

REVITALIZING NONPROFITS RENEWING NEW YORK

Leadership Committee
for Nonprofit Revitalization

Report to Attorney General
Eric T. Schneiderman



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LEADERSHIP COMMITTEE FOR NONPROFIT REVITALIZATION

December 8, 2011

Dear Attorney General Schneiderman:

We are pleased to present the Report of the Leadership Committee for Nonprofit Revitalization. In July, you charged us with developing proposals for reducing burdens on the nonprofit sector while strengthening governance and accountability. With the support of your able staff, we have been working actively since then to achieve this objective. Our Report includes clear, concrete, and actionable recommendations to strengthen New York's nonprofit sector. They are the product of a dozen formal meetings, numerous additional discussions with key stakeholders, and extensive research.

On behalf of the nonprofit community, we thank you for your leadership. You invited representatives of nonprofits to sit at the same table with their chief regulator for the first time in recent memory and develop forward-looking solutions for change. This unique collaboration has produced significant proposals that once implemented will reduce burdens, save taxpayer and charitable funds, and enhance the public's trust in the nonprofit sector.

This Report represents the beginning of an important new partnership with the Attorney General's office to enhance and revitalize New York's nonprofit sector. The Committee looks forward to working with you to implement these recommendations, and collaborating in the years ahead to ensure that our state remains home to the most dynamic and vibrant nonprofit organizations in the country and the world.

Respectfully submitted,

Members of the Leadership Committee

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EXECUTIVE SUMMARY

New York is the proud home to the most dynamic and vibrant nonprofits in the country and the world. From educating our most promising students, to nurturing the talents and creativity of aspiring artists, to providing a safety net for the neediest, nonprofits are the backbone of communities across New York. Nonprofits not only improve the quality of our lives, they also fuel the state's economy. Nonprofits generate hundreds of billions of dollars in annual revenue and are responsible for one in seven jobs in the state.

Yet today, New York's nonprofits face a period of genuine uncertainty. The lingering recession, resulting revenue declines, and precarious economic outlook present unprecedented financial, strategic, and governance challenges for nonprofits. Throughout the state, nonprofits are doing heroic work to continue their programs and services as demand increases and cash flow tightens.

Amid these challenges, a historic opportunity exists for government and nonprofits to join forces to revitalize and strengthen New York's nonprofit sector. Working together, government and nonprofits can ensure that the sector not only survives these precarious times, but thrives.

Achieving this goal requires that New York become a more hospitable environment for nonprofits. For too long, New York law and regulatory practices have placed unnecessary and costly burdens on the nonprofit sector. Redundancies throughout the system waste scarce taxpayer and nonprofit dollars, and bury nonprofits in duplicative paperwork and audits. Nonprofits that provide critical services on behalf of the State too often are not timely paid, crippling their ability to serve New Yorkers in need. In 2010 alone, state contracts valued at \$1.8 billion were late. Nonprofits should not have to endure these burdens.

Equally important in these austere times is that the public maintains its trust in the nonprofit sector. The public rightfully expects that the billions of dollars entrusted to nonprofits each year are spent wisely and managed properly. Maintaining the public's trust requires renewed focus on enhancing governance and oversight. This demands a bold and imaginative mix of new and updated laws, voluntary best practices, and director recruitment and training programs. While recent reports of improper executive compensation are not representative of the nonprofit sector as a whole, the nonprofit community would benefit from stronger statutory guidance on compensation processes. The statutory powers of the Attorney General to stop fraud must also be reaffirmed.

In this spirit, the Attorney General's Committee for Nonprofit Revitalization worked to craft significant but practical recommendations to enhance governance and oversight while reducing burdens. In formulating these recommendations, the Committee was mindful of the financial strains facing both nonprofits and government, and identified meaningful solutions that will reduce – not add to – their financial burdens.

Recognizing that there are many topics it could have explored, the Committee focused its efforts on the most pressing challenges facing nonprofits today. In drafting this Report, the Committee divided its recommendations into three sections.

The first section, **Reducing Burdens on Nonprofits**, makes recommendations for reducing unnecessary and outdated burdens on nonprofits. The Committee believes these recommendations are consistent with Governor Cuomo's plan to improve government efficiency and accountability, and will build upon the considerable success he has already achieved. The section is divided into two chapters:

- ◇ **Building a Better Business Partnership** addresses the decades-old challenges in state contracting processes, including delays in approval and payment, redundant reporting and auditing requirements, and limited transparency. The chapter highlights the need for government to treat nonprofits as essential business partners and makes recommendations to reduce burdens to conserve nonprofit and taxpayer dollars.
- ◇ **Creating a More Hospitable Environment for Nonprofits** addresses outdated and burdensome requirements that result from a regulatory scheme that has not been meaningfully updated in decades. The chapter recommends modernizing laws and eliminating regulatory burdens so that the state remains home to the country's strongest and most vibrant nonprofit sector.

The second section, **Enhancing Governance and Maintaining the Public Trust**, makes recommendations for strengthening governance and accountability. The section's two chapters recognize that maintaining the public's trust in nonprofits requires active oversight by diverse, skilled, and committed board members who clearly understand their roles and responsibilities:

- ◇ **Creating a New Statutory Roadmap for Oversight and Accountability** addresses the need to provide clearer and stronger statutory guidance to boards of directors, which have paramount responsibility for overseeing nonprofits, in such key areas as compensation, financial reporting, and conflicts of interest. Clearer guidance in these and other areas will enable boards to fulfill their obligations more effectively and improve the overall quality of governance.
- ◇ **Building Boards of the Future** identifies creative solutions for improving board governance through innovative director recruitment and education programs, as well as broader adoption of voluntary best practices. The Committee recognizes that while laws and regulations provide a necessary framework, elevating governance practices ultimately depends upon people. Developing new recruitment pipelines will produce a broader and more diverse talent pool of directors. Creating innovative educational programs will ensure directors have the knowledge and comfort to serve effectively.¹

The final section, **The Path Forward**, highlights the importance of continuing the historic collaboration between the Attorney General and the nonprofit community. This partnership can develop a strategic vision for the nonprofit sector of tomorrow and create a framework in which it can thrive.

HIGHLIGHTS OF KEY RECOMMENDATIONS

Reducing Burdens on Nonprofits

- ◇ **Bring immediate financial relief to nonprofits by making cash flow loans.** Each day, critical programs benefiting children, the elderly, and other vulnerable New Yorkers are threatened by state contracting delays. Operating with limited cash flow, nonprofits must draw down on credit lines, furlough employees, or delay salaries and vendor payments when state contracts are late. Nonprofits should not have to bear these burdens. For precisely this reason, New York established a revolving loan fund to extend interest-free loans to nonprofits, but that fund has never been capitalized. To provide immediate relief to nonprofits, the State should capitalize the fund and begin making cash flow loans.
- ◇ **Fix the state contracting problem and create cost savings by establishing a new Office of Contracting Reform and Accountability.** Numerous commonsense solutions exist to fix the decades-old contracting problem, but they have largely gone unimplemented. What the system needs is accountability. Creating a new Office of Contracting Reform and Accountability within the Executive Branch would centralize responsibility for implementing systemic changes and send a clear signal that doing so is a priority of the administration. Centralizing processes in such an office would generate savings for taxpayers and nonprofits by eliminating redundancies and cutting red tape. As an immediate step, the Governor should appoint a Nonprofit Liaison to commence this work and begin improving the State's partnership with the nonprofit sector.
- ◇ **Create a data vault to generate cost savings and improve government oversight.** Nonprofits receiving state funding must routinely submit the same information year after year, often to multiple agencies. To fix this problem, the State should follow New York City's lead and create a new data vault in which nonprofits could electronically store key organizational documents in one place for review by all agencies. This system, which could be built as an enhancement to existing or planned technology, would eliminate redundancies and produce savings to taxpayers and nonprofits. It would also improve oversight by eliminating the need for individual funding agencies to collect their own information, and allowing them to review and share key information collected across state government.
- ◇ **Modernize laws to make New York more nonprofit-friendly.** State nonprofit laws, which have not been meaningfully updated in decades, place unnecessary burdens on nonprofits. These burdens create frustration and drain funds that could be put to charitable use. Modernizing key provisions of New York law concerning board procedures, approval of key transactions, formation of new nonprofits, and other matters would reduce burdens and costs, without sacrificing oversight or accountability.

Enhancing Governance and Maintaining the Public Trust

- ◇ **Mandate independent oversight of executive compensation.** For the public to maintain trust in the nonprofit sector, it must have confidence that executive compensation is reasonable, commensurate with services, and set independently. Although board members are subject to general fiduciary principles, New York statutes are virtually silent on boards' responsibilities for overseeing executive compensation. There should be clear statutory standards to ensure active

and independent board review of compensation, including requirements that the board affirmatively determine that compensation is fair, reasonable and justified, that no individuals with an interest in the compensation participate in the compensation process, and that the board adhere to statutory criteria when making compensation determinations.

- ◇ **Mandate independent oversight of financial audits.** External financial audits provide critical assurance to nonprofit boards and the public that funds are properly used and managed. Although New York law requires most nonprofits with annual revenues over \$250,000 to obtain such audits, it does not set forth criteria for board oversight over the audit process, and boards exhibit varying levels of involvement. For nonprofits required to undergo external financial audits, the law should mandate that boards perform specified audit oversight functions, either through an audit committee or by the independent directors on the full board.
- ◇ **Enhance the Attorney General’s powers to stop fraud.** In the rare circumstances when insiders use their positions for improper personal gain, the Attorney General must have clear statutory authority to act. Relevant provisions of New York law should be amended to reaffirm and make clearer the Attorney General’s statutory authority to unwind self-interested transactions involving nonprofit insiders.
- ◇ **Launch “New York on BOARD” to recruit stronger and more diverse boards.** In a state that is home to the broadest spectrum of industry in the world, there is enormous opportunity to attract a larger and more diverse pool of nonprofit directors. New York’s nonprofit sector, with the assistance of the Attorney General, should launch new initiatives to recruit the next generation of board leaders. Through one such initiative, “New York on BOARD,” the business community can provide philanthropic leadership by encouraging employees to serve on nonprofit boards. Such a program could be expanded to include New York’s multi-talented retiree populations and its extraordinary academic community.
- ◇ **Launch “Directors U” to strengthen director education and the quality of board oversight.** New, innovative programs are needed to educate board members on their responsibilities. The Attorney General should facilitate the launch of “Directors U,” a statewide initiative that would provide training that is easily accessible and free or low-cost. Working with a consortium of existing organizations engaged in director training and academic institutions, Directors U would develop an online repository of training modules and in-person trainings on a broad range of topics relevant to nonprofits.

