An abstract graphic on the left side of the slide, consisting of several overlapping, curved, ribbon-like shapes in shades of blue, teal, and green, set against a light gray background that forms a large, downward-pointing arrow shape.

# Somebody's Watching Us: Considerations for Nonprofits Operating under Increased Government Scrutiny

Thursday, September 10, 2015, 12:30 – 2:00pm ET  
Venable LLP, Washington, DC

## **Moderator**

Jeffrey S. Tenenbaum, Esq., Partner and Chair of the Nonprofit  
Organizations Practice, Venable LLP

## **Speakers**

Eric S. Berman, Esq., Venable LLP  
Yael Fuchs, Esq., Assistant Attorney General, Charities Bureau,  
New York Attorney General's Office



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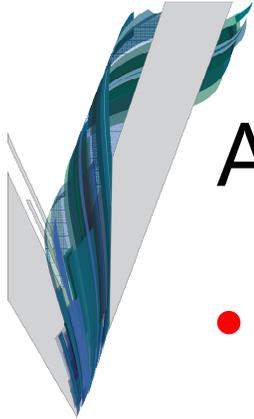
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# Upcoming Venable Nonprofit Events

Register Now

- **October 15, 2015** – [Thriving Amid Turmoil and Change: What All Nonprofits Can Learn from Nonprofit Turnarounds](#)
- **November 17, 2015** – [The DOL's Proposed Changes to the FLSA White-Collar Exemption Criteria: What Nonprofits Need to Know about the Current Rules, Where Things Are Heading, and How to Avoid Employee Classification Traps and Pitfalls](#)
- **December 10, 2015** – Privacy and Data Security: Best Practices, Common Pitfalls, and Hot Topics for Nonprofits (*details and registration available soon*)



# Agenda

- **A Regulator's Perspective:**
  - The Importance of Internal Controls
  - An Attorney General's Role in Nonprofit Oversight
  - Best Practices in the Face of an Investigation
  
- **An Outside Counsel's Perspective:**
  - Increased Scrutiny: the "New Normal"
  - Reducing Risk Before an Investigation
  - Navigating an Investigation (Redux)



Charities Bureau of the Office of  
New York Attorney General Eric T. Schneiderman,  
at  
*Somebody's Watching Us: Considerations for Nonprofits  
Operating under Increased Government Scrutiny*

Yael Fuchs, Assistant Attorney General\*  
Charities Bureau

\*All opinions expressed are individual. Nothing shall constitute NYAG endorsement of a particular practice. All expenses paid by NYAG.



A/k/a

The FitBit Effect:

Improving Behavior Through  
Effective Oversight

# AGs' Oversight Responsibilities

- In New York, regulation and support of New York's nonprofit sector –  
1.2 million employees, 80,000 registered organizations



New York State Attorney General  
Eric T. Schneiderman

***“OUR JOB AS A REGULATOR ISN’T  
JUST TO GO OUT AND CATCH BAD  
GUYS, IT’S ALSO TO HELP THE  
GOOD GUYS CONDUCT THEIR  
BUSINESS EFFICIENTLY AND  
EFFECTIVELY.”***



# Goals

- A better understanding of why internal controls are critical (and often mandatory)
- An overview of the AG's role in nonprofit oversight
- Best practices in the event of an investigation



# Internal Controls

Policies and procedures that protect the assets of an organization, create reliable financial reporting, promote compliance with laws and regulations, and achieve effective and efficient operations

Source: [http://www.charitiesnys.com/pdfs/Charities\\_Internal\\_Controls.pdf](http://www.charitiesnys.com/pdfs/Charities_Internal_Controls.pdf)



# Internal Control Failures

The Washington Post

Investigations

## Inside the hidden world of thefts, scams and phantom purchases at the nation's nonprofits

By Joe Stephens and Mary Pat Flaherty October 26, 2013

- Organizations reporting becoming aware of a "significant diversion of the organization's assets" (990, Part VI, I. 5)
- "Significant diversion" = 5% of total receipts or total assets over \$250,000
- More information expected in Schedule O



