REID AND RIEGE, P.C.
COUNSELLORS AT LAW

REID AND RIEGE, P.C.

NONPROFIT ORGANIZATION REPORT – SUMMER 2015

Connecticut Human Service Providers Take It on the Chin (Again). If nothing else, the debate over and recent adoption of the Connecticut budget for the two-year period ending June 30, 2017, should be interpreted as a declaration of the existence of a new world order for community-based independently-governed nonprofit human service providers.[1]

For all the rhetoric about the need to maintain the safety net for the State's most vulnerable residents and the Herculean grass roots lobbying efforts by the providers, at the end of the day the budget included a tax increase of approximately $1.5 billion – none of which found its way to the nonprofits in question.[2] This comes after more than a decade of stagnant funding that has created huge waiting lists and wage scales at some nonprofits that are so low that employees qualify for state assistance.

In the decades after government first assumed (in the 1960s) a major role for the provision of human services, the relationship of the nonprofits and the state was akin to a good marriage; and in the process the nonprofits came to depend on the money the State brought to the table. However, the money is tight, and the state has clearly articulated that it has different priorities.

When you combine this financial squeeze with other aspects of the relationship (one-sided contracts, nonprofits required to indemnify the State for losses, the inability to sue the State because of the State's "sovereign immunity," and others) the picture is even more dire.

At a recent meeting with providers we were asked the ultimate existential question – what would happen if it became necessary to turn people in need of services away at the door and direct them to the street? It is not in the cultural DNA of nonprofit providers ever to do this, and they know that if there is ever a bad incident involving someone who was turned away they will be the losers in any subsequent "blame game" with the State.

What to do? There are no easy answers but a logical step would be to think about a realignment of interests with the business/corporate community. Business interests are reeling from the budget's tax increases (which, as stated above, will not benefit the nonprofits) and a dismal business climate. Less business means less tax revenue, less charitable giving, and more need. In other words, a poor

[1] "Human services" is a broad and generic term that includes everything from hospital funding, earned income tax credits for low income families, Medicaid, and others. Our focus is on independently incorporated nonprofit organizations funded through Purchase of Services Contracts ("POS") with state agencies such as the Department of Disability Services and the Department of Children and Families.

[2] The word "none" in the text above was chosen carefully, though some may object to its use. The complexity of the budget makes bottom line "apples to apples" comparisons difficult if not impossible. For example, nonprofits funded through POS may also be able to bill Medicaid for some services, which may look like additional funding until you learn that Medicaid rates are far below the cost of service. Moreover, although a recent 1% COLA was announced, it is almost meaningless because it is paltry in the context of a decade of flat funding, and because amounts payable under POS are subject to the budgetary rescission powers of the governor – which means that the rug can be pulled out from under nonprofits if money gets tight (which has happened in the past).

business climate is also a poor nonprofit climate, and everyone's climate suffers if there is not a robust nonprofit sector addressing problems inherent in human nature as we know it.[3]

Navigating the Charity Navigators. Readers may be familiar with the 1969 film *Butch Cassidy and the Sundance Kid*, starring Paul Newman and Robert Redford. The duo play infamous robbers who eluded lawmen for years until a posse hired by the Union Pacific Railroad relentlessly tracks them down and drives them out of the country. There are several times during the chase when Butch and Sundance, stunned by their inability to shake the posse, ask themselves incredulously: "Who are those guys?"

This is also a question which should be asked about Charity Navigator. For readers not familiar with Charity Navigator, it is a nonprofit organization established in 2001 by a former businessman who wanted to be sure his generous charitable donations went to reputable organizations, and who also wanted to make it easier for other donors to vet organizations to which they were considering donations. Charity Navigator uses a "Four Star" rating system in which it awards four stars to the best and zero to the worst organizations. Its rating methodology is explained on its website.[4]

These are laudable goals and Charity Navigator has successfully built its brand. According to a story in the May 2015 edition of *The Chronicle of Philanthropy* titled, *A Course Correction for Charity Navigator*, it "has become the most prominent charity ratings organization in an 'ever burgeoning field.'" But notwithstanding its success, the *Chronicle* article also references the fact that many charity officials "contest its methodology and its capacity to evaluate so many diverse organizations." The principal criticism is that Charity Navigator focuses too much on overhead expense ratios which, many say, is not the best indicator of a charity's effectiveness.

We fully respect Charity Navigator's objectives. However, our two-part criticism (offered constructively below) is a function of the "who are those guys" question and a matter we handled for a nonprofit client which was nearly not permitted to participate in quasi-public recycling activities in Rhode Island because it did not have a Charity Navigator rating and could not simply request one.

---

[3] There are signs that the nonprofit and for-profit sectors are moving closer. See, for example, the editorial in the July 6, 2015, edition of the *Hartford Business Journal* written by four Connecticut United Way executives explaining the important support the corporate sector provides to nonprofits (available at http://www.hartfordbusiness.com/article/20150706/PRINTEDITION/307029950/connecticut-residents-deserve-a-more-coordinated-problem-solving-approach). The November 2013 and 2014 *Giving Guide* published by the *Hartford Business Journal* includes essays from our Nonprofit Practice Area addressing the natural commonalities between the for-profit and nonprofit sectors (available at http://www.rrlawpc.com/RCAB7S126/assets/files/News/GG13_ReidRiege_.pdf and https://nebusinessmedia.uberflip.com/i/479545-giving-guide-2014/8).