The Path Forward

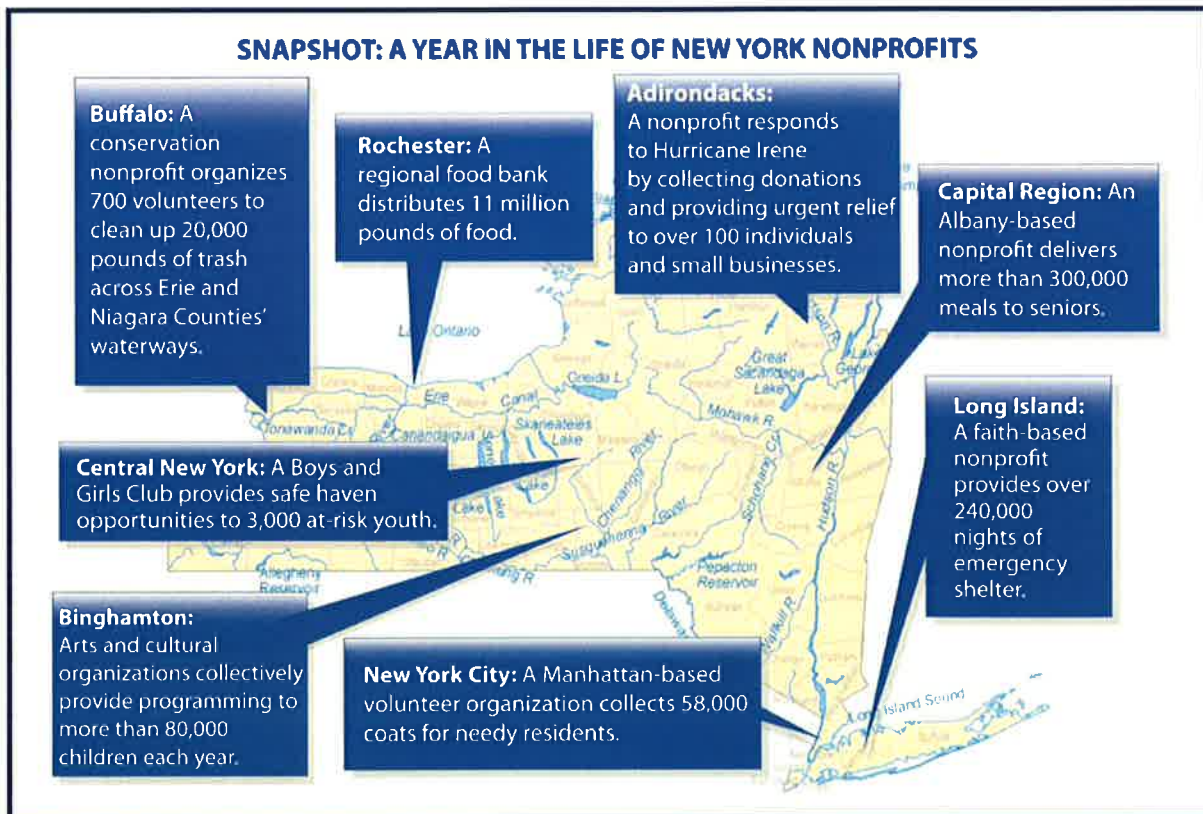
- ◇ **Develop a blueprint for the future.** As important as it is to address today’s challenges, the nonprofit sector must also plan for its future. The Committee recommends that the Attorney General and New York’s nonprofit community continue their historic collaboration by launching *Nonprofits 2020: A Blueprint for the Future*, a new initiative to craft a strategic vision for the nonprofit sector of tomorrow.

INTRODUCTION

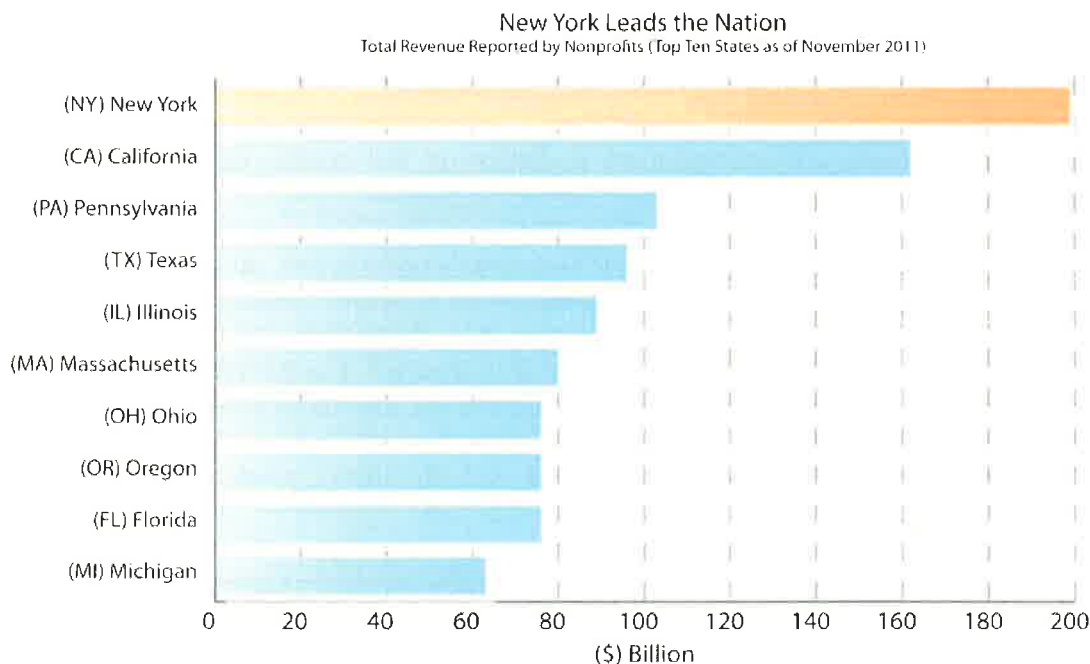
NEW YORK'S NONPROFIT SECTOR AT A TIME OF UNCERTAINTY

The value of nonprofits to New York cannot be overstated. Nonprofits provide a safety net for the most vulnerable New Yorkers, from caring for our neediest, to supporting the elderly and feeding the hungry. They are also the principal source of the art and culture that make our cities, towns, and villages livable. A remarkable example can be found in Binghamton, New York. The city has faced precipitous population declines and erosion of its manufacturing base. Yet, Binghamton's opera, philharmonic, theater companies, museums, and galleries endure, serving as catalysts for community and economic revitalization, and standing as a symbol of pride and continuity.

Nonprofits are also a key partner for New York State's government. At a time when the State is cutting spending, government continues to call on the nonprofit community to provide critical services to New Yorkers in need. As of October 2011, the State had 22,000 active contracts with nonprofits totaling \$16.8 billion to provide services.² These contracts cover an array of service areas, including emergency relief, homelessness, affordable housing, legal services, employment and training, child care, child welfare, food and hunger, HIV and AIDS, mental health, senior services, substance abuse, persons with disabilities, youth, and family services.



Nonprofits remain a key economic engine for New York. Nonprofits employed 1,246,916 paid workers in 2010, representing 18.1 percent of the state's total private workforce.³ In this regard, New York is distinct from the nation at large and from neighboring states, where nonprofits employ smaller percentages of the workforce.⁴ New York's nonprofits also generate more revenue than their counterparts in other states:⁵



A Sector Under Stress

Despite its critical importance, today's nonprofit sector is under stress. The impact of the global economic recession has been substantial, causing declines in both private contributions and government funding. In New York City, 66 percent of executive directors of human services organizations reported decreases in public funding from 2008-2009.⁶ A June 2010 survey of nonprofits nationwide, including 422 in New York, found that 68 percent of organizations saw contributions decrease or stay the same from January through May 2010, as compared to the prior year.⁷ The \$39.9 billion in federal stimulus funds that New York received from the American Recovery Reinvestment Act of 2009 provided an essential lifeline for many agencies, but that funding has virtually dried up.⁸

The economic outlook for the next several years remains precarious. New York State's budget deficit is expected to grow to \$3.5 billion in FY 2013 and to \$4.8 billion by FY 2015.⁹ Prospects for economic growth that might increase government revenue and spur public and private sector contributions to nonprofits remain uncertain.¹⁰

For many nonprofits, especially human services organizations, growing demand for services is further compounding the problem posed by funding shortfalls. With increasing numbers of Americans living below the poverty line – an additional 2.6 million people slipped

into poverty last year¹¹ – nonprofits are feeling the impact. As these organizations struggle to do more with less, there may be no way to avoid tough choices that lie ahead.

Burdens We Can No Longer Afford

In this environment, it is more important than ever that nonprofits conserve resources and focus their efforts on serving people and communities. Yet nonprofits across the state routinely face regulatory burdens and inefficiencies that waste charitable dollars, financially strain balance sheets, and divert resources from mission. The burdens stem in part from a statutory scheme that has not been updated meaningfully in nearly a half-century, as well as from a bureaucracy that has resulted in redundant, fragmented and overlapping oversight of nonprofits.

In ordinary times, nonprofits should not have to endure these burdens; in these extraordinary financial times, nonprofits simply cannot afford to. What is needed now is smart, focused regulation that eliminates unnecessary burdens while strengthening governance and accountability. It is essential that nonprofits be able to spend more time and resources on performing their missions and tending to governance, and less on dealing with unnecessary red tape and bureaucracy caused by outdated laws and regulations.

Strengthening the Public Trust

Boards of directors are critical to maintaining the public's trust in the nonprofit sector. Donors rightfully expect that nonprofit boards, in whose collective hands billions of dollars are entrusted each year, are providing effective oversight and strategic leadership. Yet, improving board governance and effectiveness remains one of the greatest challenges facing the nonprofit sector.

Many nonprofit boards are experiencing increasing difficulties in recruiting new members who have the necessary skills, time, and commitment. Others lack guidance on governance best practices and legal requirements. Still others face the historical issues of board passivity and inconsistent levels of board participation.

These challenges present an enormous opportunity for the nonprofit sector, partnering with government and other key sectors, to think about creative new solutions to enhance board governance, effectiveness, and recruitment. Statutory enhancements will provide boards with new roadmaps to effective oversight.

TAKING ACTION

With these challenges in mind, and just three months into his administration, Attorney General Eric Schneiderman announced a groundbreaking partnership to support and strengthen New York's nonprofits. At a speech before the Association for a Better New York, Attorney General Schneiderman announced that he would form the Leadership Committee for Nonprofit Revitalization, saying:

We need to revisit and revamp our laws and regulations. And we need to revitalize and re-energize the sense of volunteerism — of giving back to our community through service on the boards of New York's nonprofit organizations that has been a hallmark of our state.

- Attorney General Eric T. Schneiderman, April 26, 2011

In forming the Committee, the Attorney General took the step, unprecedented in recent memory, of inviting key nonprofit leaders to sit at the same table with the Attorney General's Office to reassess the regulatory framework in New York and address longstanding challenges facing the sector. The Committee's diverse membership includes 32 individuals from organizations large and small, from upstate and downstate, and representative of the full breadth of New York's nonprofit sector. The Committee also includes several of the leading nonprofit practitioners in the country.

The Attorney General charged the Committee with developing proposals to make New York an environment in which nonprofits can flourish, while ensuring that the public maintains its trust in the sector. Working together, members of the Committee have sought to modernize New York's regulatory framework, eliminate unnecessary burdens and costs, and strengthen oversight and accountability.

Through an iterative process, the Committee identified key challenges, evaluated statutory schemes and existing best practices, and crafted recommendations to the Attorney General to modernize nonprofit laws, reduce burdens and improve governance practices. The Committee focused its activities on the most pressing challenges facing nonprofits, recognizing that solving them would have the greatest impact on the nonprofit sector statewide.

The Committee organized itself into three subcommittees, each tasked with addressing a specific set of issues facing the nonprofit community:

- ◇ The **Modernizing and Strengthening Nonprofit Laws Subcommittee**, chaired by Victoria Bjorklund of Simpson Thacher & Bartlett LLP and Michael Cooney of Nixon Peabody LLP, considered changes to New York's nonprofit laws to eliminate outdated and burdensome provisions. The subcommittee also explored statutory changes to strengthen governance and enhance accountability.

- ◇ The **Reducing Burdens on Nonprofits Subcommittee**, chaired by Susan Hager of the United Way of New York State and Michael Stoller of the Human Services Council, explored ways to lessen burdens that government funding practices place on nonprofits, particularly those in the social services sector. These burdens place strains on already stressed nonprofit balance sheets and divert government resources that instead could be used to improve oversight.
- ◇ The **Enhancing Board Governance, Effectiveness & Recruitment Subcommittee**, chaired by Clotilde Perez-Bode Dedecker of the Community Foundation for Greater Buffalo and Lee Perlman of Greater New York Hospital Association, examined ways to keep New York's nonprofits strong by ensuring that boards of directors are positioned to provide effective governance and oversight. The subcommittee focused particularly on expanding pipelines for director recruitment and creating new educational opportunities to improve governance.

The Committee and its subcommittees held a dozen formal meetings between July and December 2011, as well as numerous additional discussions among members and with key stakeholders. The Attorney General's staff, led by Charities Bureau Chief Jason Lilien, provided substantive and administrative support in facilitating the Committee's work and drafting this Report.

