

Attorney General Releases Report On Nonprofits And Proposes Nonprofit Revitalization Act

On February 16, 2012, N.Y. Attorney General Eric Schneiderman (the “AG”) released a report prepared by the Leadership Committee for Nonprofit Revitalization entitled “Revitalizing Nonprofits Renewing New York” (the “Report”). The Report highlights the importance and significance of New York’s nonprofit sector and offers numerous recommendations for improving cash-flow to organizations, reducing regulatory redundancies and strengthening oversight. The AG also announced that he will propose a Nonprofit Revitalization Act (the “Proposed Act”) which will represent comprehensive reform of New York’s Not-for-Profit Law. According to the AG, the Proposed Act would incorporate several of the Report’s recommendations as they apply to enhancing oversight, improving the AG’s ability to prevent fraud and abuse, and reducing unnecessary bureaucratic burdens.

The Report and the Proposed Act come at a time when nonprofits have been receiving unusual amounts of attention and negative press related to executive compensation. They also come when nonprofits are feeling strain and pressure from the “twin stresses” of the ongoing recession: increased demand for services at the same time there is a decrease in funding. The “twin stresses” place greater pressure on nonprofits than that felt by most industries. Nonprofits have also been receiving increasing legislative attention as there are currently several proposed bills to amend the Not-for-Profit Law pending in the Legislature.

The Report points out that New York leads the nation in nonprofit activity. As of November 2011 New York nonprofits generated nearly \$200 Billion in revenue. During 2010 they employed over 18% of New York’s total private workforce. While it leads the nation in nonprofit activity, New York’s Not-for-Profit Law has not been meaningfully amended or updated in decades. The Report’s recommendations look to elevate New York to the status of national leader in nonprofit law.

The Report’s first set of recommendations focus on helping nonprofits financially by reducing government redundancy and improving cash flow. Along with various reforms to the state contracting process, the Report recommends that a Nonprofit Liaison to the Governor be appointed to begin implementing proposed changes to the state contracting process and serve as a point person within government. A new Office of Contracting Reform and Accountability would also be established to centralize contract approval, oversight and auditing functions currently handled by multiple agencies with overlapping levels of oversight. While existing fragmented and duplicative state processes drain nonprofits, centralizing control will save tax dollars through government efficiency while reducing expenses.

Modernizing New York’s Not-for-Profit Law will also save nonprofits money by clarifying certain requirements and reducing duplicative state approval processes. First, the Report recommends clarifying formation requirements because ambiguities in the law often increase expenses by causing organizers to submit multiple applications to form a nonprofit. Second, it recommends streamlining the approval process for certain Board actions, such as asset sales and mergers. The current law requires court approval of asset sales and mergers following consent from the AG. This results in a de facto double approval requirement, as nonprofits will first seek AG approval before petitioning

the court. The Report recommends only requiring AG approval for these actions and allowing court review if the AG denies approval. According to the AG, the Proposed Act would include measures that expedite the nonprofit formation process and the approval of key transactions. The Report also recommends allowing nonprofit Boards to take action through electronic communication (i.e. email) to improve Board efficiency and reduce costs. The AG stated that this measure would also be included in the Proposed Act.

While the Report focuses much attention on improving cash flow and reducing regulatory burdens for nonprofits, it also addresses the important issues of Board oversight, accountability and executive compensation. The Report recommends establishing new independence requirements for nonprofit Boards when setting executive compensation along with clear guidelines for what constitutes reasonable compensation. The Board independence requirements would restrict decisions on executive compensation to Board members or an independent subcommittee with no interest in the compensation decision. The Report also proposes that Board oversight of external audits be required, forcing the Board to perform its function of overseeing an organizations financial affairs. Executives who are compensated by the nonprofit would also be excluded from actively participating on the nonprofit's Board as a voting member. Based on the AG's statements, the Proposed Act would include requirements for enhanced board independence and oversight of executive compensation and financial audits. Finally, the Report recommends that all nonprofits be required to adopt Conflict of Interest and Whistleblower policies to further promote Board independence and financial accountability. According to the AG, the Proposed Act would also require Conflict of Interest and Whistleblower policies be adopted.

The Report recommends that the enhanced Board independence requirements be supplemented by granting the AG stronger enforcement powers. The recommendations include expressly granting the AG authority to commence proceedings to challenge improper transactions and expressly vesting the AG with authority to unwind improper interested party transactions. The AG stated that the Proposed Act would include enhanced police powers to prevent fraud and abuse.

The Report concludes with several initiatives for increasing the diversity of directors, promoting participation on nonprofit Boards, offering means to better educate directors about their responsibilities and duties, and looking toward the future of the Sector. These initiatives include "New York on BOARD" and "Directors U" which have received the AG's support. The Report and the Proposed Act represent a step toward improving the future for organizations that make up this important sector of New York's economy. They also represent a commitment by the AG to push for reform and promote the needs of this sector.

The Report and the Attorney General's announcement lay the groundwork for the Proposed Act. We will continue to monitor the development of the Proposed Act and provide updates as they become available.

The Report is available online at: [http://www.ag.ny.gov/media_center/2012/feb/NP%20Leadership%20Committee%20Report%20\(2-16-12\).pdf](http://www.ag.ny.gov/media_center/2012/feb/NP%20Leadership%20Committee%20Report%20(2-16-12).pdf)

If you have any questions about this memorandum, please contact Frank Patyi in our Syracuse office at 315.218.8164 (or fpaty@bsk.com) or any of the other members of our Exempt Organizations Practice Group noted below.

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