# Internal Control Failures

Schedule O excerpts from *Washington Post* database:

FORM 9 The Board of Directors is the oversight group for the Company. It consists of volunteers from various walks of life and includes no members with a financial background. The  
POOL D Board of Directors, we believe, was intended to meet at least once per month. For various  
CUSTOD reasons this did not always happen. The Board of Directors averaged approximately 8 meetings per year for 2007 and 2008. The minutes of the meetings contained no financial presentation at any meeting. The Board President explained to us that on occasions when

## Explanation

A PROGRAM MANAGER ISSUED CHECKS TOTALING APPROXIMATELY \$90,000 TO A FICTITIOUS SUBCONTRACTOR FOR ALLEGED HOME REPAIRS AND MOVING SERVICES FOR FAMILIES IN THE KINSHIP CAREGIVER PROGRAM

The agency experienced an extraordinary loss of \$161,113 resulting from a cyber-crime in which funds were diverted to



# NY AG Charities Bureau



# AG's Enforcement Function

- Preservation and recovery of charitable assets through public education, investigations, and legal actions
- Cases developed through:
  - Complaints
  - Referrals
  - News/media
  - Filing review
  - Data analysis



# Types of AG Enforcement Actions

- Informal contact
- Formal investigation
  
- Assurance of discontinuance
- Civil suit
- Criminal charges



# Fraudulent Solicitation

- Outliers, but decrease public confidence in the sector

## Red Flags:

1. Use of high-cost telemarketers as the primary source of fundraising, for an extended period of time. High fundraising costs are not fraudulent per se.
2. Sound-alike/"warm glow" charities.
3. Extensive use of joint cost allocation and/or gift in kind.



# Common Issues

- Reporting violations
  - Patterns of deficiencies
  - False reporting
- Related party transactions (self-dealing)
- Use of restricted funds
- Diversion of assets (embezzlement, waste, imprudent investment)

Common cause? Oversight failures.



# Importance of Governance

What is governance?

The establishment of policies (a/k/a internal controls), and the continuous monitoring of their proper implementation, by members of the governing body of an organization



# Codification of Compliance Regimes

- Federal Sentencing Guidelines for Organizations –  
Seven criteria for an “effective compliance program”

1. Standards and procedures to prevent and detect criminal conduct	5. Monitoring, auditing, and whistleblower systems
2. Oversight by high-level personnel	6. Consistent enforcement of compliance standards
3. Due care in delegating substantial discretionary authority	7. Appropriate response to criminal conduct and steps to prevent reoccurrence.
4. Effective communication and training for all levels of employees	



# Codification of Compliance Regimes: Highlights of the New York Nonprofit Revitalization Act

- Audit committees
- Related party transactions
- Conflict of interest policies
- Whistleblower policies



# When Bad Things Happen to Good Organizations

- Sometimes bad things happen in well-meaning organizations
  - Embezzlement, insolvency, data breach, public criticism
- Regulators' job to determine what happened, why did it happen, and **how are you going to fix it?**



# So You're Under Investigation...

## What will we ask?

### Backward-looking questions:

- Who is in charge of your compliance function?
- Compliance with your reporting obligations?
- Past complaints
- Public-facing representations
- Internal control policies
- Board engagement
- Senior management oversight and compensation



# So You're Under Investigation...

What will we ask?

Forward-looking questions:

- How are you addressing the problem?
- Appropriate response to whistleblowers
- Identify the nature and scope of the problem
- Isolate the bad behavior
- Get control of your accounts
- Take appropriate disciplinary/legal action
- New policies/procedures



# So You're Under Investigation...

## Additional considerations:

- Candor, transparency to donors, board, regulators
- Internal or external review?
- Document retention





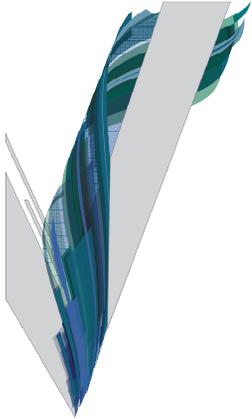
# Fundamentally...