Ultimately, the Committee developed 38 concrete recommendations, which are presented here. In formulating its recommendations, the Committee was mindful of the financial strains facing both nonprofits and government, and developed significant solutions that are feasible in this challenging economic environment.

REDUCING BURDENS ON NONPROFITS

Nonprofits throughout New York State are suffering from the twin effects of the recession: increasing demand for services and declining revenues. At the same time, the State is facing unprecedented budgetary challenges. Modernizing nonprofit regulation will result in substantial cost savings for both nonprofits and state government as administrative processes are streamlined and burdens on nonprofits and state agencies are reduced. It will also result in better service delivery by nonprofits and more focused oversight by government.

BUILDING A BETTER BUSINESS PARTNERSHIP

Nonprofits are essential business partners to government. They provide critical, cost-effective programs and services to New Yorkers on behalf of the State. Yet the partnership between the State and the nonprofit sector needs strengthening. Nonprofits routinely see resources wasted and balance sheets strained by unnecessary and costly burdens imposed by the state contracting process. These burdens have impeded nonprofits' ability to carry out their missions, plan rationally, and serve New Yorkers.

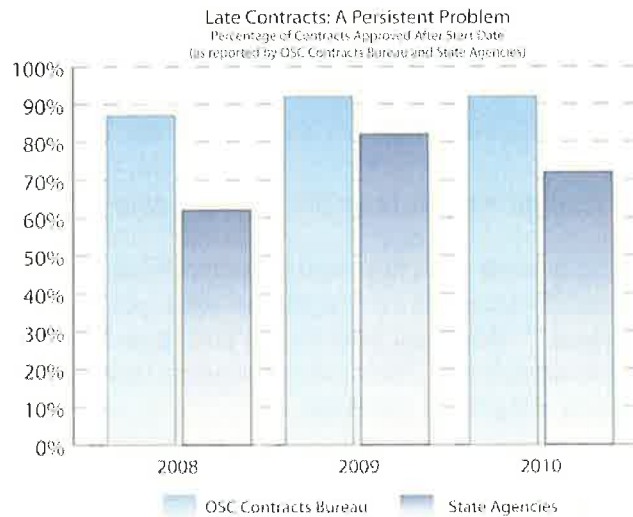
Nonprofits and the people they serve simply cannot afford to see dollars lost to bureaucracy and red tape. Yet this is precisely the situation they face as they contend with:

- ◇ **Delays in contract approvals, renewals, and payments** - For nonprofits, the contracting process takes too long, and organizations often do not learn about the status of approvals and renewals until after contract start dates pass. When contracts are approved and executed, payments are nonetheless delayed.
- ◇ **Redundancies in reporting requirements and audits** - Nonprofits receiving funding from multiple agencies must routinely provide the same information and documents to each agency, year after year. They must also submit to duplicative fiscal and program audits. These requirements tax limited resources at nonprofits and at state agencies.
- ◇ **Cash flow shortfalls** - Delayed payments cause nonprofits to face cash flow shortages, forcing them to “foot the bill” for the State, cut staff and expenses, or discontinue services entirely. Nonprofit providers report that New York is among the ten worst states nationally when it comes to making timely payment under government contracts.¹²
- ◇ **Limited transparency in contracting processes** - Nonprofits often cannot effectively track the status and timing of contract approvals and payments.

These challenges are not new but have existed for decades. The time to address them is now.

Fix the Contracting Problem

Contracting delays present one of the most significant and persistent burdens facing New York’s nonprofits. Despite efforts over the years to alleviate these delays, including the enactment of a “prompt contracting” statute, the situation has not improved. In 2010, agencies reported to the State Comptroller that 71 percent of contracts were not approved until after their start dates. A separate review by the Comptroller of 3,807 contracts valued at over \$50,000 and approved by the Comptroller in 2010 found that they were late 92 percent of the time.¹³ The Comptroller estimates that these contracts were worth \$1.8 billion over their lifetimes.¹⁴ Over the last three years, the vast majority of contracts, by either measure, were late:



Source: Office of the State Comptroller (“OSC”), Prompt Contracting Annual Report Calendar Years 2008 - 2010.

Note: The OSC Contract Bureau’s data includes only nonprofits contracts approved by OSC and valued at over \$50,000. Agency self-reported data includes nonprofit contracts of any value.

The causes of contracting delays vary and include factors extrinsic to funding agencies.¹⁵ The contract approval process requires state agencies with limited resources to follow a laundry list of steps and coordinate with numerous control agencies, including the Division of Budget, the Office of the State Comptroller, and the Office of the Attorney General, each of which has its own process. For example, individual funding agencies perform their own compliance and integrity checks, in addition to those performed separately by control agencies. Since 2008, the Division of the Budget has also added steps to contracting and payment processes,¹⁶ further compounding delays. Taken together, these processes do not allow sufficient time for most contracts to be approved prior to their start dates.¹⁷

While conversations on how to address these delays necessarily focus on issues of process, a cultural change within government is also needed. The relationship between nonprofits and the State should be one of mutual respect that recognizes the critical role nonprofits play.

It is equally important that we never lose sight of the fact that people's lives and well-being are at stake, as the story of one nonprofit provider reminds us:

A daycare center in Dutchess County works to provide a safe space where children from working families can spend the day so their parents can find and keep jobs. The daycare center receives referrals from the State of children from low-income families, who are at risk of abuse, or are in foster care. Because it takes as long as six months for the State to reimburse the center for its services, the center is forced to cut back on services to needy children, and must at times discontinue or deny service completely. Without the support the center provides, parents must often give up their jobs, harming the very families the State is seeking to help and perpetuating cycles of poverty.

Hold Government Accountable for Fixing Contracting Delays

Fixing the contracting process does not require “reinventing the wheel.” In 2010, the State Comptroller recommended numerous commonsense solutions to expedite processes and make the system more efficient.¹⁸ What has been absent until now has been an accountability mechanism to ensure they are carried out. Real reform requires that an entity within government take responsibility for implementing these solutions.

Centralizing redundant functions currently housed in multiple agencies in a new Office of Contracting Reform and Accountability would save taxpayer dollars and expedite contract approval and payment.¹⁹ New York needs designated personnel within the Executive Branch responsible for overseeing contracting processes across state agencies. Currently, oversight and compliance oversight functions are handled independently by state agencies. This results in often-duplicative audit and reporting requirements. A centralized office would create clear lines of authority over the contracting process and direct accountability to the Governor, sending a signal that solving the decades-old problem of contracting delays is a priority of the administration.

The Office of Contracting Reform and Accountability would also ensure that the numerous existing recommendations to expedite and simplify contracting processes are implemented. These include:

- ◇ **Lengthening the contracting calendar** - The current system provides insufficient time to complete the steps necessary to finalize contracts before their start dates. State agencies should begin the planning cycles for both new contracts and renewals earlier in the year so that nonprofits can plan rationally for the future. Agencies should also adjust contract start dates to be later in the fiscal year than April 1, thereby divorcing them from the state budget process. This would provide funding and control agencies additional time to finalize contracts before service provision is to begin. It would also give nonprofits earlier notice as to the status of contract

renewals, and stagger workloads in state agencies to accommodate resource constraints.

- ◇ **Restructuring contracts to allow for 5th Quarter financing** - Agencies should make use of “5th Quarter Financing” provisions in appropriate contracts to allow for continuity of services. These arrangements allow the State to continue paying nonprofits for services under the terms of an existing contract when the State intends to renew that contract but has not been able to complete the process. Sums advanced to the nonprofit are recaptured from payments under the renewal contract once it is in place.²⁰
- ◇ **Moving to multi-year contracts** - Moving contracts from annual terms to multi-year terms, as appropriate, would relieve strain on the system, allow contractors to plan programs more efficiently, eliminate potential interest payments to nonprofits, and free up limited staff resources at agencies and nonprofits.
- ◇ **Standardizing contracts** - Utilizing more uniform contract forms and terms across programs and state agencies would reduce time and expense. Currently, 80 percent of state agencies that contract with nonprofits utilize a standard boilerplate contract adopted many years ago,²¹ but there is tremendous variation within that format across agencies (*e.g.*, different payment terms, documentation requirements, and budget requirements).

In addition to creating the Office of Contracting Reform and Accountability, the Governor can take an immediate, significant step by appointing a single official with significant authority to begin the work of streamlining the state contracting process. This new **Nonprofit Liaison to the Governor** would strengthen the State’s partnership with nonprofits by serving a dual role: beginning to implement recommendations to improve contracting processes as the Office of Contracting Reform and Accountability is being established, and serving as nonprofits’ point-person and troubleshooter within government. Several states have created similar liaison positions in recent years, and preliminary reports are quite promising.

In Connecticut, for example, Governor Dan Malloy announced the creation of a cabinet-level Nonprofit Liaison in January.²² The Connecticut Liaison’s mandate is to interact and communicate directly with nonprofit providers, and to advise the Governor with regard to reforms to improve Connecticut’s partnership with the nonprofit sector. One of the Connecticut Liaison’s earliest contributions was a set of instructions to the Commissioners of the state’s largest funding agencies to take steps to expedite contracting processes.²³ While Connecticut’s Nonprofit Liaison position is relatively new, early reports of its impact have been positive, with nonprofits in that state praising the Liaison’s efforts.²⁴

Here in New York, one of the new Nonprofit Liaison’s first responsibilities should be to work with funding and control agencies to conduct a comprehensive review to inventory and assess individual agencies’ contracting processes. This would enable the Liaison to look broadly across agencies and identify redundancies and inefficiencies worthy of elimination, as well as practical improvements to be made.

Recommendations

- **Create an Office of Contracting Reform and Accountability.** To save taxpayer dollars, reduce burdens, and improve oversight, New York should centralize reporting and integrity functions currently housed across multiple agencies in a new Office of Contracting Reform and Accountability. This Executive Branch office's mission would be to streamline contracting processes, hold funding agencies accountable, improve transparency and information sharing, and provide support and training to nonprofits. The office would direct state agencies to implement longstanding recommendations to improve the contracting process, such as adjusting contracting cycles to allow for earlier planning and later contract start dates; restructuring contracts to allow for "5th quarter financing;" and moving to standardized and multi-year contracts. Depending upon their subject matter, these recommendations should be implemented through a combination of new statutes, regulations, budget bulletins, and other guidance, as needed.
- **Create a Nonprofit Liaison to the Governor.** As the Office of Contracting Reform and Accountability becomes operational, the Governor should take the immediate step of appointing a dedicated official who would begin focusing on expediting contract approvals and payments and improving the State's relationships with nonprofit providers. Initially, the Nonprofit Liaison to the Governor should undertake a broad review of agency contracting processes and timelines to identify redundancies and opportunities for improvement.

Centralize Functions to Eliminate Redundancies

Centralizing integrity review functions within the new Office of Contracting Reform and Accountability would eliminate redundancies and reduce costs and burdens. The State's contracting process, for example, requires that organizations seeking funding from multiple agencies must undergo a separate integrity review with each agency every time they seek funding. These checks are often duplicative and delay the contract negotiation process, which would be expedited substantially if checks were performed in advance.

Centralizing this function within this new office would also strengthen oversight. Because agencies conduct integrity reviews independently, there is no centralized mechanism to share issues, and individual agencies may not benefit from critical information when making contracting decisions. Rather than having each agency make an independent (and potentially differing) assessment of vendor responsibility, one centralized unit would make determinations based on uniform criteria, and with access to the full range of available information.

This process would further allow "prequalification" of nonprofits prior to negotiations with agencies over terms of service, so that only "responsible" nonprofits could participate in the contracting process. Not only would this conserve limited agency resources, it would also expedite contract approval by eliminating time-consuming steps that individual funding agencies must now take. Prequalification could take place on a continuous basis, allowing funding agencies and nonprofit providers to focus exclusively on the terms of service provision in structuring Requests for Proposals and other procurement documents. A prequalification

procedure is particularly appropriate for established nonprofits that have lengthy track records of providing efficient and honest services to state agencies.

