing Standards No. 99*, or SAS 99, which provides auditors with guidance on the "Consideration of Fraud in a Financial Statement."

As a result, many charities will see a difference in the way their annual audit is conducted. SAS 99 requires auditors to:

- Approach audits with professional skepticism and not assume honesty on the part of management.
- Inquire as to risk of fraud, or existence of fraud.
- Design tests for fraud in unexpected areas, locations and accounts.
- Use procedures to test for management override of controls that could lead to financial statement fraud.

SAS 99's provisions and procedures are effective for audit periods beginning on or after December 15, 2002.

### **Compliance Audits of Federal Funds**

Similarly, the requirements for those organizations receiving substantial federal funds have been modified to provide greater protection against fraud. In particular, those nonprofits subject to an OMB Circular A-133 audit should be aware of the changes contained in the recently released *Supplement to OMB Circular A-133*.

As of January 1, 2004, the Supplement requires that organizations:

- have a process for the recruiting, hiring, continuous development, and evaluation of staff, and
- prepare documentation to demonstrate compliance with policies and procedures for its systems of quality control.

Controversially, the Supplement also expands the definition of performance audits to include objectives of effectiveness, economy and efficiency.

On a compensating perspective, the Supplement does increase the income thresholds for agencies subject to an OMB A-133 audit from \$300,000 to \$500,000.

### What's A Charity To Do?

The widespread impact of corporate fraud—from which the nonprofit sector has not been immune—has created a heightened regulatory environment and led to greater public scrutiny of charities. These shifts, however, need not be viewed only in a negative light.

Media and regulatory attention has brought the independent sector to the forefront,

creating a greater awareness of the role nonprofits play in our society and educating people about their operations.

By requiring increased accountability measures, funders are creating new evaluation criteria to support grant-making decisions, as well as an opportunity to effect change in nonprofit organizations.

By adopting a policy of fiscal “transparency” and improving accountability measures, board members and managers have an opportunity to differentiate their organization in the eyes of potential funders and donors and to attract dedicated and participatory board members, volunteers, and staff. ■

*For more information on accountability issues and the steps your nonprofit can take to protect itself from fraud and/or reputational risk, please contact:*

*Hilda H. Polanco, CPA, Managing Director  
212.931.9240 or hpolanco@fmaonline.net  
or*

*Terence Cook, MPA, Manager, Client Services  
212.931.9134 or tcook@fmaonline.net*

“The New Face of Accountability – A Briefing for Funders, Board Members and Managers” was created by Hilda H. Polanco, CPA, Managing Director and Jennifer Ahern Lammers, Strategy Consultant and Lead Trainer, Fiscal Management Associates, LLC.

© 2004 Fiscal Management Associates, LLC. All rights reserved.



## Accountability Check List

### Board Structure

- The Board has at least 5 members
- The Board meets at least 3 times a year
- The duties of the Board and its committees are clearly defined in the organization's by-laws
- Does the Board have an executive committee? \_\_\_\_ Is one needed? \_\_\_\_
- Does the Board have an audit committee? \_\_\_\_ Is one needed? \_\_\_\_

### Basic Documentation

#### *Annual Report:*

- The organization has an annual report

The annual report contains the following information:

- Organization's mission statement,
- Summary of the past year's program service accomplishments,
- Roster of the officers and members of the board of directors,
- Financial information that includes:
  - (i) total income in the past fiscal year
  - (ii) expenses in the same program, fund raising and administrative categories as in the financial statements,
  - (iii) ending net assets.(BBB Wise Giving Alliance, Standard for Charitable Accountability)
- The annual report is made available to anyone requesting information on the organization

#### *Audited Financial Statements:*

- The organization has audited financial statements for the most recently completed fiscal year
- The Auditor's Opinion, attached to the audit, indicates that the statements present fairly, in all material respects, the financial condition of the organization
- Board members are provided with a copy of the audited statements and an opportunity to ask questions of both the auditor and fiscal staff
- Copies of the audited financial statement are provided to anyone requesting information on the organization

#### *IRS Form 990*

- The IRS Form 990 is completed correctly, either by auditors or by fiscal staff, using appropriate software (i.e., this document is not completed by hand in pen or pencil)
- Board members are provided with a copy of IRS Form 990 and an opportunity to ask questions of both the auditor and fiscal staff
- Copies of IRS Form 990 are available for viewing at office and provided promptly to anyone requesting a copy—with Supplement B: Major Donors removed
- The IRS Form 990—with Supplement B: Major Donors removed—is available on the organization's website