

new york state society of

NYSSCPA

certified public accountants

530 fifth avenue, new york, ny 10036-5101
www.nysscpa.org

April 23, 2003

Attorney General Eliot Spitzer
120 Broadway
New York, New York 10271-0332

Dear Attorney General Spitzer:

The New York State Society of Certified Public Accountants (the Society) is pleased to submit comments on your proposed legislation for governing not-for-profit organizations in New York State. Many of the nearly 30,000 CPA members of the Society are either actively engaged as auditors of not-for-profits or are employed by not-for-profits as accounting, finance, or management executives. Many CPAs also serve their communities by participating as board members of not-for-profit organizations.

The Society's Not-for-Profit Organizations Committee, chaired by David Ashenfarb, drafted the attached comments, which have been approved by the Society's Board of Directors. Please contact NYSSCPA staff member Dennis O'Leary at (212) 719-8418 if you would like to discuss our comments further.

Very truly yours,

Jo Ann Golden, CPA
President

new york state society of

NYSSCPA

certified public accountants

530 fifth avenue, new york, ny 10036-5101
www.nysscpa.org

**NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC
ACCOUNTANTS**

**COMMENTS TO THE STATE OF NEW YORK OFFICE OF
ATTORNEY GENERAL'S ON LEGISLATIVE BILL #
06251-01-3**

APRIL 23, 2003

Principal Drafters

**Julie L. Floch, CPA
David C. Ashenfarb, CPA
Howard Becker, CPA
Ian Benjamin, CPA
Martin Cantor, CPA
Bonnie Chambers, CPA
Miriam Katowitz, CPA
Michael L. McNee, CPA
Melvin Zachter, CPA**

NYSSCPA 2002 - 2003 Board of Directors

Jo Ann Golden, President	William Aiken Spencer L. Barback	David W. Henion Nancy A. Kirby
Jeffrey R. Hoops, President-elect	Michael G. Baritot Rosemarie A. Barnickel	Vincent J. Love Sandra A. Napoleon-Hudson
Thomas E. Riley, Secretary	Peter L. Berlant Arthur Bloom	Nancy Newman-Limata Raymond M. Nowicki
Frank J. Aquilino, Treasurer	Andrew Cohen Walter Daszkowski	Kevin J. O'Connor Robert S. Peare
Laurence Keiser, Vice President	Michael J. DePietro Katherine K. Doran	Mark A. Plostock Joseph J. Schlegel
Stephen F. Langowski, Vice President	Barbara S. Dwyer Andrew M. Eassa	Robert E. Sohr Robert A. Sypolt
Carol C. Lapidus Vice President	David Evangelista Franklin H. Federmann	Edward J. Torres Beth Van Bladel
Ian M. Nelson Vice President	Peter H. Frank Angelo J. Gallo	Howard D. Weiner Philip Wolitzer
Louis Grumet, ex-officio	Neville Grud	

NYSSCPA 2002 - 2003 Not-For-Profit Organizations Committee

David C. Ashenfarb, Chair	Michael F. Hayes	John W. Polsky
Daine C. Abrams	Philip J. Healy	Lisa F. Quint
Samuel Alleyne	Mark P. Hettler	Susan A. Rich
Elizabeth Almonte	Maria L. Isip	Ronald F. Ries
Irene M. Amican	Jeffrey L. Jacobs	Richard J. Roberts
George J. Bartalsky, Jr.	Suzanne M. Jensen	Joan M. Robinson
Howard M. Becker	Raymond P. Jones	Paul Rogoff
Ian J. Benjamin	Steven Jones	Richard A. Romer
Allan M. Blum	George P. Kaminski	Warren Ruppel
Thomas A. Bradley	Miriam Katowitz	Jane E. Rydberg-Ryan
Gerald L. Carter	Brian Kelly	Rashmi Satyadeo
Ellen P. Cason	David Korn	Christine Shadlich
Kenneth R. Cerini	Theodore Kravitz	Morris Shoretz
Bonnie J. Chambers	Simon Lazowsky	Gordon M. Siess
Lynn T. Chambers	Mitchell Lewis	Stanley Simon
Kristen M. Clark	John B. Lloyd	William J. Skody
John L. Corcoran	Howard B. Lorch	William L. Smith
James P. Crisci	Alan Mandelbaum	Thomas Sorrentino
John D'Amico	Christine M. Manna	Delferine A. Spooner
Matthew D. Dapolito	Debra A. Mareello	Gary M. Stehr
Zelege Dasho	Richard T. Marini	Janet Stemmer
Christopher Didio	Dean N. Martin	Marc Taub