The Office of Contracting Reform and Accountability's second mandate would be to create and maintain an electronic data vault to house organizational documents. Both nonprofits and state agencies have long been frustrated by redundant reporting requirements. Because the State currently lacks a centralized electronic repository of key documents required for integrity checks, nonprofit organizations must often provide the same documents to multiple agencies, and submit identical copies of organizational materials, such as certificates of incorporation and bylaws, year after year. These duplicative requirements tax the limited resources of both nonprofits and state agencies, which must devote staff to processing submissions.

The data vault would enable the State to eliminate additional redundancies in the process of performing integrity checks. The vault would be accessible to all agencies and improve oversight by enabling them to quickly and confidentially share and obtain information about nonprofits generated across state government. The vault could leverage existing technology and be built as an extension of the State Comptroller's VendRep system or of the planned Statewide Financial System (SFS). By allowing nonprofits to file documents at one time and in one location, the data vault would reduce costs and frustrations that nonprofits regularly endure, and conserve taxpayer and charitable dollars. Agencies could also reallocate staff and resources to more pressing needs.

State audit processes are an additional avenue for eliminating redundancies and finding new efficiencies. Duplicative fiscal audits force nonprofits to divert crucial resources that could be used on mission and governance. For its part, government could better utilize taxpayer dollars by consolidating auditing efforts and disseminating audit results broadly to agencies. Adopting a "single audit" format in which one agency would be responsible for conducting fiscal audits on behalf of multiple funding agencies would reduce burdens and costs.²⁵

Recommendations

- **Centralize Integrity Functions.** Integrity review functions currently performed across agencies should be centralized within the Office of Contracting Reform and Accountability to eliminate redundancies, save costs, and improve oversight. Centralizing integrity checks will allow nonprofits to "prequalify" for contracts and reduce burdens and costs at agencies and nonprofits.
- **Create an Electronic Data Vault for Nonprofit Filings.** The Office of Contracting Reform and Accountability should create a centralized, electronic data vault accessible to all funding agencies. This system would allow nonprofits to submit electronic filings required as part of the contracting process.
- **Simplify Fiscal Audits by Adopting a "Single Audit" Approach.** For nonprofits that contract with multiple state agencies, the Office of Contracting Reform and Accountability should designate a single lead agency to conduct fiscal audits, or itself conduct audits on behalf of all agencies.

Provide Immediate Cash Flow Assistance to Nonprofits

New York nonprofits can no longer shoulder the burdens of contracting and payment delays. The nonprofit sector needs help now. Immediate steps should be taken to provide bridge financing when contracting delays occur so that nonprofits can continue services without interruption.

Nonprofits throughout the state, particularly social service agencies, operate on thin margins and have limited capacity to cover program costs when contracts and payments are late. Contracting delays cause cash flow shortages at nonprofits, which face the unenviable choice of either cutting services or “footing the bill” for the State by funding services out of their own reserves (assuming organizations have the resources to do so).²⁶ The following story highlights the problem:

Late contracts and payments have severely imperiled an Upstate New York rape crisis center. The average wait time for the center to receive payment from the State ranges from 12 to 24 weeks. This excessive delay has taken a toll on the center’s credit rating, forced it to borrow from its certificate of deposit reserve, and placed a tremendous burden on the center’s staff and board as they strive to make payroll. Staff members have taken pay cuts, and vendors have suffered because of delays in payments. Collectively, the contracting delays have subjected staff members to unnecessary stress and burdens, making it harder for them to continue doing the heroic work of supporting victims of sexual assault.

Because of inordinate delays in the contracting and payment process, nonprofits like the rape crisis center are effectively floating interest free loans to the State. This is money they do not have and imperils nonprofit programs and operations. The paradigm should be reversed. The State, not the nonprofit, should fund continuation of services when state payments are late.

New York needs a well-capitalized loan fund to provide immediate cash flow assistance to nonprofits. Although New York created such a fund,²⁷ the State has never capitalized or utilized it.²⁸ It is essential that such a fund be capitalized and begin providing bridge financing to nonprofits awaiting payment from the State.

Here, New York City’s Revolving Grant Fund serves as an instructive model. This fund provides interest-free loans to hundreds of City-funded nonprofits whose payments are late due to bureaucratic delays.²⁹ The fund, which is administered by a nonprofit outside of city government, has a virtually nonexistent default rate, as loan payments are recaptured from future payments under the delayed contracts.³⁰

A similar fund at the state level would provide much-needed relief to nonprofits. After its initial capitalization, the fund would be revenue-neutral, as loans advanced would be recaptured from future payments under state contracts. The Not-for-Profit Contracting Advisory

Committee, which was established by statute to advise on state contracting issues, should work with the nonprofit sector and relevant agencies to determine the appropriate size and structure of the fund.³¹ The fund should have a clear and simple application process and be administered in a manner that allows cash flow loans to be disbursed quickly.

Recommendation

- **Provide Immediate Relief to Nonprofits by Making Cash Flow Loans.** The State should capitalize its existing revolving loan fund to provide interest-free loans to nonprofits when contracts are delayed. The Not-for-Profit Contracting Advisory Committee should work with the nonprofit sector and relevant agencies to make recommendations as to the appropriate size and structure of the fund. Enhancements to the fund's structure should be considered, such as allowing for administration of the fund by an independent entity and simplifying loan application procedures.

Shine Sunlight on the Contracting System

As frustrating as the contracting system is for nonprofits, its lack of transparency exacerbates the problem. Nonprofits should be able to ascertain the status of contracts and payments, particularly those that are delayed. This would allow nonprofits to plan service and staffing levels rationally and manage finances properly. While some state agencies provide limited information on contract status online, there is no centralized mechanism allowing nonprofits to track the status of contract renewals, approvals, and payments throughout the various stages of the contracting process. Just as consumers are able to track the status of express mail and Internet orders online, nonprofits should be able to follow their contracts from the Requests for Proposal stage through payment and audit.

The State should create and maintain a website that allows nonprofits to track the status of contract approvals and payments. The new Nonprofit Liaison to the Governor should take the lead in developing the website until the Office of Contracting Reform and Accountability becomes operational. The website would allow agencies to communicate well in advance of the following fiscal year the services it intends to fund. It would also allow agencies to issue Requests for Proposals and nonprofit vendors to respond. Such a website would open the contracting process and demonstrate that nonprofits are genuine partners of government.

Recommendation

- **Create a State Contracting Website to Improve Transparency.** The State should create a dedicated website to allow nonprofits to track the current status of Requests for Proposals, contract approvals, renewals, payments, and audits.

CREATING A MORE HOSPITABLE ENVIRONMENT FOR NONPROFITS

Eliminating outdated and unnecessary barriers to formation and operation is essential to ensuring that New York remains home to a strong and vibrant nonprofit sector. However, the State's current regulatory framework often produces unnecessary obstacles for newly forming organizations and frustrating burdens for nonprofits already doing business. Modernizing key provisions of New York law governing formation, dissolution, transactions, and board procedures will reduce unnecessary burdens and costs, without sacrificing oversight or accountability.

Eliminate Barriers to Entry

The process for forming a nonprofit should be clear, simple, and inexpensive. The opposite is currently the case in New York. New York laws impose unique barriers to incorporation, causing nonprofits to incur start-up delays and expenses not experienced by nonprofits forming in other states. Eliminating these unnecessary barriers to entry will enable nonprofits that elect to form in New York to do so more quickly and less expensively.

Even before submitting a proposed certificate of incorporation to the Department of State, a nonprofit's founders must interpret a confusing statute requiring them to select a corporate "type": A, B, C, or D.³² The confusion caused by this requirement, which does not exist in other states, delays formation and increases legal and other expenses. These burdens outweigh any regulatory benefit the classification system might achieve.³³

In particular, there is widespread confusion about the distinction between Type B corporations, which are charitable in nature, and Type C corporations, which may be charitable but also have a "business purpose." Many nonprofits, such as local community theaters, believing they are Type B corporations, find that their certificates of incorporation are rejected because they conduct business-like activities, such as selling tickets. Not only do rejections delay incorporation and add unnecessary legal fees, they also complicate the process for applying for federal tax-exemption, because they may cause the Internal Revenue Service to question the charitable nature of the corporation.

Additionally, many organizations must obtain approval from various state agencies before incorporating, resulting in further delays and legal costs. Section 404 of the Not-for-Profit Corporation Law lists a total of 17 state agencies that may have to grant approval prior to formation. Securing approvals from these agencies may take months, yet rarely are approvals ultimately withheld.

Agency pre-approval of certificates of incorporation makes sense in certain situations. The Department of Health, for example, should be involved when a nonprofit hospital is being formed. However, in most cases, the burdens of pre-approval significantly outweigh its benefits. For example, if the community theater discussed above were to include "conducting community workshops" among its corporate purposes, it may need to obtain Department of Education approval in order to incorporate. It is understandable that such approval would be necessary for a nonprofit school, but not for an arts organization that exists to put on plays.

Eliminating such approvals would expedite incorporation without affecting regulatory oversight. Licensing, certification and other regulatory requirements would be unaffected. For example, a childcare center or ambulance corps that must obtain a license or certification prior to commencing operations would still have to do so. This change would only streamline the process of incorporating; substantive laws and regulations governing the new corporation's activities would remain unchanged.³⁴

Further delays and costs result from an easily correctible ambiguity in New York law. The law requires that a certificate of incorporation describe the organization's *purposes*. However, because of differing interpretations of "purposes," certificates of incorporation may be rejected if a nonprofit does not delineate its planned *activities*. It is impractical for a nascent organization to describe the activities it will undertake years in the future. A plain English interpretation of the term "purposes" should be applied by the Department of State, so that a new organization need only identify its particular charitable or other purposes in its certificate of incorporation, and not the means by which it expects to achieve them.

Another burden imposed by New York's system is that the Department of State is not clearly empowered to correct minor mistakes, such as typographical errors, in submitted certificates of incorporation or applications for authority to conduct business in New York. New York law should expressly permit the Department of State to correct non-substantive and typographical errors with direction from the nonprofit.

Recommendations

- **Eliminate Type C Corporations.** While the legislature should give serious consideration to consolidating all statutory types, it may be simpler to eliminate the Type C classification and deem as Type B existing corporations designated as Type C without requiring them to make additional filings. This statutory change would substantially improve the processing of certificates of incorporation and simplify the formation process. It would have little impact on other provisions of New York law, which substantively treats Type B and Type C corporations in the same manner in nearly all provisions.
- **Replace Most Agency Pre-Approvals with Notifications.** The Not-for-Profit Corporation Law should be amended to require that nonprofits timely notify relevant agencies following formation, rather than obtain their pre-approval, in most circumstances. Pre-approval should still be required where there is a compelling policy justification, such as when a new hospital is formed or when a fire corporation is created. Granting a certificate of incorporation in this manner would not affect other laws or regulations, including requirements to obtain certification or licensing.
- **Clarify Review Process.** To expedite processing of certificates of incorporation, the Not-for-Profit-Corporation Law should be amended to make clearer that nonprofits need only state their corporate purposes, and not specific activities they plan to undertake. This requirement would not relieve certain types of nonprofits of legal requirements to include particular language in their statements of purpose.

- **Empower the Department of State to Make Changes.** Non-substantive and typographical errors in certificates of incorporation or applications for authority should not create delays and additional costs. The Not-For-Profit Corporation Law should be amended to permit the Department of State, when authorized in writing by the filer, to correct minor errors without resubmission of the filing.

Modernize Outdated Requirements

Certain outdated provisions of the Not-for-Profit Corporation Law need to be modernized. For example, New York law does not currently permit board and membership meeting notices and waivers of notice to be transmitted electronically, despite the nearly universal acceptance of email. Also, New York law requires that unanimous written consent of board and member actions be manually signed by each director or member.³⁵ Allowing such notices and votes to be sent electronically would save time and money. Electronic notice and voting has the additional benefit of creating a supplemental record of an organization's affairs and activities.