[4] The website states as follows: "We rate charities by evaluating two broad areas of performance: their Financial Health and their Accountability & Transparency. Our ratings show givers how efficiently we believe a charity will use their support today, how well it has sustained its programs and services over time and their level of commitment to being accountable and transparent. In the not-too-distant future, we plan to also rate charities' reporting of their results. We provide these ratings so that givers can make intelligent giving decisions, and so that the philanthropic community can more effectively monitor itself."

First, outsiders (such as the ones in the Rhode Island matter mentioned above) may be under the false impression that Charity Navigator ratings are akin to seals of approval or codes of conduct established by the myriad accrediting, certification, professional and standard-setting associations in the country. These associations draw upon an entire industry of members and professionals when setting standards applicable to their industries or professions. Think, for example, of the Underwriters Laboratory seal of approval on an electrical appliance, or the Codes of Conduct established by bar associations and medical societies.

If you read the Charity Navigator website and its audited financial statements and tax returns, you will find that it is a small organization with total Form 990 Reported Revenue of $1.8 million in fiscal 2014 and 13 paid staff members. While some might argue that the small size is evidence of desirable operating efficiencies, we think it is also indicative of lack of the depth and breadth of experience typically seen in standards-setting associations in this country.[5] In other words, the answer to the "who are those guys" question are the 13 staff members and handful of board members – all of them good people we are sure – but still a shallow and narrow pool of thought when compared to most organizations which do this type of work.

Second, Charity Navigator has announced that it is expanding its rating systems (perhaps to address some of the criticisms mentioned in the abovementioned *The Chronicle of Philanthropy* article) to include what it refers to as "Results Reporting." According to its website, this effort is intended to "address the final dimension of information we believe donors must consider to make a wise giving/social investment decision – the charity's results reporting."[6]

A *bona fide* and generally accepted way of reporting on results is the "Holy Grail of Philanthropy" – something which has been talked about and pursued for years without success. While a charity can compile certain metrics, such as the number of people served and the like, we have always maintained that it is quixotic to try to "quantify" (in a manner that will be a useful guide to prospective donors) terms such as "meaningful change in communities and peoples' lives" because of such terms' inherent subjectivity. Candidly, Charity Navigator's attempt to do this may end up creating controversy and actually end up damaging its brand.

Can Your Lawyer Also Be Your Next Whistleblower? We have been watching with interest a case working its way to the Pennsylvania Supreme Court about an attorney for a nonprofit organization who "turned her client in" to the Pennsylvania Attorney General because she suspected there had been

---

[5] We should add that entire legal treatises have been written about the law applicable to associations which set industry standards, and the courts have not always been kind to the associations when they are sued by organizations which claim they were harmed economically by inaccurate or unfair ratings.

[6] See the earlier reference to this above in footnote 4. In addition, the website further states: "By results we especially are interested in the outcomes of the work of the charity and whether these results are providing a social value (in other words, offering meaningful change in communities and peoples' lives). Mission related results are the very reason that charities exist. Therefore, it is the most important dimension of all for our rating system and yet the hardest to measure due to the tremendous variation in the work that charities do as well as the lack of standardized public reporting on results by most charities. However, after years of research and with the advice of many experts, we believe we have taken a major step forward by adding this new dimension to our rating system."

diversions of charitable funds. Apparently she continued to represent the organization in the subsequent investigation.

Many details are unknown because the names of the parties and some facts have been redacted from public records so far, but the general thrust of the lawyer's argument appears to be that she has a fiduciary duty to the public (as the beneficiary of the charitable funds) that trumps her fiduciary duty of confidentiality to her client. If the court ultimately agrees with the whistle-blowing lawyer, nonprofits in Pennsylvania (and any other states which decide to follow) will forever have an arm's length and potentially adverse relationship with any lawyer they hire. In essence, lawyers for nonprofits would become potential "quasi –agents" of the state government and potentially put the entire "third sector" at risk by making it very difficult if not impossible to hire counsel at times when legal advice is most needed.

What is most disturbing to us is the fact that there are well recognized ethical guidelines for lawyers to follow in situations in which there is reason to suspect wrongdoing at some level in the organization (board, management, or staff).[7] The process involves taking the issues of concern to higher and higher levels within the organization, and possibly advising the organization to self-report to the authorities to correct the problem. If an organization refuses to "do the right thing," the lawyer should then resign from the engagement.

We would be stunned if the Pennsylvania Court agreed with this lawyer's position – and from our perspective, and depending on the details, she may deserve to be professionally sanctioned for what she did to her client.

The Reid and Riege Nonprofit Organization Report is a quarterly publication of Reid and Riege, P.C. It is designed to provide nonprofit clients and others with a summary of state and federal legal developments which may be of interest or helpful to them.

This issue of the Nonprofit Organization Report was written and/or edited by John M. (Jack) Horak, Chair of the Nonprofit Organizations Practice Area at Reid and Riege, P.C., which handles tax, corporate, fiduciary, financial, employment, and regulatory issues for nonprofit organizations.

For information or additional copies of this newsletter, or to be placed on our mailing list, please contact Carrie L. Samperi at (860) 240-1008 or info@rrlawpc.com, or members of Reid and Riege, P.C., One Financial Plaza, Hartford, CT 06103. For other information regarding Reid and Riege, P.C., please visit our website at www.rrlawpc.com.

[7] A situation we have confronted on a few occasions is that of a CEO (our main contact at the organization) who, when communicating with the board of directors (with whom we are not in regular contact), either fails to report our advice or spins it inaccurately, typically because the CEO does not like what we have to say or because it reflects badly on the CEO. These are delicate situations, but at the end of the day if we feel the CEO has "crossed a line" we will go around the CEO to the board and/or resign, as appropriate.