Edward G. Donnelly
S. Allan Dubow
Phyllis Eichler
Peter R. Epp
Lynda G. Feldman
Derek A. Flanagan
Julie L. Floch
Kevin P. Foley
Sandi M. Franks
Herb Friedman
James Giordano
Scott J. Goldberg
Kenneth J. Gralak
Jeffrey D. Green

Edward J. McGinty
Beatrix G. McKane
Michael L. McNee
Steven P. Monteferante
Stephan R. Mueller
Israel Neiman
Donald J. Neubecker
Patrick J. Norton
John E. Oehler
Cheryl R. Olson
Isimeme Omogbai
Christopher J. Orella
James F. Passikof
Theodore E. Phillips

Robert H. Taylor
Maureen L. Thomas
Leslie S. Thompson
Gerald N. Tischfeld
Charles Toder
Ellen R. Trageser
Joseph Trapani
John S. Trussalo
Donna M. Turk
Tilak K. Vadehra
Michael A Van Sertima
Bernard Werner
Melvin Zachter

NYSSCPA 2002 – 2003 Legislative Committee

Kevin McCoy, Chair
Stephen Langowski

Jo Ann Golden
Vincent Love

Jeffrey Hoops

NYSSCPA Staff

Dennis O’Leary

NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS

**COMMENTS TO THE NEW YORK STATE OFFICE OF
ATTORNEY GENERAL'S ON LEGISLATIVE BILL #06251-01-3**

APRIL 23, 2003

General Comments

The existing New York State statutes relating to the governance and public accountability of not-for-profit organizations do not distinguish clearly enough between the exercise of executive authority and the appropriate governance oversight required for public confidence. Either the same individuals on the board of directors of not-for-profits hold both the executive and oversight authority, as is often the case in smaller organizations, or the board of directors does not exercise adequate governance oversight, as sometimes occurs in larger organizations. The intent of the proposed legislation is to bring stronger governance oversight through expanding the activities of not-for-profit organizations' boards of directors, an intent that the NYSSCPA endorses and supports.

Unfortunately, the proposed legislation inadvertently confuses governance oversight by not-for-profit boards of directors by placing both executive powers and governance oversight powers in the same individuals in all not-for-profits as a matter of law. The same individual(s) should not in general have both executive and oversight powers for internal control purposes. The only exceptions to this principle would occur for practical reasons in small organizations where board members might retain executive authority because the public interest demands that their small amount of funding should be dedicated to programs rather than to professional executives. In such circumstances,

the only alternative is to hold the not-for-profit's board members responsible for both governance oversight and executive functions.

The contributions to education, health, welfare, and public service of the thousands of not-for-profit organizations in New York State amount to billions of dollars of benefits. Many highly qualified board members that currently serve in the capacities of president or treasurer might not choose to serve the public in this way if exposed to the level of fiduciary responsibility and liability created by the proposed legislation. The separation of executive responsibility exercised by professional employees and oversight responsibility exercised by volunteer board members that occurs in most large not-for-profit organizations should be recognized in the legislation. The separation of executive power and governance oversight should also be the foundation for providing a high level of accountability in such large organizations. Therefore, the primary focus of the proposed legislation should be shifted from the volunteer board members' accountability to the executive employees.

It may be impossible, however, to separate effectively the executive and governance functions in small not-for-profit organizations. In such cases, introduction of a third party may be necessary to accomplish the proposed legislation's goals of accountability and control. The danger of misappropriation of funds is far higher when the same individuals serve in both executive and oversight capacities, as is frequently the case in small not-for-profit organizations. The appropriate third party is the Attorney General Charities Bureau, which should receive additional resources and staffing to ensure adequate oversight of such small not-for-profit organizations.