Additionally, in order for nonprofits to enter into significant transactions, such as mergers or substantial asset sales, they must undergo a lengthy and complicated approval process. Under New York law, nonprofits must obtain court approval of the transaction "on notice" to the Attorney General. Although only "notice," and not prior Attorney General approval, is required, in practice, most nonprofits seek sign-off from the Attorney General before seeking court approval. Courts look to the Attorney General's sign-off (or objection) before acting, and the Attorney General's position generally informs the courts' decision-making. This two-step approval process creates delays and costs, and it could be simplified and shortened. The statute should be amended to provide nonprofits the option of seeking only the Attorney General's approval, which would expedite the process significantly without eliminating substantive oversight. Nonprofits objecting to the Attorney General's determination would still have the opportunity to seek review by the courts.

Private foundations, including charitable trusts, face an additional unnecessary and costly burden. New York law requires that they publish newspaper advertisements announcing the public availability of their annual reports. With the advent of the Internet, Congress saw fit to repeal this requirement from federal law over a decade ago. However, New York's publication requirement remains in effect despite the widespread availability of private foundations' and trusts' financial reports, including on their own websites, the New York State Attorney General's website, and sites of third-parties like GuideStar.org. These newspaper advertisements serve no functional value but cost thousands of dollars each year, funds that should be dedicated to charitable purposes.

Additionally, New York law does not authorize either education or religious corporations to enter into merger transactions, allowing them only to "consolidate." This restriction often requires a more complicated and expensive process; instead of one entity simply merging into the second, an entirely new corporation must be created and the original entities extinguished. There appear to be no policy objectives that justify continuing this statutory distinction for

education and religious corporations.³⁶ Consideration should also be given to simplifying processes for dissolving nonprofit corporations so their assets can be more quickly allocated to other charitable purposes.

Board procedures present another opportunity for modernization. The Not-for-Profit Corporation Law requires that many boards obtain a two-thirds vote to approve the sale, mortgage or lease of real property.³⁷ While such a requirement is appropriate for substantial transactions, many nonprofits are party to small, routine transactions in which they must adhere to those stringent requirements. For example, if a nonprofit board seeks to amend or renew a short-term lease for a small satellite office, it must convene the entire board to act and obtain up to a supermajority vote. Amending the law to allow a lesser vote for small, ordinary-course transactions, and specifying the nature of the transactions to which a lesser vote would apply, would allow nonprofits to function more efficiently without sacrificing the oversight appropriate for substantial transactions.³⁸

Recommendations

- **Allow Electronic Communications.** The Not-for-Profit Corporation Law should be amended to permit better utilization of technology. The law should encourage electronic transmission of board and membership meeting notices, waivers of notice, and votes requiring unanimous written consent. This would reduce burdens, improve recordkeeping, and allow quicker dissemination of information.
- **Expedite Approval of Nonprofit Transactions.** Sections 510 and 511 and Articles 9 and 10 of the Not-for-Profit Corporation Law should be amended to provide nonprofits the option of seeking approval of mergers, substantial asset sales, or dissolutions by the Attorney General in lieu of obtaining court approval but permit nonprofits to appeal to the courts if approval is not granted. The law should also be amended to simplify processes for dissolving nonprofit corporations so their assets can be more quickly allocated to other charitable purposes.
- **Eliminate Publication Requirements for Private Foundations and Trusts.** Section 406(b-1) of the Not-For-Profit Corporation Law and Section 8-1.8(b-1) of the Estate, Powers and Trusts Law should be amended to eliminate the requirement that private foundations and trusts publish notice of the availability of annual financial reports. This would have no practical impact on these entities' disclosure obligations or upon the public's ability to review annual reports. It would, however, significantly reduce the costs currently incurred by private foundations and trusts.
- **Allow For Mergers by Educational and Religious Corporations.** Relevant provisions of the Education Law and the Religious Corporation Law should be amended to permit education and religious corporations to enter into merger transactions like other nonprofits. This change would simplify transactions and result in more equitable treatment of educational and religious nonprofits.

- **Permit Board Approval of Small, Routine Real Estate Transactions by a Lesser Vote Than Required for Substantial Matters.** The Not-for-Profit Corporation Law should be amended to permit a lesser vote for small, routine real estate transactions, specifying the nature of the transactions to which a lesser vote would apply.

Simplify Filing with the Attorney General's Charities Bureau

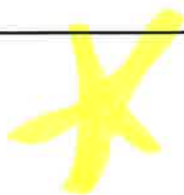
New York law requires nonprofits that hold charitable assets in New York, solicit New Yorkers for donations, or receive government grants to register with the Attorney General's Charities Bureau and file annual reports. The Charities Bureau works diligently to process the more than 100,000 filings it receives annually, but the Bureau's filing process is largely paper-based and in need of modernization.

While the Charities Bureau posts nonprofits' annual filings on the Internet, the Bureau can accept them from charities only in paper form. This requires charities to generate and mail paper copies to the Charities Bureau, including the federal Form 990, despite being able to submit the Form 990 electronically to the IRS. Because the system requires the Charities Bureau staff to process the paper filings manually before posting them online, there is an inevitable lag time and cost to the State before forms are available to the public.

In addition to the obvious environmental benefits that would result, implementing an electronic process for submitting annual filings to the Charities Bureau would improve oversight and substantially reduce burdens on nonprofits. Many state agencies and private funders have adopted a custom of checking with the Charities Bureau to ensure that nonprofits' filings are up-to-date when performing integrity checks, finalizing contracts and releasing funds. Members of the public often review the filings online when evaluating recipients of charitable contributions. The immediate posting of financial reports would improve transparency by making nonprofits' reports available in "real time" to members of the public, foundations and government agencies. The submission of data in electronic form would also allow the Charities Bureau to aggregate and analyze it for dissemination to the public.

Recommendation

- **Allow Nonprofits to File Electronically with the Attorney General.** Nonprofits should be able to file annual financial reports and other documents electronically with the Attorney General's Charities Bureau. This would simplify filing, improve transparency, and expedite funding determinations.



ENHANCING GOVERNANCE AND MAINTAINING THE PUBLIC TRUST

Effective governance is essential to maintaining public trust in the nonprofit sector. The public rightfully expects that nonprofit boards, in whose collective hands billions of dollars are entrusted each year, provide effective oversight and ensure accountability. However, we have all seen instances of inconsistent oversight by boards, and significant opportunity for improvement exists. The future viability and success of the nonprofit sector rests on developing new solutions to ensure effective governance.

Improving governance meaningfully requires a mix of enhancing laws, instituting voluntary best practices, and attracting and bolstering human capital. As a first step, New York law should be strengthened to provide boards with a better roadmap for governance and accountability. In key areas, such as compensation and financial oversight, the law should set forth clearer expectations of board duties and procedures. Secondly, elevating the quality of oversight requires broader dissemination and adoption of voluntary best practices. Finally, while new laws and the adoption of practices are critical, good governance ultimately depends on people. Nonprofits require committed board members with diverse backgrounds and skills, and robust knowledge of their responsibilities.

PROVIDING A NEW STATUTORY ROADMAP FOR OVERSIGHT AND ACCOUNTABILITY

Although directors' fiduciary duties help ensure proper oversight, New York statutes could be clearer in setting forth certain board responsibilities. For example, in the area of executive compensation, the law requires that nonprofits pay "reasonable compensation" that is "commensurate with services performed."³⁹ However, it does not delineate any procedures to ensure compliance with these requirements. Similarly, while New York law requires that certain nonprofits obtain independent financial audits,⁴⁰ it does not set forth the board's responsibilities with respect to overseeing the audit process. Clearer statutory guidance in these and other areas will enable boards to fulfill their obligations more effectively and improve the overall quality of governance. While the recommendations set forth in this chapter are drafted primarily in the context of publicly-supported nonprofits,⁴¹ many of the principles apply equally to private foundations and charitable trusts, and those entities should be taken into account in formulating statutory enhancements.⁴²

Enhance Board Oversight over Executive Compensation

Government, the press, and the public are increasingly focused on nonprofit executive compensation. Recent reports of inappropriate compensation have heightened concerns about board oversight and independence. While the Committee believes these isolated instances are not representative of the nonprofit sector as a whole, it also recognizes that the nonprofit community would benefit from stronger statutory guidance on compensation processes. This would improve accountability and inspire public confidence that executive compensation is reasonable.⁴³

New York statutes do not expressly require that the process of setting compensation be conducted free from the influence of those who would benefit from the compensation. Executives simply should not be involved in determining their own compensation. New York statutes also do not delineate procedures or criteria for determining when compensation is reasonable, and they are silent as to boards' responsibilities in retaining outside consultants, who are increasingly utilized in determining compensation. While some nonprofits look to IRS rules when setting compensation, the primary purpose of those rules is to provide a safe harbor from federal sanctions; they do not impose affirmative responsibilities on boards to ensure compensation is reasonable, nor are they intended to supplant state law fiduciary obligations.

In seeking solutions to these issues, the Committee was guided by the following principles:

- ◇ Boards and/or board committees should be meaningfully and actively engaged in setting and reviewing executive compensation;
- ◇ The process of determining compensation should be objective, independent, and free of influence by anyone with an interest in the outcome;
- ◇ Statutes should provide guidance to nonprofits on appropriate oversight procedures; and
- ◇ New York law should supplement and build upon existing federal requirements without imposing significant new costs and burdens.⁴⁴

In light of these principles, the Committee believes the following four measures will ensure that boards are actively engaged in, and accountable for, overseeing the reasonableness and justification of executive compensation.⁴⁵

Recommendations

- **Require Independent Board Oversight over Executive Compensation.** New York law should be amended to require that independent directors make an annual affirmative determination that compensation paid to the chief executive, as well as the chief financial officer and other key employees (as reported in the IRS Form 990), is reasonable, justified and commensurate with services provided. In lieu of action by all independent directors, the board may delegate this function to a board committee of independent directors. New York law should also be amended to set forth criteria for independence. For example, interested individuals should be deemed presumptively conflicted and their participation in the compensation process subjected to the organization's conflict of interest policies.
- **Set Forth Criteria for Board Review.** The board should be required to consider: total compensation, including all perquisites and benefits; relevant comparability data appropriate to the size and type of nonprofit; employees' qualifications and performance; payments or other benefits from related entities; and budgetary challenges and other issues affecting the corporation's overall financial position.

- **Require Contemporaneous Documentation of Board Action.** New York law should be amended to require contemporaneous documentation of the justifications for and reasonableness of compensation. This will help ensure that the basis for compensation determinations is timely recorded in board records.
- **Require Oversight of Compensation Consultants.** Nonprofits that utilize outside compensation consultants should be required to adopt policies and procedures governing consultants' selection and retention, and oversight of their work. Boards should also be required to affirm compensation consultants' qualifications and independence, which should be defined by New York statute.

Enhance Board Oversight over External Financial Audits

The external financial audit process is a critical governance and oversight tool. External financial audits can provide boards with key information concerning the reliability of financial data, as well as information regarding internal and financial controls, policies, procedures, and risks to the organization. In the for-profit sector, regulations governing publicly-traded companies now recognize the importance of board engagement in the audit process, and effectively require that most public companies have independent audit committees. While public company governance standards do not universally translate to the nonprofit sector, it is essential that nonprofit boards engage actively in the audit process and understand and utilize the information produced.

New York's Executive Law requires annual external financial audits of charities meeting certain revenue thresholds. (*i.e.*, those that raise more than \$250,000, including through public donations or government grants).⁴⁶ However, the statute provides no express guidance on the board's responsibilities for overseeing the audit process, nor does it expressly require the board to take any action with respect to the audit or the results it produces. As a result, boards have varying involvement in the audit process, and issues raised by auditors may not always be addressed.

