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NONPROFITS: GENERAL INFORMATION

Nonprofits: More "What Not to Do"

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In *Nonprofits: What Not To Do* (July 13, 2021), we crafted a post loosely inspired by "What Not to Wear," the popular British TV series that debuted in 2000.

The BBC gambled on a risky premise: A clueless fashion criminal would be ambushed each week and confronted with her tragic wardrobe mistakes. The TV audience would hopefully identify with the bewilderment of the fashion-expert hosts: "What in the world was she thinking?" But if the perpetrator agreed to follow a long list of fashion don'ts, she would be rewarded with a lavish London shopping spree.

Our July 13th nonprofit-organization version of "what not to" do featured the "Case of the Careless Classified" and also mentioned the "Case of the Disappointed Donor" and two other hapless examples of "it seemed like a good idea at the time."

With the caveat already presented in the first post – namely, that "the stakes [of a mistake] are generally much higher" for the nonprofit community "than making unwise outfit selections" – we now present the second episode of our series.

The Case of the Problematic Perk

The issue of top-executive compensation at nonprofits is a tricky one, sometimes attracting criticism.

But there's no question that a major organization, particularly in a large urban area with a high cost of living, can and should pay compensation that is "'reasonable and not excessive,' but that also is attractive enough to retain the best possible talent to lead the organization." The total package can include "salary and benefits, such as insurance, a car, housing allowance, or other fringe benefits."

According to the New York Times's Robin Pogrebin, among the most coveted perks offered by "... leading premier cultural institutions, besides the substantial salaries, is the use of elegant apartments, which are often owned by arts organizations and passed from one top executive to the next." For instance, when the Metropolitan Museum of Art's director, Thomas Campbell, resigned in 2017, he was obliged to move out of the organization's $4-million Fifth Avenue co-op apartment.

Of course, each prospective top hire may have specific family needs that are not suited to a one-size-fits-all housing arrangement, however opulent. See *BAM Helped Buy Its Boss a New Home. She Left in Under Six Years.* (March 5, 2021).

The Brooklyn Academy of Music (BAM), a performing-arts venue, was founded over 150 years ago in 1861 but is "known as a center for progressive and avant-garde performance." In 2015, the board made a compensation decision to lure a new executive director that may have seemed like a "good idea at the time" but is now raising eyebrows and second-guessing.

Karen Brooks Hopkins was leaving after some 36 years of service to BAM including 16 years in the top job. By her final year, Ms. Hopkins made a total of $433,000 in compensation; there was never any housing allowance.

The person lured for the job was Katy Clark, who had previously been the director at Manhattan's Orchestra of St. Luke's, a smaller organization than BAM. At St. Luke's, Ms. Clark had successfully led a $50 million campaign in 2011 to build its new DiMenna Center for Classical Music, the "only acoustically-optimized rehearsal and recording space dedicated to classical music." Ms. Clark was earning about $200,000 at St. Luke's. She lived with her husband and two children in an apartment in the Washington Heights area of Manhattan.

But the Brooklyn Academy of Music wanted its top executive to live close to the venue. Ms. Clark was offered a starting salary of $355,000 along with an "unusual one-time housing bonus of $968,000." That was about half the cost "of a $1.9 million, three-bedroom prewar home overlooking Prospect Park" that Katy Clark and her husband purchased and enjoyed.

Fast forward to November 2020. Ms. Clark informed the board that, after fewer than six years at BAM, she had accepted a "lower-profile job at a foundation" in Brooklyn. There, she explained in a "release," she can "have a focused impact on work that is especially meaningful" to her, "notably in arts education and civic engagement."

Leaving in January 2021, "... the apartment has gone with her." This has led to "questions about the fiscal prudence of such an outlay to lure a leader whose tenure wound up being much shorter than her predecessor's." Apparently, in the flurry of dotting i's and crossing t's back in 2015, the Board of Directors of the Brooklyn Academy of Music had set no conditions at all on acceptance of the nearly $1-million housing bonus.

