

Charity Fat Cats

THE IRS IS CRACKING DOWN ON EXCESSIVE PAY AND PERKS AT NONPROFITS.
COULD THE SCRUTINY GO TOO FAR?

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December 19, 2005; US Edition

TIME BONUS SECTION JANUARY 2006: INSIDE BUSINESS/PHILANTHROPY; Pg. A21 Vol. 166 No. 25 Special Issue: The Best Photos of 2005

There was no particular reason for Steven J. McCormick's salary to raise a red flag. In fact, his 2003 remuneration as CEO of the Nature Conservancy, the world's largest environmental charity--at \$275,000 plus health and retirement benefits--might even have seemed inadequate. With operations in 28 countries and claims of having nearly a million members, the Conservancy that McCormick was running was, after all, the nonprofit equivalent of a multinational. But it turned out that McCormick had also received a \$75,000 sign-on bonus, \$75,000 to cover living expenses, a \$1.7 million loan to buy a new house and a no-strings-attached discretionary fund to use toward finishing pet projects.

After an exposé by the Washington Post in May 2003 revealed his benefits package and other irregularities, Congress launched an inquiry, and the Conservancy has spent the past two years overhauling its accountability practices. The nonprofit has instituted mandatory ethics training for its staff and voluntarily implemented sections of the strict new governance guidelines in the Sarbanes-Oxley Act, which does not apply to charities. McCormick took a 5% pay cut, discontinued the discretionary fund and immediately paid back the loan. "The management has taken this situation very seriously," says Stephanie Meeks, the Conservancy's chief administrative officer. "We have taken specific steps to make sure there isn't even the perception of wrongdoing." McCormick was not available for comment.

McCormick and the Conservancy learned the hard way that charity is no longer beyond reproach. Corporate America has been penned in by new regulations imposed by the Sarbanes-Oxley Act, but the nonprofit sector faces few rules for disclosing financial health, paying executives or explaining spending. But in the postscandal era, state and federal lawmakers are pushing for stricter standards of governance for nonprofits.

The new scrutiny is a response to the exponential growth of the nonprofit sector over the past decade--and to concerns that some institutions are scamming the system by seeking tax-exempt status. The Internal Revenue Service lists more than 1.8 million charities, up from 739,000 charities 25 years ago. The tax-exempt sector includes not just soup kitchens and scholarship funds but also labor unions, hospitals, the NCAA--even Major League Baseball. "Today you see nonprofit holding companies," says Minnesota state attorney general Mike Hatch, who has aggressively pushed for better nonprofit governance. "We're dealing with multibillion-dollar enterprises, many times with no tie to the community."

The IRS has been working overtime to catch the scammers. Flush with funding to root out nonprofits connected to terrorism and given a new institutional mandate to do a tougher job, its Exempt Organizations Division has added 160 auditors over the past two years. Since August 2004, according to Mark Everson, commissioner of the IRS, the agency has contacted 1,240 organizations with questions about how they pay their executives. So far, 719 returns have come under audit for suspicious accounting. State regulators, who have traditionally policed nonprofits, are pushing for new laws. The House and Senate held hearings this summer on nonprofit governance and drafted legislation that is being reviewed as part of a tax-reform package. (The last major regulations covering the industry were adopted in 1969.)

Hatch set out to look at the management of nonprofit HMOs in Minnesota in an effort to investigate spiraling health-care prices. In testimony before the Senate Finance Committee in April, he claimed that one of the HMOs, Allina Health Systems, paid for employee travel to Aruba, London, Paris, Venice, Grand Cayman, Athens, Pago Pago, Cancún and Los Cabos. "Executives charged the organization for \$100 floral arrangements to decorate their \$855-per-night suites," he said. Another nonprofit HMO, HealthPartners, paid to have masseuses during executive board meetings, Hatch said. In the face of bruising media attention, both companies scrambled to apply governance rules. Allina selected a new board of directors and split its corporate structure. "To Hatch's defense, I think nonprofit insurers and hospitals had fallen complacent and started acting like their for-profit equivalents, and he brought that to light," says Mary Fourde, general counsel for Allina Health Systems. Hatch is pushing the Minnesota legislature to pass laws that would adopt whistle-blower provisions similar to those applied to for-profit corporations and would require top executives to disclose their compensation in more detail than federal standards mandate.

California, meanwhile, passed the Nonprofit Integrity Act in 2004, one of the country's most comprehensive nonprofit-governance laws. The state's attorney general, Bill Lockyer, could be applying the law for the first time soon if it finds irregularities in its inquiry into the J. Paul Getty Trust. In June the Los Angeles Times revealed that the trust had paid its chief executive, Barry

Munitz, a \$1.2 million salary plus perks including a new Porsche SUV when the trust was scaling back other expenses. New York and Massachusetts are working on similar laws, partly in response to their own scandals. Dick Grasso, the disgraced former CEO of the New York Stock Exchange, is facing trial under New York's existing nonprofit laws this winter for his \$187.5 million payday. Last December, Massachusetts attorney general Thomas Reilly exacted \$4 million from Paul Cabot Jr., the former executive director of Boston's Cabot Foundation, who admitted to the Boston Globe last year that he had given himself a raise partly to pay for his daughter's \$200,000 wedding in Florida.

While most people applaud the attempt to crack down on abuse, nonprofit experts are worried that the new get-tough approach will unfairly punish an industry in which most people are genuine do-gooders, burdening small charities with a host of new regulations and scaring off talented directors from nonprofit boards. "If you get too tough in terms of the provisions and potential liabilities, you will drive away some of the best and most important people," says Jon Small, director of government relations at the Nonprofit Coordinating Committee of New York, which represents 1,350 organizations. Diana Aviv, executive director of Independent Sector, a nonprofit-governance group based in Washington, has advocated for some new rules but believes that the industry should remain on a model of self-regulation.

The challenge is to reform the nonprofit sector without crushing it. Critics say voluntary disclosure doesn't go far enough. "To think that disclosure by itself is going to stop abuse is being naive," says Pablo Eisenberg, founder of the National Committee for Responsive Philanthropy. "There is a need to ask big questions, to say, 'Are pieces of the charitable sector still legitimate?'" But few people, even regulators, are willing to saddle nonprofits with a version of Sarbanes-Oxley. California's Lockyer hopes states can help nonprofits develop better management skills rather than simply throw a raft of new rules at them. "The next step ... would be to try to figure out how to provide those [accountability] skills to people who are devoted but don't have a history of management," he says.

Perhaps most encouraging is the rise of armchair regulators, curious donors who are using the power of technology to find out more about the organizations they support. For the nonprofit industry, it's time to go over those spreadsheets again.

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