To ensure the necessary oversight of the audit process, New York law should mandate that boards of nonprofits required to undergo an external financial audit perform the audit committee function, either by a dedicated committee of independent directors or by the independent directors on the full board. Core audit committee functions include but are not limited to: engaging external auditors and overseeing their work; meeting with external auditors to plan the scope of audits and review findings; overseeing internal auditors (if applicable); overseeing the establishment and effectiveness of internal and financial controls and reporting processes; monitoring and addressing risks; ensuring compliance with legal and regulatory requirements and "best practices"; and reviewing the results of external financial audits, management letters, management responses, and regulatory filings (*e.g.*, the IRS Form 990).

Along with this legislative change, there will be a great need to educate directors about the audit committee function. The Attorney General's Office should assist the nonprofit sector by initiating training programs in partnership with representatives of the accounting profession.

Recommendations

- **Require that Boards Perform the Audit Committee Function.** New York law should be amended to mandate that boards of those nonprofits that are required to obtain annual external financial audits perform the audit committee function. The function may be performed either through a committee of independent directors, or by independent directors on the full board. The statute should set forth core audit committee functions and criteria for independence.
- **Require Boards to Adopt Audit Oversight Charters.** The law should require that boards of nonprofits required to obtain external financial audits adopt charters setting key oversight functions, including the core functions prescribed by statute; oversight procedures; and requirements for independence.
- **Initiate Director Training on the Audit Committee Function.** The Office of the Attorney General should develop comprehensive training programs for nonprofit directors in conjunction with representatives of the accounting profession.

Protect Against Self-Dealing and Illegality

Central to maintaining trust in the charitable sector is public confidence that insiders are not exploiting their positions for personal gain. The vast majority of nonprofit organizations are operated by honest, dedicated board members and staff, but when scandals emerge, they cast a shadow on the entire sector.

Nonprofits that operate in the public interest and act as stewards of public contributions must maintain ongoing vigilance against misappropriation of charitable assets. Encouraging such vigilance requires a multi-faceted approach that includes statutory changes and adoption of best practices to prevent self-dealing, reduce and address conflicts of interest, and protect those who discover and report malfeasance.

Transactions that directly or indirectly benefit officers, directors or key employees may create opportunities for self-dealing and abuse. Provisions of relevant statutes should be amended to articulate board oversight responsibilities in connection with such transactions. For example, although section 715 of the Not-for-Profit Corporation Law requires disclosure of material terms to the board, it should also require that boards affirm that any such transaction is fair, reasonable, and in the nonprofit's best interest. Additionally, although the Attorney General already possesses authority to challenge improper transactions under various other statutes, section 715 does not expressly grant the Attorney General authority to commence proceedings to enforce its requirements. As the provision most directly governing interested party transactions, section 715 should be amended to vest in the Attorney General express authority to unwind improper interested party transactions. Similar changes should be made to provisions of other relevant statutes, including the Estates, Powers and Trusts Law.

In addition, New York law does not require nonprofits to maintain policies to prevent conflicts of interest, despite the fact that such policies are considered “perhaps the most

important policy a nonprofit board can adopt.”⁴⁷ New York law also does not require nonprofits to adopt policies that set forth procedures for reporting suspected violations of the law or for protecting whistleblowers. Widely used by for-profit companies, whistleblower policies are equally important in the nonprofit context.⁴⁸ As articulated by the IRS, a sound whistleblower policy “encourages staff and volunteers to come forward with credible information on illegal practices or violations of adopted policies of the organization, specifies that the organization will protect the individual from retaliation, and identifies staff, board members or outside parties to whom such information can be reported.”⁴⁹

Recommendations

- **Enhance the Attorney General’s Power to Police Self-Dealing.** As New York’s principal regulator of the nonprofit sector, the Attorney General should be granted additional tools to police self-dealing and ensure integrity. The interested party provisions of the Not-for-Profit Corporation Law, as well as the Estates, Powers and Trusts Law, should be revised to strengthen the Attorney General’s power to bring judicial proceedings challenging interested-party transactions.
- **Require a Determination that Interested-Person Transactions are Fair and Reasonable.** The Not-for-Profit Corporation Law and the Estates, Powers and Trusts Law should also be amended to require that, in addition to the full disclosure to the board of material terms and recusal of interested board members, the board (or a designated committee of the board) make an affirmative determination that a transaction with an interested person is fair and reasonable before it can be approved. The law should be further amended to clarify that it applies to key employees (as reported on the IRS Form 990), in addition to directors and officers.
- **Require Conflict-of-Interest Policies.** The Not-for-Profit Corporation Law and the Estates, Powers and Trusts Law should be amended to add a requirement that nonprofits adopt conflict of interest policies and procedures for implementing them. The Office of the Attorney General should arrange for the creation and public dissemination of model conflict of interest policies.
- **Require Whistleblower Policies.** The Not-for-Profit Corporation Law and the Estates, Powers and Trusts Law should be amended to require nonprofits with employees to adopt policies providing for reporting of potential illegality and prohibiting intimidation and retaliation to protect employees who make such reports. The Office of the Attorney General should arrange for the creation and public dissemination of model whistleblower policies.

Delineate the Distinct Roles of Management and the Board

Under New York law, boards are responsible for managing the affairs of nonprofit corporations.⁵⁰ In practice, boards delegate day-to-day management to full-time employees and oversee their work. However, nonprofit boards historically have struggled with maintaining the proper balance between oversight and deference to management.⁵¹ An inverted power relationship may result in which nonprofit executives maintain disproportionate influence over board decision-making, particularly when an executive is the organization's founder.

Restoring the proper balance requires a cultural shift within many nonprofit boards. Such an evolution is not achievable through statutory change alone, but legal reforms can help. One clear way to set the appropriate tone on boards is to limit board service by executives and other compensated employees, such as by prohibiting them from serving as board chairs. This will make clear that management is accountable to the board, while ensuring the board chair — and the board as a whole — is positioned to oversee management effectively. Recognizing that board service by compensated employees may blur the division of responsibilities between management and the board,⁵² New York law should require that boards adopt policies governing service by employees on boards.

Recommendations

- **Promote Independent Board Leadership.** To emphasize the oversight role of the board over management and promote independence, New York law should prohibit the chief executive and other compensated employees from serving as board chair.
- **Require Policies on Board Independence.** New York law should be amended to require that boards have policies on board independence, including whether the CEO and other compensated employees may serve on the board and whether they have voting rights, the circumstances in which recusal from board deliberations and voting is required, the percentage of the board that must be independent, and criteria for determining director independence.

BUILDING BOARDS OF THE FUTURE

Nonprofit boards are only as strong as the people who serve on them. While statutory change can improve the framework for improving governance, ultimately, good governance can only be achieved by people who have the requisite time, experience, backgrounds, and competencies to serve as directors. Building stronger boards for the future will require creative new approaches to recruitment and education of directors, as well as broader adoption of voluntary best practices.

Recruit the Next Generation of Board Leaders

Thousands of New Yorkers generously contribute their time, effort and resources to nonprofit boards. Nonetheless, the demand for board talent outstrips known supply.⁵³ In a state that is home to the broadest spectrum of industry in the world, there is enormous opportunity to reach beyond traditional sources and attract a larger, broader and more diverse pool of directors. New York's nonprofits, with the assistance of the Attorney General, can forge new partnerships with the business community to develop pipelines for recruiting the next generation of board leaders. New York's multi-talented retiree populations and its extraordinary academic community are also untapped talent pools that present natural avenues for new partnerships.

Create a Pipeline of New Directors

Creating a pipeline of new directors will help fill critical gaps that exist on nonprofit boards. From strategy, to finance, to public relations, new directors will provide depth and experience at a time when effective oversight and strategic leadership are critically needed. For many organizations, tough choices lie ahead as budgets are tightened and demands increase. New programs to attract directors with needed skills will position nonprofits to face today's challenges while building stronger foundations for tomorrow.

A new pipeline will also help boards better reflect New York's diversity. From New York City, the most diverse city in the country,⁵⁴ to communities in upstate New York undergoing unprecedented population shifts,⁵⁵ enormous potential exists to expand the composition of nonprofit boards. Yet, diversity remains an ongoing challenge for nonprofits. National and New York data indicate that boards do not always reflect the diversity of the communities their organizations serve, whether in terms of race, ethnicity or gender.⁵⁶ Diversity, of course, extends beyond these traditional definitions, and boards should take into account life experience and perspective when recruiting new members. Directors who bring varied backgrounds, viewpoints, and skills enrich and strengthen boards.

The Committee believes that innovative programs are needed to expand the available pool of director talent statewide and build stronger and more diverse boards. The Committee encourages Attorney General Schneiderman to launch **New York on BOARD**, an exciting and multi-faceted new initiative to recruit directors and match them with nonprofits.

*“New York on **BOARD**”*

Through **New York on BOARD**, New York’s business community can lead the way towards stronger and more diverse nonprofit boards. New York businesses have long provided generous support to nonprofits. Corporate foundations and individual leaders have raised and contributed billions of dollars to charity — from literacy programs in Buffalo, to food and poverty programs on Long Island, to community health programs in Syracuse. Their support has been critical in keeping charitable programs running through the recession. Building on this historical support, New York’s business community can provide an additional level of philanthropic leadership by encouraging and incentivizing their employees to serve on nonprofit boards.

*Boosting
Oversight
Awareness
Resources &
Depth*

New York companies can get on **BOARD** by agreeing to take three steps:

1. Expand existing philanthropic programs to include board service by employees;
2. Sponsor employee board service, such as by making financial contributions to nonprofits in employees’ names; and
3. Incentivize employee participation, such as by recognizing the value of board service in performance evaluations.

Companies that pledge to get on **BOARD** will help create a corporate culture that values and encourages board service. Setting a “tone from the top” that board service is compatible (and not in competition) with service to the company will motivate employees to participate. Incorporating board service into employee performance evaluations will incentivize participation by signaling to employees that board service has value to both the company and the employee. By assisting employees in meeting financial obligations that may be expected of directors, companies will help eliminate a significant barrier to service.

This new program will benefit everyone involved. Nonprofits would enjoy improved governance as core competencies become better represented on their boards. Individual employees would develop new business relationships, leadership experience, and skills through board service. Businesses, by lending employees and their imprimatur to charitable efforts, would reaffirm the old adage of “doing well by doing good.” Not only would they help society, they would also enhance the strength and reputation of their brands.

Beyond New York’s business community, the Committee recommends that **New York on BOARD** be expanded to the state’s academic institutions — a rich but underutilized source of potential directors. With vast and prominent public university and community college networks, equally expansive and prestigious private schools, and some of the most celebrated research institutions in the world, New York’s academic community has thousands of potential nonprofit board members in its ranks. In addition, New York’s significant retiree population is a largely

untapped and hugely talented source of career experience, diversity and life perspective, especially as baby boomers retire in increasing numbers. Through new partnerships with civic and retiree organizations, additional programs can be created through **New York on BOARD** to further improve the quality and depth of nonprofit boards. Certain boards may also benefit by recruiting cultural entrepreneurs and social innovators to provide creative energy and skills.

Prospective directors recruited through **New York on BOARD** must be matched with suitable nonprofits. Leveraging technology, the **New York on BOARD** database populated with the names of prospective directors and individual profiles containing their interests and skills. Nonprofits would likewise create profiles identifying core competencies needed on boards, along with their missions, programs, and other relevant information. The system would be scalable, with nonprofits throughout the state able to use it for director recruitment.

The Attorney General's Office should work with New York's business community to initiate **New York on BOARD**. A committee of business and civic leaders and regional nonprofit representatives should be appointed to develop and promote the program, with the assistance of the Attorney General's Office. **New York on BOARD** would be a statewide program, but it requires community focus. Local foundations, organizations, and businesses are best positioned to identify prospective nonprofits and directors to participate in the program. Importantly, **New York on BOARD** would supplement, but not compete with, existing director recruitment and matching programs. While these programs serve an important function, their reach is necessarily limited by geography and other constraints. When possible, existing programs should be given the first opportunity to place directors recruited through the new statewide pipeline. Prospective directors not placed through existing programs would be matched using the **New York on BOARD** database.

