

The New York Nonprofit Revitalization Act of 2013: Enhancing the Governance and Accountability of the Not-for-Profit Organization around the World

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Abstract—New York Non-Profit revitalization Act of 2013 has brought sweeping and critical changes that were lagging for New York’s vital non-profit sector as there has not been any changes in four long decades. The bill was simply seeking to correspond to the prior stagnation and to bring about new rules and regulations that would enhance governance controls and accountability, regain public trust that had been heavily undermined due to the multiple fraud scandals that have occurred in the past. The most significant changes were made in reporting requirements that reduced the regulatory burdens and raised the thresholds for financial reporting and eliminated barriers to incorporation; the Act also reduced procedural hurdles for non-profit transactions and modernized the board procedures and voting requirements.

The Revitalization Act of 2013 significantly improved many requirements related to the governance and accountability of the non-profit organizations. In particular the audit functions of the audit committee, as well as internal control conflict of interest and whistleblower policies.

Keywords—revitalization Act of 2013, governance controls and accountability, internal control, conflict of interest, whistleblower policies, barriers to incorporation, financial reporting and related party transactions.

INTRODUCTION

For the last forty years, New York State’s non-profit sector has not undergone any significant reforms or changes. There has been no modernization of the corporate laws that regulate non-profit organizations, nor has there been any transformation of the structure of charitable and non-profit sector in the state¹. On December 18th 2013 the Governor of New York State, Andrew Mark Cuomo, signed into law the New York State Nonprofit Revitalization Act. The bill was simply seeking to correspond to the prior stagnation and bring about new rules and regulations that would toughen the system of the non-profit sector, improve the efficiency of administrative processes and to reinforce governance and oversight. It took over a year until the Act became effective on July 1st, 2014.

New York State Attorney General, Eric Schneiderman, was the one who seeded the initiative for the Act and organized the Leadership Committee for Non-profit Revitalization. The Committee consisted of thirty-two leaders of different non-profit organizations throughout the state². After much deliberation, the Committee issued a report that became the basis for the new law. The task was fulfilled and the board issued a comprehensive report that became the foundation for the bill. It took two years for Schneiderman’s office to assemble the Act and another year of legislative negotiations before Governor Cuomo signed it into the law.

As long as one can remember, there have been no changes up until now, to the Non-Profit Laws in New York State; they are antiquated and outdated. Attorney General Schneiderman stated - “I am proud of the work we’ve done with nonprofit leaders and the legislature to transform our antiquated charity laws into a model for the nation after years of hard work and effort, his office put into the legislative matter”³.

It is significant to mention that New York has been one of the leading sectors among charitable organizations. The annual revenues amount to hundreds of billions of dollars, not dismissing the fact that the New York State nonprofit segment is accountable for an impressive one out of seven jobs in the state. Due to the significance that the organizations play in the role of the state, modernization and change was inevitable. The most significant changes were made in reporting requirements for non-profits that are required to register under Article 7-A that reduce regulatory burdens and reforms that enhance governance controls and accountability. Each reform is extremely important and designed to not only strengthen the New York State non-profit sector, but also to regain public trust that has been heavily undermined due to the multiple fraud scandals that have occurred in the past. To avoid public frustration and to guarantee the assurance and goodwill from the non-profit

¹ Sullivan and Cromwell LLP. December 20, 2013 The New York Non-profit Revitalization Act of 2013. <http://open.nysenate.gov/legislation/bill/S5845-2013>.

² A.G. Schneiderman’s Non-Profit Revitalization Act Signed into Law December 19, 2013 <http://www.ag.ny.gov/press-release/ag-schneidermans-non-profit-revitalization-act-signed-law>

³ <http://open.nysenate.gov/legislation/bill/A8072-2013>

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sector, the reforms that were initiated can be divided into four major categories⁴:

1. Reforms that raise thresholds for Financial Reporting;
2. Reforms that eliminate Barriers to Incorporation;
3. Reforms that reduce Procedural Hurdles for Non-profit Transactions;
4. Reforms that modernize Board Procedures and Voting Requirements.

The first category focuses on contributions received from New Yorkers or received from government grants. Under current law, non-profit organizations in New York State must register with the Attorney General’s office and file their annual financial reports. Under current law, all non-profit organizations that receive in any fiscal year, up to \$100,000 in gross revenue and support, must file their unaudited financial reports. Organizations that receive in any fiscal year more than \$100,000 but not more than \$250,000 must file an independent CPA Review Report. Organizations that receive in any fiscal year more than \$250,000 in gross revenue and support must file with the Attorney General and submit an independent CPA Audit Report. Beginning July 1, 2014, the Act greatly increases the reporting threshold for gross revenues and support. As can be seen from the table below, and to reduce the burden on smaller nonprofits, the revenue and support levels increase on July 1st, 2014 from \$100,000 to \$250,000 and from \$250,000 to \$500,000; on July 1, 2017, from \$500,000 to \$750,000 and again on July 1, 2021, from \$750,000 to \$1 million¹.