The chair of the University of Maryland's DeVos Institute of Arts Management, Michael M. Kaiser, "called the apartment arrangement unorthodox." Sometimes, according to Professor Kaiser, "...a board will loan an executive funds to purchase a home when they must move to a new city [but it's] highly unusual for these funds to be a signing bonus that the executive is allowed to keep."

This scrutiny has also arisen amidst the background of severe fiscal carnage due to the pandemic; BAM lost millions. It had to "cease live programming, lay off or furlough staff and dip into endowments."

And there was staff grumbling all along. "To be in an all-staff meeting where we were hearing so much about capital projects and how grateful Katy was to be able to walk to work was very disheartening," said a former education coordinator. "It made a lot of us question the austerity we saw in other parts of the institution."

Chief-executive compensation is one of the most important decisions for a nonprofit's board of directors which has a fiduciary duty to get it right in the first place. There's no do-over after an uncomfortable encounter with a three-way-mirror has the trustees wonder what in the world they were thinking back when the choice was made.

But there's no shortage of help and information available online; this is a topic generously covered by experts and the IRS. Start, for instance, here: *Executive Compensation,* National Council of Nonprofits; *CEO Compensation Packages for Nonprofit Boards* (September 30, 2020) Lena Eisenstein, *BoardEffect Blog*; Treasury Regulations, 26 C.F.R. section 53.4958-6, [Rebuttable presumption that a transaction is not an excess benefit transaction (re executive compensation)].

And call your lawyer. This is a big deal.

The Case of the Signature Shortcut

Several weeks ago, in *Social-Services Nonprofit: Pervasive Fraud Alleged* (August 4, 2021), we alerted you to the sorry circumstances of the San Diego affiliate of a respected 120-year-old national organization, Volunteers of America.

"At the beginning of May 2021, behind its facade as one of San Diego's most prominent and powerful social-services agencies, Volunteers of America Southwest (VOASW) was poised to crumble spectacularly under the weight of self-inflicted wounds." It was an unfolding tale of audacious fraud that was bound to be discovered sooner or later.

Not only did a few brave insiders uncover the mess and report it to superiors (only to be rewarded with retaliation), but County of San Diego auditors were hot on the trail in their investigations of several government contracts.

Amidst a mountain of evidence of whoppers of wrongdoing, there was also sloppiness discovered that could have been inadvertent or more likely was just another way of getting away with cheating the government.

One of the examples popped out of this mess as a candidate for inclusion in this second episode of "what not to do." Of course, the innocent and unintentional version of it fits best here.

Here it is: The diligent County auditors wrote it up as point (G) in the long list of problems. "As previously noted on our January 21, 2020 report," these officials explained, "it appears that both required signatures on a majority of the checks were pre-printed and/or stamped without evidence of a process or procedure for ensuring review for signatory authority occurred prior to stamp. This is a significant internal control weakness."

Even many of the smallest nonprofit organizations are aware that it's a good practice to have more than one individual control significant expenditures of money. So most groups – large, medium, or small – set up their finances so that payments larger than a set amount require the signatures of two people. We've written a lot on the topic over the past seven years. See, for instance, *Charities And Embezzlement* (August 9, 2016); *Charity Embezzlement: Thwart It With Good Controls* (November 17, 2016); and *Common Accounting Errors Of Small Nonprofits* (August 29, 2017).

"There is no 'one-size-fits-all' model for every entity; appropriate precautions depend on the size and the complexity of the organization and its financial management systems. But accounting and security experts generally suggest a number of steps that can be taken to prevent fraud and embezzlement or to detect it in progress."

Unfortunately, insider embezzlement and theft in charities is not rare, so effective controls need to be established *and* maintained. As a practical matter, the two people required for check signatures may not be readily available or present at the office when needed for real-time authorization.

So, it's not unreasonable to have some shortcuts for those circumstances. But if there are stamps or other "pre-printed" signatures or signature pages available, there must be a meticulous set of controls to ensure there is no opportunity for abuse or even carelessness.

Conclusion

There's no chance that any time soon we'll run out of interesting and instructive examples for this series of "what not to do" tips for nonprofits.

Stay tuned, for instance, for the Case of the Possible Pledge [big donors successfully threaten to revoke $50-million "verbal pledges" if the board doesn't reverse a decision].

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