For this system to succeed, nonprofits must do their part. New recruitment pipelines are only effective if boards of directors meaningfully assess and identify their needs. Boards must evaluate their members' core competencies and identify gaps to fill. Boards should also candidly assess the diversity represented among their members and use the new system to enhance diversity where needed.

Recommendations

- **Launch New York on BOARD.** The Attorney General's Office should facilitate the launch of **New York on BOARD**, a new initiative with New York's business community to build a pipeline for director recruitment. Companies across the state would be asked to encourage and sponsor board service by their employees. Special efforts should be made to identify candidates for board service with diverse backgrounds and experiences.
- **Expand New York on BOARD to Additional Communities.** The Attorney General's Office should facilitate the expansion of the **New York on BOARD** consortium to reach additional sources of prospective nonprofit directors, including members of the academic and retiree communities, by launching **Boomers on BOARD** and **Academia on BOARD**.

- **Develop a Database to Match Directors with Nonprofits.** The New York on BOARD consortium should develop a database to match nonprofits with board members who have relevant skills and backgrounds.

Promote Director Education

Board effectiveness depends not only upon board composition, but upon directors' understanding of their roles and responsibilities. Unless directors are aware of their core functions and the specific issues they must address, they are not positioned to provide strategic leadership and oversight. Even sophisticated and experienced directors must learn the nuances of nonprofit laws and practices, such as fundraising, endowment spending, regulatory compliance, labor and employment issues, and political and lobbying restrictions. Similarly, directors must become familiar with state law fiduciary obligations and federal tax exemption requirements, as well as evolving standards of governance best practices. Above all, directors must understand the structural relationship between board and management, and the board's paramount oversight function.

For recruitment efforts to succeed, directors must feel comfortable in their ability to perform their roles. New education programs not only would provide directors with a substantive knowledge base, but also alleviate unfounded fears about personal liability that may deter board service.

New and innovative programs are needed to educate and train board members on these and other topics. The Attorney General should facilitate a new, statewide initiative called "**Directors U**" to provide training that is easily accessible and free or low-cost. The Attorney General should form a consortium of existing organizations engaged in director training and academic institutions to develop an online repository of training modules covering a full range of topics relevant to nonprofits. The online repository should be supplemented by a series of live, in-person trainings. **Directors U** could build upon existing programs, such as those conducted by the State Board Training Consortium, which has provided free training programs to nonprofits contracting with the State.⁵⁷

The Attorney General's Office, which already conducts substantial training, is well situated to provide content on legal requirements and best practices for the training repository. Through **Directors U**, the Attorney General could work with the nonprofit sector to develop, broadly disseminate, and provide education on best practices. **Directors U** also could develop specialized programs to promote effective leadership by board chairs, who play a critical role in ensuring accountability and sound management. It could also be expanded over time to develop training programs for nonprofit executives and staff on key issues.

To incentivize participation in this voluntary program, **Directors U** should provide certificates to recognize directors who complete training courses. Organizations would also receive recognition based upon the extent and frequency of participation by members of their boards. Nonprofits could publicize this recognition to donors and the public to provide evidence of their commitment to effective governance.

Recommendations

- **Launch Directors U.** The Attorney General should facilitate a new partnership between nonprofits and universities called “**Directors U**” that will build upon existing director educational programs statewide and make them more accessible. **Directors U** would create an online library of webinars on a variety of topics related to nonprofits and governance.
- **Incentivize Participation.** **Directors U** should incentivize participation in its education programs by developing a system to acknowledge organizations whose board members participate.
- **Develop and Disseminate Best Practices.** Through **Directors U**, the Attorney General should facilitate the development and promotion of best practices on topics such as board composition, executive compensation, committee structure, the role of the board chair, director independence, conflict of interest policies, and financial oversight. The Attorney General should also offer educational programs on these practices through **Directors U**.
- **Create a Repository of Model Documents.** **Directors U** should build upon existing resources and create a clearinghouse of information regarding governance, such as model by-laws, conflict of interest policies, and internal control policies.

THE PATH FORWARD

ENVISIONING THE NONPROFITS OF TOMORROW

The Attorney General's Leadership Committee for Nonprofit Revitalization has been a groundbreaking effort, marking the beginning of an important new partnership between nonprofits and the Attorney General's Office. This unique collaboration has produced recommendations that, if implemented, will revitalize the nonprofit sector by substantially reducing burdens and costs on nonprofits and strengthening governance and accountability.

As we address longstanding challenges, the Committee believes it is equally important to plan for the future. Here, too, the Attorney General's Office can play a central role. Working together, nonprofits and the Attorney General can craft strategies and recommendations to build new paradigms for the nonprofits of tomorrow.

We recommend that the Office of the Attorney General initiate the next phase in its partnership with the nonprofit community by working with the nonprofit sector to develop a blueprint of the vision and strategy for its future. Entitled "*Nonprofits 2020: A Blueprint for the Future*," this initiative would address such topics as:

- ◇ What do nonprofits want the sector to look like in 2020 and beyond, and how do we get there?
- ◇ How can technology improve service delivery and governance?
- ◇ How do we further strengthen the relationships between the nonprofit sector and government for the public good?
- ◇ Can we develop innovative ways to measure and communicate the successes of nonprofits and individual programs?

The Attorney General should initiate the process of developing this blueprint next year, with one or more conferences that would bring key nonprofits leaders and thinkers together with staff from the Attorney General's Office. Conference attendees would discuss challenges and opportunities facing the sector in the years ahead, and begin brainstorming ideas and frameworks to form the foundation of *Nonprofits 2020*.

By thinking and planning in advance, the nonprofit sector and government can direct resources and craft policy more strategically and thoughtfully. Together, government and nonprofits in New York can create a national model for collaborative and innovative reform that will improve delivery of programs and services to individuals and communities and further strengthen oversight and public trust.

Recommendation

- **Launch *Nonprofits 2020*.** The Attorney General should continue his new and productive partnership with the nonprofit community and work with the sector to develop a blueprint for its future. The Attorney General should initiate this process by convening one or more conferences to promote a frank and forward-looking discussion among nonprofit leaders and thinkers about the direction of the sector and strategies for future success.

ENDNOTES

¹ This report uses the term “directors” to refer to individuals serving as members of nonprofit boards. It is intended to refer interchangeably to board members, directors, trustees, and similar roles.

² Office of the State Comptroller, New York State’s Not-for-Profit Sector (Nov. 2011).

The Mayor’s Office of Contract Services in New York City similarly reported that in Fiscal Year 2011, city agencies processed contracts and grants with nonprofits that had a total value of \$8.6 billion, and that human services contracts represented 48% of all awards by the City. Mayor’s Office of Contract Servs., City of N.Y., Agency Procurement Indicators: Fiscal Year 2011, at vi & 51 (2011), *available at* http://www.nyc.gov/html/mocs/downloads/pdf/procurement_indicators_2011.pdf.

³ Lester M. Salamon, S. Wojciech Sokolowski & Stephanie L. Geller, Johns Hopkins Ctr. for Civil Soc’y Studies, U.S. Nonprofit Employment: The Impact of Recession (forthcoming Jan. 2012).

⁴ Nationwide, the nonprofit sector employs only 5.9 percent of all workers, and in neighboring New Jersey, recent data shows that nonprofit workers represent only 10 percent of the workforce. Amy Butler, Bureau of Labor Statistics, U.S. Dep’t of Labor, Wages in the Nonprofit Sector: Management, Professional, and Administrative Support Occupations (Oct. 28, 2008; rev’d April 15, 2009); Unpublished data from the Current Population Survey (CPS), 1994 and 2007 annual averages of the total number of full-time nonagricultural private wage and salary workers employed at nonprofit organizations; Lester M. Salamon & S. Wojciech Sokolowski, Johns Hopkins Ctr. for Civil Soc’y Studies, Employment in America’s Charities: A Profile (Dec. 2006), *available at* http://ccss.jhu.edu/wp-content/uploads/downloads/2011/09/NED_Bulletin26_2006.pdf.

⁵ See Nat’l Ctr. for Charitable Statistics, Urban Inst., Registered Nonprofit Organizations by State, <http://nccsdataweb.urban.org/> (last visited Nov. 28, 2011) (Chart includes organizations that filed a Form 990, 990-EZ, 990-PF and, since 2008, 990-N ePostcard within 24 months of the BMF release date, as reported in NCCS Core Files and IRS Business Master Files.).

⁶ Ctr. For Nonprofit Strategy and Mgmt., Baruch Coll. Sch. of Pub. Affairs, The Helpers Need Help: New York City’s Nonprofit Human Service Organizations Persevering in Uncertain Times 5 (Sept. 2009), *available at* http://www.baruch.cuny.edu/spa/researchcenters/nonprofitstrategy/documents/CNSM_HelpersNeedHelpReport.pdf.

⁷ Chuck McLean & Carol Brouwer, GuideStar, The Effect of the Economy On the Nonprofit Sector 3 (June 2010), *available at* <http://www2.guidestar.org/ViewCmsFile.aspx?ContentID=2963>.

⁸ Office of the State Comptroller, Track New York’s Spending of Federal Stimulus Money, Open Book New York, <http://www.openbooknewyork.com/stimulus> (last visited Nov. 4, 2011); Shane Dixon Kavanaugh, *Job programs threatened as stimulus funds dry up*, CRAIN’S N.Y. BUS., Jun. 19, 2011.

⁹ State Div. of the Budget, Mid-Year Financial Plan Update FY 2012 Through FY 2015, at 22 (Nov. 2011), *available at* http://publications.budget.ny.gov/budgetFP/midYearUpdate/FY2012_Mid-YearUpdate.pdf.

¹⁰ Federal Reserve Board, Minutes of the Federal Open Market Committee, Sept. 20-21, 2011, *available at* <http://www.federalreserve.gov/newsevents/press/monetary/fomcminutes20110921.pdf>.

¹¹ Sabrina Tavernise, *Soaring Poverty Casts Spotlight on “Lost Decade,”* N.Y. TIMES, Sept. 13, 2011, *available at* <http://www.nytimes.com/2011/09/14/us/14census.html>.

¹² Elizabeth T. Boris, Erwin de Leon, Katie L. Roeger & Milena Nikolova, Urban Inst., National Study of Nonprofit-Government Contracting 73 (2010), *available at* <http://www.urban.org/uploadedpdf/412227-National-Study-of-Nonprofit-Government.pdf>.

¹³ Office of the State Comptroller, Prompt Contracting Annual Report Calendar Year 2010, at 1 (May 31, 2011) (noting that this represents an 11 percent improvement from 2009, when contracts were late 82 percent of the time).

¹⁴ Estimate provided by the Office of the State Comptroller.

¹⁵ See Office of the State Comptroller, *supra* note 13, at 4.

¹⁶ See Press Release, Div. of the Budget, Governor Paterson Issues Cost Control Measures to State Agencies (Nov. 3, 2008), available at http://www.budget.ny.gov/pubs/press/2008/press_release08_1103.htm.

¹⁷ Office of the State Comptroller, *supra* note 13, at 13 (“The Not-for-Profit Contracting Advisory Committee surveyed NFPs and major contracting agencies regarding the factors affecting prompt contracting. Responses confirm that resources at NFPs and agencies are limited, time frames for response are tight, and the requirements of contracting (e.g., aggregating necessary information and approvals) cumbersome for many organizations.”).

¹⁸ See Office of the State Comptroller, *supra* note 13, at 8; see also Office of the State Comptroller, *supra* note 2, at 1.

¹⁹ Following the creation of the Office of Contracting Reform and Accountability, the responsibilities of the Nonprofit Liaison to the Governor would shift from improving state contracting processes to facilitating communication between nonprofits and the Governor’s office, between agencies and nonprofits, and among nonprofits themselves. The liaison could become a resource that would work with nonprofits to help them become more sustainable, create strategic partnerships, and develop alternative and supplemental funding mechanisms.

