

# Operational Ethics – Tuning Up Your Sensitivity

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- Explore: **Abuse that stops short of Fraud**
- Focus: cases where bad actors are genuinely surprised when scandal becomes public
  - Financial managers lose track
    - borderline situations
    - the way we've always done it
    - go along to get along
  - Auditors focus on Fraud, pass on Abuse
    - fraud is burdensome enough with new audit standards
    - need to turn up "sniffer"
    - need to find ways to educate & sensitize clients
- Interaction: Session relies on your ideas & examples

- *“How the heck could these people have lost such sight over how this would look that they seem genuinely shocked?”*
  - *did they lack a moral compass?*
  - *how did it come about? when did they cross the line?*
  - *do we each put up with things to get along?*
  - *how do we stop?*

- *Our whole field involves little compromises for the greater good*
- *For example: functional accounting vs. true costing: what the public thinks “Management & General” means vs. what it really means.*
- *How do you know when you’ve crossed the line?*
- *Problems can begin innocently, ‘for the greater good’*

- Fraud framework from:
  - Fraud and Abuse in Nonprofit Organizations,
    - Gerald "Gerry" Zack, Wiley, 2003
  - 1. Perpetrated on the NPO by Insiders
  - 2. Perpetrated on the NPO by Outsiders
  - 3. Perpetrated on the Public
    - by the NPO
    - for the NPO
    - through the NPO
- Abuses of Type 3, sometimes Type 1, are our focus
  - Charitable Trust: waste is abuse

### ➤ Management

- If something makes you uncomfortable, now is the time to address it, internally
- Create a culture that genuinely invites critical thinking (the lower-level people are the ones who often realize)
  - whistleblower policy
  - conflicts of interest policy
  - ethics policy

### ➤ Auditors

- Find ways to educate and sensitize clients
- Avoid having your client be the next one on the front page

- Thesis Exploration
- Review Agenda
- Brief Case Studies (to set up the discussion)
  - Grey Areas are hard to identify, by definition
  - Some from us, hopefully some from you
  - Look for and apply patterns
- Warning Signs: dangerous structures & situations
- Problematic Transactions
- Policy Suggestions
- Discuss real-world implementation

- Not all cases are Abuse: apply the “Front Page” test
  - What would a hostile reporter do?
  
- American University story
  - *perks run amok: when was the line crossed?*
  
- Grassroots health charity
  - *low paid E.D. with loans from charity: history*
  
- XYZ Arts Foundation
  - *“good actor” looks bad: lack of retirement arrangement*
  
- International Charity
  - *field v. D.C. Office: When is lodging v. housing?*



- Enron: Conspiracy of Fools, Kurt Eichenwald, 2005
  - *history & anatomy of a disaster*
- Catholic Charities Director in San Francisco
  - *when did the boundaries go missing?*
- Family Foundation
  - *3rd generation, not wealthy...pay for travel for Nanny during board meetings?*
  
- YOUR examples?

- Lack of boundary between NPO and Insider
  - Founders syndrome; lack of retirement planning; artists, spiritualists, activists; Family Foundations “our money”
- Financial / Class pressures on Senior Staff
  - Keeping up with peers: donors, trustees
- Weak Boards / “Coalition” Boards / “Clubby” Boards
- *We don't pay well, so we are not too demanding*
  - Management not working hard begins a culture of corruption
- CEO & CFO expenses
  - no review or approve each other's expense reports

- Note that both Section 4958 and so-called “Automatic Excess Benefit Transactions” overlap heavily with this list
  
- Travel Issues
  - Luxe choices: town cars, expensive meals, alcohol, fare class
  - Choice of vendors: frequent customer “loyalty” programs
  - Choice of timing: optimized for traveler vs. for NPO
  - Choice of conferences: “junkets” posh locations
  - Spousal travel

- Personal use of NPO real property
  - Apartment in satellite office city: when is it OK?
- Substantial personal use of NPO equipment & facilities
  - Laptops, PDA/Blackberries, cell phones, excessive internet & email time at work, supplies & postage
- Personal use of NPO employees
  - Pick up laundry, do vacation travel arrangements
- Widespread, cavalier, undocumented leave time
- Violating Donor Intent
  - Willfully, or
  - Merely aggressive cost accounting?

- Purchase of a “table” or tickets to a fundraiser of another NPO
- Gifts to board, officers, senior staff, key volunteers, e.g. thank-you gifts, bereavement flowers and more
- Expense reports of very powerful senior staff
- “Meetings” (entertainment) expense sign-off
- Education, parking, other employee benefits not in compliance with non-taxable fringe

- Mounting pressure on auditors / exposure
- GAO compliance issues
- What if disagree with advice from other side of firm?  
(MIS or Tax?)

- Tools: how to discover Abuse that isn't actually Fraud?
  - Questionnaires
  - Interviews
  - Testing?
- Tactics: how to act / educate
  - Verbal warning
  - Management letter
  - Audit Committee interaction
  - Situations so rife with abuse that becomes material weakness and qualified opinion

- Top Level
  - Conflict of Interest
  - Ethical Code of Conduct Statement
    - Staff, Management, Board, Vendors
  - Audit Committee (Board Committee)
  - Whistleblower Procedure and Protection
  - Gift Acceptance Policy



- Travel Policies
  - Fare class
  - Vendor choice
  - Food cost per diem or actual with cap
  - Alcohol (not A-122 eligible)
  - Nannies, spouses
  - Trip approval in advance
- Meetings (entertainment): with who? how much?
- Reimbursement and expense approval policies AND procedures, especially for senior staff expenses

- Compensation & fringe benefits
  - Executive Comp package – complete, including Taxable
- Fringe Benefits for Senior Staff
  - Clarify, report properly
- Paid leave policies and actual paid leave tracking
  - ok to identify a *de minimis* level, e.g. exempt employee leaves at 3:00 for a medical appointment
- Employee handbook
  - Hiring process, nepotism
  - Non-discrimination
  - Sexual Harassment

- Purchasing authority, vendor selection
- Basic internal controls (relates more to Fraud than Abuse)
- Use of equipment and facilities (watch automatic 4958)
  - de minimis policy OK, e.g. personal calls
- Gift policies (e.g. bereavement flowers)
  - note it becomes compensation at a certain level
- Donation policies (e.g. purchase of tables at fundraisers)
  
- More suggestions?