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State and Federal Regulators Must Do More to Police Nonprofits



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By Pablo Eisenberg

The problem of poor governance at nonprofits, as well as the large number of reports of fraud, excessive compensation, conflicts of interest, and other inappropriate behavior, won't be stemmed unless federal and state regulators take a tougher stand. But they seem either unwilling or unable to strengthen their efforts to police nonprofits.

The government agencies that oversee charities, both federal and state, have too few staff members and too little money. The Internal Revenue Service's tax-exempt division has about 850 employees, fewer than half of whom are charged with overseeing the operations of about 1.2 million charities.

State charity regulators are even more short-handed. Probably no more than eight attorney-general offices have even a handful of regulators supervising nonprofits in their states.

But more money and staff members are not all that are needed. What charity regulators lack most are the political will and courage to supervise and police nonprofit organizations effectively.

The primary responsibility for this state of affairs must fall on the Senate Finance and House Ways and Means committees, which have set the tone for the permissive practices of regulators at the federal level, just as state legislators have failed to demand tough action and enforcement from state charity officials.

Regulators, quite simply, are afraid to tackle wealthy organizations that are big and influential or perceived to hold significant political power.

Federal and state regulators have avoided taking much action until Congressional and state legislators speak out. Unless state regulators begin to articulate and take a more aggressive approach, little will change in the way nonprofits are regulated.

The regulators' lack of political will and courage are reinforced by their misunderstanding of nonprofit values and the way nonprofits operate.

Few have actually run nonprofits or struggled with compensation or conflict-of-interest problems. They tend to think that large charities are not that much different from private for-profit corporations. That view partly explains why they have been so lax in defining and moving against excessive compensation.

Many of them seem to think nothing is wrong with universities, museums, or nonprofit hospitals paying their chief executives salaries and benefits that exceed \$1-million.

After all, from their perspective, those jobs are scarce and must compete with for-profit salaries in the job market. As a result, the definition of excessive compensation in the IRS regulations is at best mushy. That is why regulators permit nonprofits seeking new executives to compare pay to senior jobs at businesses, thereby unleashing a slew of highly paid, so-called compensation experts to advise nonprofits about what salaries to offer their new executives, adding unnecessary costs to their searches.

They seem to buy the corporate argument that the importance of a job is defined by a high salary, not by the quality and competence of the person who fills the job. They fail to understand that thousands of highly qualified people are willing to take top jobs for a modest, reasonable salary.

Many regulators also overlook the nonprofit tradition that board members should not receive any compensation for serving on boards or providing services that are typically paid for, such as accounting or investment advice. Conflicts of interest and self-dealing among board members are

serious problems, yet regulators are doing little or nothing to stop these abuses. Cozy relationships and sweetheart deals may be common in corporate America, but they are antithetical to the values and best interests of the nonprofit world.

Poor governance is a major reason for many of the scandals and objectionable practices that have riddled the nonprofit world. Yet in very few cases have regulators persuaded or pressured irresponsible board members to resign their positions.

Again, political will and courage could have prevented serious problems at nonprofits and also sent a tough message to nonprofits that poor governance will not be tolerated.

Despite all the indicators of inappropriate behavior and practices among large, politically influential nonprofits, the Internal Revenue Service and state attorneys general have chosen either to look the other way or to pursue half-hearted examinations.

Plenty of abuses deserve serious attention: nonprofit hospitals that offer better care to wealthy and insured patients than to indigent and uninsured patients; religious organizations that pay overly high salaries to their executives; museums that provide few or no benefits, such as free admission, to low-income families; and universities that spend profligate sums on football, basketball, and other coaches.

- The Senate Finance and House Ways and Means committees should direct the IRS to issue tougher regulations where necessary and to strengthen their enforcement practices. The lawmakers should make clear that regulators must confront abuses in the nonprofit world even if they are caused by large and influential organizations.
- Federal and state lawmakers should devote more money and more staff members to charity regulatory offices. Besides empowering them to do more, this would make it clear that lawmakers and the public value regulators' work.
- State legislatures should either make their charity regulators independent of the state attorney general's office or insulate them from political pressures if they remain under the attorney general's supervision.

It is probably time for a high-powered national commission to reassess the structure of the charity world, to examine if it could be changed to improve its functions and services, and to determine how it could be more effectively regulated.

Among the questions it could consider: Does it make sense for hospitals and colleges, which account for much of the wealth of the nonprofit world, to be lumped into the same legal category that includes small grass-roots and social-service organizations? Should separate rules be created for newly emerging hybrid groups that are not nonprofits nor for-profits but a combination of both?

How should nonprofits deal with compensation and conflict-of-interest issues?

Thirty-five years have passed since the Commission on Private Philanthropy and Public Needs, a private group created by John Rockefeller III, took a broad look at nonprofit groups.

Since the commission issued an influential report to Congress and other policy makers, the nonprofit world has grown much larger, much more complex, and perhaps more important to the health of our society. Why not take another look?

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