²⁰ See Office of the State Comptroller, Written Directive – Renewal Contract: Fifth Quarter Financing, available at <http://www.osc.state.ny.us/agencies/abulls/a316a.pdf>.

²¹ Office of the State Comptroller, *supra* note 13, at 12.

²² See Suzanne Perry, *Connecticut’s New Governor Creates Cabinet Position for Nonprofits*, CHRON. PHILANTHROPY, Jan. 6, 2011, available at <http://philanthropy.com/blogs/government-and-politics/connecticuts-new-governor-creates-cabinet-position-for-nonprofits/27825>.

Several other municipalities and states have recognized that their approaches to managing grants to nonprofits are fragmented and inconsistent, and they have responded by designating a single government official to help streamline processes and build stronger partnerships with the nonprofit sector. In 2003, the State of Michigan created the nation’s first Office of Foundation Liaison through a joint agreement between Michigan foundations and the Governor’s office. The Office’s purpose is to forge partnerships between private grant-making foundations and government. Like the Connecticut post, Michigan’s is a cabinet-level position. See Council of Michigan Foundations, Office of the Foundation Liaison, http://www.michiganfoundations.org/s_cmf/sec.asp?CID=2513&DID=6254 (last visited Oct. 31, 2011).

²³ See Memorandum from Benjamin Barnes, Sec’y, Office of Policy and Mgmt., to Comm’rs Arnone, Bremby, Katz, Macy, Mullen and Rehmer re Health and Human Service Purchase of Service Contracting Reforms (Feb. 1, 2011); see also Memorandum from Benjamin Barnes, Sec’y, Office of Policy and Mgmt., to Comm’rs Arnone, Bremby, Katz, Macy, Mullen and Rehmer, re: New Health and Human Services Purchase of Services (POS) Policies and Procedures (July 18, 2011), available at <http://www.ct.gov/opm/lib/opm/secretary/pospolicyandprocedurehhs071811.pdf>.

²⁴ See Suzanne Perry, *Connecticut Nonprofit Liaison Makes “Significant Impact,”* CHRON. PHILANTHROPY, Feb. 9, 2011; Press Release, Conn. Ass’n of Nonprofits, Nonprofits Support OPM’s Push for Contracting Reform (Feb. 2, 2011), available at <http://www.ctnonprofits.org/news17>.

²⁵ See Office of the State Comptroller, *New York State’s Nonprofit Sector 2* (Mar. 2010), available at <http://www.osc.state.ny.us/reports/economic/nfp2010.pdf>. Program audits may still need to be conducted by individual funding agencies.

²⁶ Interest expenses that nonprofits must incur in utilizing reserve funds are not reimbursable by the State.

²⁷ State Fin. Law §§ 97-jj & 179-z.

²⁸ While the legislature appropriated \$150,000 for the fund in the Fiscal Year 2011 budget, it is our understanding that no readily-available pool of money exists for carrying out the fund’s intended purpose, and no interest free loans have ever been provided to nonprofits. See State Operations Budget, 2011 N.Y. Laws ch. 50, at 57, available at http://assembly.state.ny.us/leg/?default_fld=&bn=S02800&term=2011&Text=Y.

²⁹ Administered by the Fund for the City of New York, the City's Returnable Grant Fund has made over 3,000 loans totaling \$170 million since its inception. Fund for the City of N.Y., MOCS Returnable Grant Fund, <http://www.fcny.org/fcny/core/cfl/rgf/> (last visited Nov. 29, 2011).

³⁰ See Fund for the City of N.Y., Cash Flow Loans, <http://www.fcny.org/fcny/core/cfl/#cashflow> (last visited Nov. 28, 2011).

³¹ See State Fin. Law § 179-aa.

³² Section 201 of the Not-for-Profit Corporation Law requires that not-for-profits be classified as one of four types – A, B, C and D. Type A corporations are membership organizations and not charities. Type D corporations are those formed under the Not-for-Profit Corporation Law when their formation is authorized by another statute and are subject to the provisions applicable to Type B corporations.

³³ Type C corporations were included in the Not-for-Profit Corporation Law to permit the formation of a “corporation, which has, among its purposes, a purpose which is usually carried on for profit ... although...the principal reason for its formation is to accomplish something other than making money.” Explanatory Memorandum of Joint Legislative Committee to Study Revision of Corporation Laws, ch. 166, L. 1969, *reprinted in* 1969 N.Y. ST. LEGIS. ANN. 130 (Jan. 13, 1969). This distinction was made to “facilitate [the] blending of public and private resources with gifts from foundations and governments funds...[such as] a local development corporation.” Senate Debate on Senate Bill S956-A, Apr. 22, 1969, at 2615 (Statement of bill sponsor, Senator Warren Anderson). However, that distinction is no longer relevant, since such not-for-profit corporations, including local development corporations, typically qualify for tax-exempt status as charitable organizations pursuant to section 501(c)(3) of the Internal Revenue Code and are subject to the same regulatory requirements under New York's Not-for-Profit Corporation Law as Type B corporations.

³⁴ The law should make clear that organizations must refrain from soliciting contributions until notice of incorporation has been provided to the requisite agencies and required approvals, licenses, and certifications have been granted.

³⁵ For example, section 608 of the Not-for-Profit Corporation Law requires notice of meetings of members be given “personally or by mail,” and section 708 permits certain votes to be taken by unanimous “consent in writing.”

³⁶ Members of the Committee have noted an absence of statutory clarity with respect to the process of merging educational institutions chartered by the New York State Board of Regents and non-chartered nonprofits. The Committee believes that such mergers may occur with increasing frequency and recommends that the Attorney General consider reforms to simplify the process.

³⁷ Boards with fewer than 21 members must obtain a two-thirds vote. N-PCL § 509.

³⁸ The Committee believes that ambiguity exists in the Not-for-Profit Corporation Law with respect to the method of counting board members for purposes of determining if a quorum is present at meetings and taking votes. The problem arises when a nonprofit's certificate of incorporation provides for a range in the number of board members (*e.g.*, “The board shall consist of between nine and fifteen members.”) and the required vote is based on the “entire board.” We recommend that the Attorney General's Office issue clarifying guidance as to the definition of “entire board” for purposes of determining whether a quorum is reached.

³⁹ N-PCL § 202(a)(12).

⁴⁰ Exec. Law § 172-b.

⁴¹ As used in this report, the terms “public charity” and “publicly-supported charity” refer to a nonprofit classified as a public charity, because it solicits funding from the public, including from individuals, governmental agencies, corporations, private foundations and other public charities, rather than from a limited number of donors, as is typical of a private foundation.

⁴² For example, section 406 of the Not-for-Profit Corporation Law already subjects private foundations to the Internal Revenue Code section 4941's prohibitions against self-dealing. Section 8-1.8(a)(2) of the Estates, Powers and Trusts Law applies these same prohibitions to charitable trusts. Consideration should be given to whether or not further enhancements to sections 406 of the NPCL and 8-1.8 of the EPTL are warranted. Any amendments should

make clear that enforcement powers of the Attorney General, and the available remedies, are substantially the same for private foundations, whether formed as corporations or as trusts.

⁴³ This report focuses on the process of setting executive compensation at public charities. The Committee recommends that further consideration be given to whether or not statutory change is needed to limit the practice of compensating public charity directors.

⁴⁴ In matters such as executive compensation, many New York nonprofits look to Internal Revenue Code section 4958 for guidance. The Code's framework for remedying "excessive benefit transactions" is an important resource, but the Committee believes New York law should provide greater specificity with respect to appropriate board practices and processes. While seeking to strengthen federal requirements, the Committee was mindful of the burdens posed by subjecting nonprofits to two conflicting regulatory schemes. As such, any legislative proposals should seek to minimize such burdens.

⁴⁵ The Committee acknowledges that many nonprofits compensate executives at levels below the value of the services they provide. Requiring that boards determine compensation to be "reasonable" in this context is intended to refer to reasonableness in light of the nonprofit's financial position and other factors, and not to the *sufficiency* of the compensation provided to the individual employee.

⁴⁶ Charities that have revenue greater than \$250,000 in a year and solicit contributions in New York, including public donations and government grants, must submit a financial audit by an independent CPA to the Attorney General. Those with revenues between \$100,000 and \$250,000 must file a CPA's review report. Those with revenues below \$100,000 are not required to retain a CPA, but must submit a financial report certified by the nonprofit's principals to the Attorney General. See Exec. Law § 172-b; 13 NYCRR 91.5(c)(3)(ii).

⁴⁷ Nat'l Council of Nonprofits, Conflict of Interest, <http://www.councilofnonprofits.org/conflict-of-interest> (last visited Nov. 2, 2011).

⁴⁸ Since the enactment of the Sarbanes-Oxley Act of 2002, publicly traded companies have had to create new mechanisms for employees to raise concerns about financial malfeasance and protect whistleblowers. See 18 U.S.C.A. § 1514A (2010). Sarbanes-Oxley's whistleblower provisions were prompted in part by the large number of employer retaliation complaints that whistleblowers filed with the U.S. Department of Labor. See Jason M. Zuckerman, Nonprofit Risk Mgmt. Ctr., *Whistleblower Protections in the Nonprofit Sector*, <http://www.nonprofitrisk.org/library/articles/employment091005.shtml> (last visited Nov. 2, 2011). The Dodd-Frank Act, passed just last year, included additional whistleblower protections, which were recently implemented by the Securities and Exchange Commission. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub.L. 111-203, § 922, 124 Stat. 1376, 1841-49; SEC Rule 21F, 17 C.F.R. § 240.21 (2011).

⁴⁹ Internal Revenue Serv., 2010 Instructions for Form 990, Return of Organization, Exempt From Income Tax 22, available at <http://www.irs.gov/pub/irs-pdf/i990.pdf>.

⁵⁰ N-PCL § 701.

⁵¹ See Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officer Paradoxes, Problems, and Proposed Reforms*, 23 IOWA J. CORP. L. 631, 632 (1998).

⁵² See, e.g., N.Y. Council on Nonprofits, *Standards for Common Sense* 17-18 (May 2009).

⁵³ See BoardSource, *Nonprofit Governance Index 2010*, at 33 (2010), available at <http://www.boardsource.org/governance/>.

⁵⁴ See Henry Goldman & Timothy R. Homan, *Brooklyn Enclave Helps New York Top Los Angeles as U.S. Diversity Capital*, BLOOMBERG, May 5, 2011, <http://www.bloomberg.com/news/2011-05-05/brooklyn-enclave-helps-new-york-top-los-angeles-as-u-s-diversity-capital.html> (last visited Nov 14, 2011).

⁵⁵ See Elizabeth Cooper, *Region's diversity increasing, according to Census Figures*, UTICA OBSERVER DISPATCH, Mar. 26, 2011, available at <http://www.uticaod.com/census2010/x796070325/Regions-diversity-increasing-according-to-Census-figures>.

⁵⁶ Using traditional methods of measuring diversity, such as race, ethnicity, and gender, national figures show that Caucasians represent 84% of directors serving on boards. BoardSource, *supra* note 53, at 27. New York does not appear immune from this trend. In New York City, one of the most ethnically diverse cities in the world, non-Hispanic Whites represent 33.3% of the population, but they represent 67% of nonprofit boards. U.S. Census Bureau, State and County Quickfacts, New York (city), New York, <http://quickfacts.census.gov/qfd/states/36/3651000.html> (last visited Nov 29, 2011); Foundation Ctr., Benchmarking Diversity: A First Look at New York City Foundations and Nonprofits 25, tbl. 4 (Oct. 2009), available at <http://foundationcenter.org/gainknowledge/research/pdf/diversity2009.pdf>.

⁵⁷ See N.Y. Council of Nonprofits, State Board Training Consortium, http://www.nycon.org/helping_nonprofits/stateBoardTrainingConsortium.asp (last visited Dec. 6, 2011).