What are you doing to preserve the value of the organization and continue its mission?



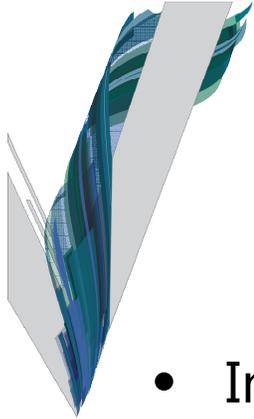
# Sources/suggested reading

- Charities Bureau website: [www.charitiesnys.com](http://www.charitiesnys.com)
- Charities Bureau guides:  
[http://www.charitiesnys.com/guides\\_advice\\_new.jsp](http://www.charitiesnys.com/guides_advice_new.jsp)
- *Tampa Bay Times*/CNN American's Worst Charities Project.  
<http://www.tampabay.com/topics/specials/worst-charities.page>
- *Washington Post* investigation:  
[http://www.washingtonpost.com/investigations/inside-the-hidden-world-of-thefts-scams-and-phantom-purchases-at-the-nations-nonprofits/2013/10/26/825a82ca-0c26-11e3-9941-6711ed662e71\\_story.html](http://www.washingtonpost.com/investigations/inside-the-hidden-world-of-thefts-scams-and-phantom-purchases-at-the-nations-nonprofits/2013/10/26/825a82ca-0c26-11e3-9941-6711ed662e71_story.html)
- Remarks of Hon. Patti B. Saris, Chair U.S. Sentencing Commission at the 12<sup>th</sup> Annual Compliance & Ethics Institute (2013).  
<http://www.ussc.gov/sites/default/files/pdf/training/organizational-guidelines/selected-articles/Steer-PLI-2003.pdf>



# **Conducting Nonprofit Operations under Increased Scrutiny**

Eric Berman  
Venable, LLP



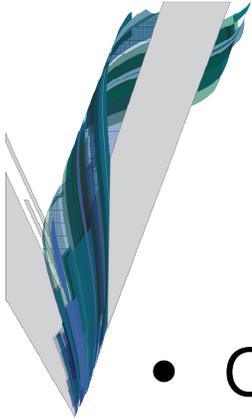
# A Recent Cautionary Tale

- In May 2015, federal and state regulators announced massive law enforcement action against several charities and their principals.
  - FTC, all 50 State AGs, D.C. AG, Eight Secretaries of State

“This is an historic moment -- the first time that the federal government and the state charity regulators have joined together to present a united front against charity fraud.”

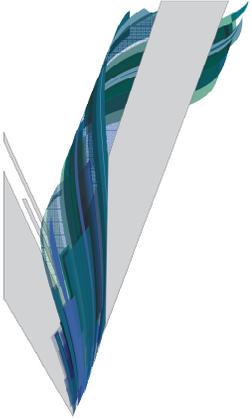
-FTC Bureau Director Jessica Rich



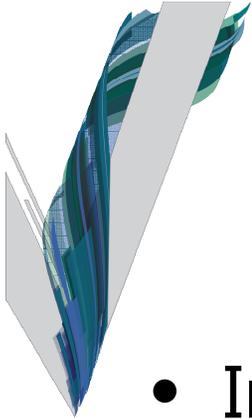


# Landscape Constantly Evolving

- Older view: state regulators stretched thin
  - “The infrastructure for monitoring the nonprofit sector is not robust relative to the size, diversity, and growing complexity of the field.” (*Nonprofit Quarterly*, Dec. 21, 2004)
- Modern view: look for increased coordination among state regulators and between states and feds
  - E.g., CFA litigation
  - NASCO & NAAG
    - Charities Project/Columbia University
    - Single Portal Filing Project