As a practical matter, not-for-profit organizations with \$5 million in revenue begin approaching the size where formal internal control begins to make sense and executive employees manage the organization's affairs. In smaller organizations, although internal control is just as important, control will inevitably depend more on board members' personal involvement and less on formal systems. Because the goals of accountability and control are just as important in small organizations as in large, appropriate measures should be adopted in this proposed legislation that will adequately deal with both classes without undermining the ability of any not-for-profit organization to attract appropriate board members or to fulfill their primary program mission. The \$250 thousand revenue threshold in the proposed legislation is simply too low to bring an adequate number of not-for-profits without formal control systems under a more direct relationship with the charities bureau.

There is language in the following specific comments that changes the proposed legislation to deal with the separation of executive and governance responsibilities in large not-for-profit organizations. In addition, the proposed legislation should be amended

- to require all not-for-profit organizations with less than \$5 million of revenues that choose not to institute formal internal control systems and not to separate the executive and governance responsibilities appropriately (including separate audit and executive committees) to have their volunteer officers, as well as any executive officers, take direct responsibility for reports submitted to the charities bureau;

- to establish adequate funding for the charities bureau to provide appropriate oversight for such not-for-profit organizations;
- to address circumstances where not-for-profit boards of directors may be precluded from having an adequate number of independent directors because of requirements imposed statute, regulation, or by-law to be composed of certain constituencies; and
- to provide that the numerous not-for-profit organizations whose principal funding comes from New York State be reimbursed for the additional costs of establishing the internal control systems and governance structures imposed by the proposed legislation.

Specific Comments

Section 1: Section 519: new paragraph (d):

1. The current non-profit corporation law (NPCL) section 519 (a) states that “The board shall present.....a report, verified by the president and treasurer....” The proposed section 519 (d) additionally would require the president and treasurer to “review” the report and sign it. Since section (a) currently uses the term “verified”, the intent in section 519 (d) would become clearer by amending section (a), rather than adding (d), and the following amended language would be appropriate:

“The board shall present at the annual meeting of members, a report signed by the principal executive officer or officers and the principal financial officer or officers, or persons performing similar functions for signatory responsibilities

that confirms to the best of their knowledge and belief, that the financial information presented is fairly stated as defined by generally accepted accounting principles, and showing in appropriate detail the following:”

2. The report presented at the annual meeting currently does not contain an opinion by the independent accountant; only the audited financial statements that could be part of the report include an auditor’s opinion. In addition, some NPOs are not required to undergo audits. The NPCL language refers to "whether or not certified by an independent public or certified public accountant...", which is confusing because it implies that presenting the audited financial statements at the annual meeting will satisfy all the requirements of section 519, which is not the case. Therefore, the reference to the accountants should be deleted (see amended language above).

3. Although current NPCL requires the president and treasurer to present this report at the annual meeting, and the proposed amendment would require them to sign it, this amendment is inconsistent with the Sarbanes-Oxley Act, after which the proposed legislation is ostensibly modeled. Sarbanes-Oxley uses the terms "principal executive officer or officers and the principal financial officer or officers, or persons performing similar functions for signatory responsibilities," but other than specifying a different signatory responsibility, the language and requirements in this proposed section are identical to Sarbanes-Oxley. Such signing responsibility should not be different in the non-profit organizations (NPO) and commercial sectors, and this section should be revised to conform to the Sarbanes-Oxley language (see the amended language above).

Section 1: Section 519: new paragraph (e):

1. The first sentence requires that organizations with over \$250k in gross revenue and support or pay their president or treasurer for their services (without regard to the level of gross revenue or support) to have the president and treasurer assume responsibility for the internal controls. The \$250K threshold is far too low to begin instituting requirements for the establishment and evaluation of formal internal controls. Organizations of this size do not have enough employees to institute formal controls. Instead, they rely on informal controls and greater involvement of board of directors members in executive functions. Because the intent of the proposed legislation is to promote financial control over the “thousands of not-for-profit entities that control millions of dollars in charitable dollars”, the requirement for formal internal controls should be on larger organizations. Requiring formal internal controls for small entities would also be burdensome to the regulatory structure without necessarily creating any better control.

2. Because Sections (1) and (2) repeat the proposed section 519 (d), they would be eliminated if our first suggestion were implemented. Section (3) reiterates the objectives of section 519 (a) since the "report" encompasses the information in the financial statements. Accordingly, this section should be eliminated as well.

