

‘Tis The Season For Nonprofit Scandals

Law360, New York (December 04, 2013, 5:39 PM ET) -- If it's the holiday season, a time for charity and good deeds, it must also be the time for nonprofit scandals, mismanaged money and outright fraud. You need look no farther than recent articles in the Washington Post outlining a "diversion" of funds that many nonprofits' tax returns revealed. As the founder of an investigative firm, I often get brought in by in-house counsel and outside law firms to review suspicious activity in a charity or nonprofit organization, and have subsequently uncovered some of the largest frauds in the industry. My experience tells me that there are clear signals to look for and lessons to be learned when investigating nonprofits and charity organizations.

On Nov. 25, the Washington Post reported on its investigation of the financial malfeasance at the Progressive Policy Institute as an example of how nonprofits choose to forego legal action in exchange for restitution. Rather than reporting the actions of an employee to law enforcement, they choose to handle internal thefts quietly, seeking only to be compensated for the losses.

Generally, nonprofits fear exposure because they don't want to discourage donors, and they value their reputations more than good governance. After firing the offender and seeking restitution, they may institute better financial controls, believing that's sufficient to prevent similar losses in the future. But without exposure, the thief is free to relocate to another, unsuspecting, nonprofit — as many do. In many ways, it's as though the theft and the thief go unpunished. That result nullifies the deterrence factor that prosecution provides.

Nonprofits that are victims to an inside theft job would benefit from engaging independent private investigators to explore the malfeasance and make recommendations for safeguards to prevent such thefts in the future. Members of nonprofit boards should be confident that standards are high and systems are in place to guarantee full satisfaction of their fiduciary responsibilities. But nonprofits too often choose to cover up and lose the benefits of the full and objective examination that a private investigation can provide.

If an organization experiences a "diversion of funds," it probably has serious management or governance issues that an internal assessment or simple procedural revision will not remedy. An impartial investigation may discover financial irregularities by management that can be corrected or, in worst cases, should be referred to law enforcement. It can provide guidance to improve procedures and practices that will withstand scrutiny, satisfy legal requirements, and enable board members to adequately fulfill their fiduciary responsibilities.

Although the recent Post article didn't mention it, that same newspaper's investigative journalists led to the undoing of a major nonprofit luminary in a sensational case two decades ago. In 1991, the Post

undertook an investigation of United Way of America (UWA) based on whistleblower revelations of financial irregularities by its vaunted CEO, Bill Aramony. UWA hoped to quash the press inquiry by retaining a well-known PR expert to handle the nose reporter. The general counsel hired my firm, Investigative Group International, to look into the possible sources behind the rumors, determine if any were true, and conduct an internal investigation that the board hoped would clear Aramony of any dereliction or wrongdoing.

When I first interviewed Aramony, he offered full access to UWA's staff and documents. I asked about his sources of income and assets — an innocuous question that he answered by denying any assets. But when we ran a public database search, we found his name on the deed for an expensive house in Florida. I challenged Aramony immediately, and he claimed he had forgotten about the house. This slip led to an investigation that revealed numerous improper activities.

Over six weeks of intense investigation, we found a pattern of financial irregularity and self-dealing by the CEO and his allies that led, ultimately, to Aramony's federal trial, conviction and imprisonment. United Way suffered enormous losses as disenchanted donors withheld contributions. This national charity struggled for years to address institutional problems and rebuild confidence.

The UWA case was a warning to all nonprofit governors to beware of over-trusting their most respected leaders and shirking their duties as fiduciaries. Since then, most charities have become much more scrupulous and transparent in their activities, and the requirement for their indicating on nonprofit tax returns any diversion of funds has been instituted. But it's obvious that many charities continue to suffer from a failure of due diligence and reluctance to be forthcoming about financial difficulties.

The UWA and Progressive Policy Institute cases offer many lessons that boards of charities should take to heart. Individual board members need to take full responsibility for the transparency and good governance of their organizations. A first rule is to not trust implicitly the senior administration. A CEO or chief financial officer may intend no harm, but a board that relies too heavily on administrators' claims and assertions without independent verification risks disaster.

For example, many trustees depend on an annual financial audit to assure them that all is well. But most auditors frankly base their conclusions on data provided by the CFO. They don't examine the underlying source material, and accept organizational systems and standards as they are described. In the case of UWA, no audit questioned the conflicted governance and inappropriate financial relationships between UWA and its for-profit offspring. These issues should have raised red flags for UWA's board — they did, immediately, for us — but members were too pleased by the revenue that the for-profits contributed to UWA to question their legality.

One simple measure that boards can take to preclude many financial problems is to require checks to be signed by two officers. This won't help if both signers are in cahoots with one another or under a confederate CEO, but the requirement for two signatures can often dissuade one who is tempted to take advantage of access to the bank account.

Nonprofit board members need to feel empowered to question management. Newcomers — particularly those from the corporate or for-profit world who are less familiar with how a charity should operate — can be intimidated by the apparent confidence of veterans, and acquiesce to sketchy situations they are too timid to question in meetings. It's great when a board has confidence in the organization's leader, but that leadership should be able to withstand the critical scrutiny of outsiders.

Trustees (and donors) should be suspicious of any board that is too closely connected to the CEO, or composed primarily of the CEO's or board president's cronies. In these cases where the group's allegiance is more to one another than to the charity, careful oversight is lacking. Those overriding relationships may also pertain when a charity's board is made up of like-minded people whose connection is primarily social.

Board membership can offer benefits more than the opportunity to do good. Too often, a trustee is seduced by the chance to be part of a special club of major corporate players. The tony group of corporate CEOs that Bill Aramony assembled for UWA's board could benefit from their interrelationships as much as he gained from associating with them. In that kind of situation, we uncovered just how easy it was for board members to lose sight of their primary responsibilities to the organization.

In the United Way case, we examined financial records and interviewed dozens of employees over six weeks. We deconstructed complex and illegal relationships between various entities, and discovered misuse of the charity's funds. Without meaning to condone irregularities, UWA's board members had tacitly agreed to Aramony's activities.

Charities facing charges of irregularity often turn to their familiar legal counsel to investigate as well as to advocate. In my experience, law firms' investigations can be inadequate: Most lawyers are not good at fact-finding; they argue issues more than they make factual connections. And in some cases the familiar lawyers are too biased to be helpful.

United Way was represented by a lawyer who had a long-standing relationship with Aramony and UWA. It was obvious that the lawyer expected to satisfy both UWA's critics that all was well, and satisfy Aramony that he would not be prosecuted. In fact, the lawyer had worked before not only for UWA, but also for Aramony in a private matter, but that conflict was not disclosed. That leads to another significant rubric: Don't hire a lawyer who has been involved with the charity or any of its manifestations to do a complete investigation.

The underlying lesson with nonprofit organizations is that if the charity's success seems too good to be true, it probably is. Arm yourself with skepticism, especially around deified heroes with bloated reputations.

—By Terry F. Lenzner, Investigative Group International

Terry Lenzner is the chairman of Investigative Group International. His career has included positions with the U.S. Department of Justice and the Organized Crime Division of the Southern District of New York, U.S. Attorney's Office. He was assistant chief counsel to the Senate Watergate Committee, and authored and personally served the first congressional subpoena of a sitting U.S. president.

*Lenzner recently published a memoir, *The Investigator: Fifty Years of Uncovering the Truth*, highlighting some of his more high-profile cases as an attorney and investigator.*

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