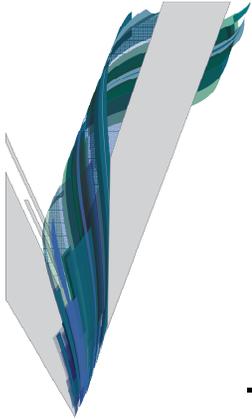


# Reducing the Risk of an Investigation



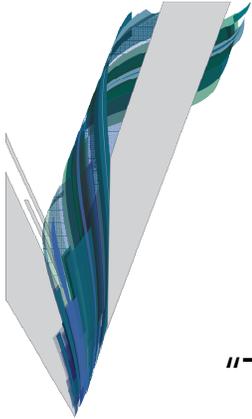
# Be Proactive (and Thorough)

- Internal compliance audit:
  - Governance documents (bylaws; articles of incorporation)
  - Directors
    - Qualifications
    - Relationships to each other and to officers
    - Length of tenure
  - Written policies and procedures
    - When implemented
    - When revised



## Be Proactive (cont'd)

- Meeting minutes
- Regulatory filings and 990s
- Donor-facing materials
  - Scripts, donation receipts, reminder cards
- Fundraising sources
  - Diversity
  - Telemarketing contracts
- Vendors
  - Fundraisers, auditors
- Past complaints or inquiries

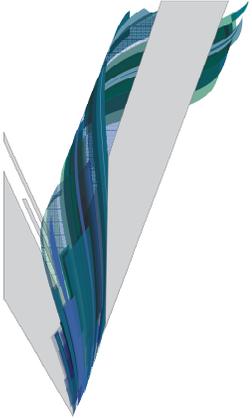


## Be Proactive (cont'd)

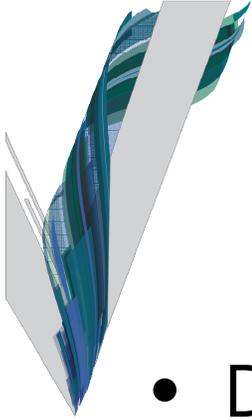
"This is not to say that a nonprofit organization may not compensate its employees at a market rate....Just as a nonprofit hospital may pay \$5 million for a new MRI machine that costs \$5 million, it may pay \$400,000 a year to hire a radiologist when the going rate for a radiologist is \$400,000 a year."

*Spencer v. World Vision, Inc.*, 633 F.3d 723, 734 (9th Cir. 2010)

- Dig deeper into:
  - Program services
  - Executive compensation
    - GIK and joint cost allocation issues

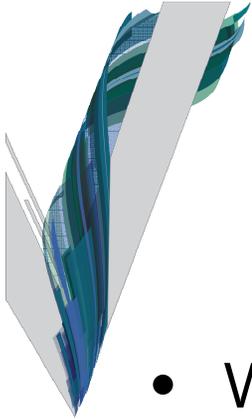


# Navigating an Investigation



# Operational Considerations

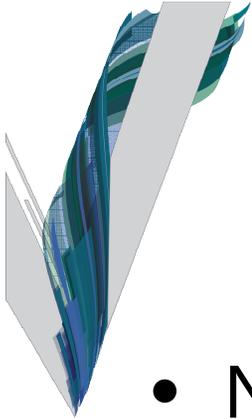
- Document hold
- Briefing the Board
  - Who? How often?
- Communicating with staff
- HR issues
- Continuing/discontinuing operations
- Insurance coverage



# Strategic Considerations

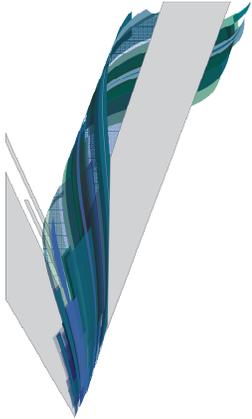
- Who is investigating?
  - Scope shapes response
  - Likelihood of referral/coordination
- States can, and do, share information
- When might FTC get involved?
- First Amendment offers protection, but see fraud exception

The attorney general may enter into reciprocal agreements with a like authority of any other state or states for the purpose of exchanging information made available to the attorney general or to such other like authority. *Minn. Rev. Stat. 309.60*



# Additional Strategic Considerations

- Nonprofit's goals
  - Executives' goals
- Regulators' stance
  - First offer is worst offer
- Advocacy
- PR/Crisis Management
  - Government has home-microphone advantage



# Questions?

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