3. Section (4) refers to the president and treasurer. This should also be changed to conform to the Sarbanes-Oxley requirement of “principal executive officer or officers and the principal financial officer or officers, or persons performing similar functions.”

In addition, for NPOs the annual report is an internal presentation that can be done at any time rather than a quarterly or annual filing as considered in the Sarbanes-Oxley Act. For this reason the ninety day assessment should be linked to the end of the year rather than when the report is presented. The following amended language would also clarify this section:

(A) “are responsible for the establishment and maintenance of internal controls; to provide reasonable assurance about the corporation’s ability to prepare its financial statements in conformity with generally accepted accounting principles;”

(B) “have had such internal controls designed so as to facilitate communication of information material to the financial reporting process (as defined by generally accepted accounting principles) to the signing officers;”

(C) “have effected an evaluation of the effectiveness of the corporation’s internal controls as of a date within ninety days prior to the end of the fiscal reporting period; and”

(D) “have presented in the report the conclusions about the effectiveness of the corporation’s internal controls to the best of their knowledge and belief as of that date.”

4. Sections (5) and (6) should refer to “to the best of their knowledge and belief.” In section (A), the word “all should be deleted, and it should be revised to read:

Any significant deficiencies noted...and have identified for the corporation’s auditors and any material weaknesses noted in internal controls.”

Section (B) should be revised to read:

“... any fraud of which they become aware, whether or not material;”

Section 712 (f):

1. The threshold requirement for the establishment of an executive committee and audit committee should be raised from the proposed \$250K to \$5 million for reasons discussed above. Because some NPOs are not audited (because they do not solicit public contributions), this requirement should only apply to NPOs that are required to have an audit. Language to reflect this point is as follows:

In the case of any corporation required to have its financial statements audited by an independent public accountant, and which shall receive in any fiscal year gross revenue and support in excess of five million dollars...

In Section (1), the word “registered” should be replaced by “licensed”.

Section 301 (3)(B) of Sarbanes-Oxley precludes members of an audit committee from accepting any consulting, advisory, or other compensatory fee from the corporation other

than those earned in their board and committee service capacity. Section 301 (3)(C) provides an exemption from this requirement as the SEC determines appropriate in light of the circumstances. Proposed section 712 (f)(2) should also reflect a possible exemption to the prohibition of fees, depending on the circumstances.

2. This bill establishes duties for the audit committee but other than creating the requirement for an executive committee, it does not address what its function should be. In addition, a threshold requirement should be considered, such as requiring organizations with boards greater than 25 members to have an executive committee.

3. The term "related work" requires more specific definition both in terms of what type of work is covered and whether the extent of the work needs to be considered.

Section 715:

1. (g) states “For purposes of this section... an affiliate... is controlled by, in control of, or under common control with...” The definition of control in the corporate world has proven difficult to define, and FASB has continued to use percentage of ownership rather than a control concept for its requirements. Establishing definitions of control in the not-for-profit arena has proven even more elusive because of the lack of ownership interest. Nonetheless, generally accepted accounting principles have addressed the rudiments of what constitutes control for accounting purposes in the not-for-profit sector. The following amendments to the language on control would prove more useful in practice because it adopts an approach that CPAs already implement:

“For purposes of this section, an entity shall be deemed an “affiliate” of a corporation if such entity is controlled by, in control of, or under common control with such corporation, as control is defined by generally accepted accounting principles.”

Memorandum:

Summary of Provisions:

This should be amended to incorporate the changes suggested in our previous pages.

Existing Law:

There is currently a provision in Section 519 (a) that requires the president and treasurer to verify the annual report presented. Therefore this first sentence should be reworded to reflect the proposed changes to the section.

Justification:

1. The justification should clarify that Sarbanes-Oxley applies only to public companies.
2. Although there are no shareholders in an NPO, there are significant “stakeholders”, including the volunteer board members, donors, charity watchdog agencies, government funders, regulators, and others. Many NPOs submit reports to these stakeholders on an ongoing basis. Acknowledging this environment should be incorporated into the paragraph regarding these “protections.”

Effective Date:

This proposed legislation will require significant changes in the governance structure of some NPOs, and accordingly an effective date of one hundred and eighty days after enactment is more realistic than the proposed ninety days.