TABLE I. SUMMARY OF REPORTING REQUIREMENTS¹

Gross Revenues	Unaudited Financial Report on Form Provided by AG	Independent CPA Review Report	Independent CPA Audit Report
Current Levels	\$100,000 or less	More than \$100,000 but not more than \$250,000	More than \$250,000
Effective July 1, 2014	\$250,000 or less	More than \$250,000 but not more than \$500,000	More than \$500,000
Effective July 1, 2017	\$250,000 or less	More than \$250,000 but not more than \$750,000	More than \$750,000
Effective July 1, 2021	\$250,000 or less	More than \$250,000 but not more than \$1,000,000	More than \$1,000,000

The second category reduces the barriers to incorporation. Under the current law, each organization formed is required to be categorized as a Type A, B, C, or D corporations. The Act reduces the four types of non-profit corporations down to two categories: Charitable Corporations and Non-Charitable Corporations¹. A charitable corporation is one “formed for charitable, educational, religious, scientific, or cultural purposes or formed for the prevention of cruelty to children or animals. Any other type of non-profit corporation is deemed non-charitable”⁴. With this change, the non-profit corporation no longer has to be concerned with the previous “Certificate of Type” requirement; they are either a Charitable Corporation or a Non-Charitable Corporation. This change will help to reduce the time and costs when applying for tax exempt status⁴.

The third category changes the procedural requirements for a merger or consolidation transaction for both religious and educational corporations. Current law allows for a consolidation of not for profit entities but not for a merger transaction. In the consolidation transaction both entities continue to exist but in the merger transaction only one of the entities survives; the Act authorizes such mergers. In addition, The Act allows a charitable corporation to “sell, lease, exchange, or dispose of all (or substantially all) of the corporation’s assets. The approval process only requires the attorney general’s approval. In the past, they needed the approval of the court and they had to give notice to the attorney general.⁵ This change will not only expedite the lengthy process, but will also reduce the associated legal costs.

The last category modernizes the board procedures and voting requirements required. The voting requirements can be divided into three groups: First, the Act provides the non-profit corporation the ability to “enter into a normal real estate transaction when authorized by a majority of the Board of Directors or a majority of the committee authorized by the board.⁴ Currently, such transactions must be authorized by two-thirds of a corporation’s entire board. Second, the Act provides for procedures to enable Directors who are unable to attend meetings in person, to participate via electronic means- e-mail, telephone, and closed circuit video conferencing. ¹ Third, the Act eliminates the distinction between “standing and special committees and, instead, provides for two simple committee categories: only the Directors in one committee and a separate committee consisting of both Directors and Non-Directors.⁵

The Revitalization Act of 2013 significantly improved many requirements related to the Governance and Accountability of the Non-Profit Organizations. In particular, audit functions of the audit committee, as well as internal control, conflict of interest, and whistleblower policies all have undergone major changes intended to strengthen the procedures and nonprofit oversight. The Act, for the first

⁴ Hayley Kelch, January 10, 2014 Cullenad Dykman What You Need to Know about the Non-Profit Revitalization Act of 2013. <http://www.cullenanddykman.com/news-advisories-68.html>

⁵ McGuire Woods October 3, 2013. The Non-Profit Revitalization Act of 2013 Overhauls New York Non-profit Corporation Law. <http://www.mcguirewoods.com/Client-Resources/Alerts/2013/10/NY-Non-Profit-Revitalization-Act-2013.aspx>

time, provides clear requirements for the board oversight and financial processes². Specifically, the Act requires that for each corporation required to file a CPA audit report, that the independent directors on the board or audit committee, must oversee the accounting and financial reporting processes and the audit of the organization's financial statements. The Directors must review the results of the audit report and the Management Letter.¹ There are additional requirements set for the charitable corporations whose annual revenue is expected to be \$1,000,000 or more. In particular, the designated independent committee must plan the audit prior to its commencement; review with the auditor the scope of the audit plan; and discuss any weaknesses in internal control identified by the auditor, discuss material risks, as well as auditor's restrictions and access to requested information¹. Additionally, any disagreements between the auditor and organization's management must be discussed in detail, along with the adequacy of the accounting and financial processes of the organization. Independence and the performance of the auditor must also be considered each year. Besides discussing and reviewing the accounting and financial processes of non-profit organization, implementation and compliance of the corporation's conflict of interest policy must also be evaluated¹.

The Act, for the first time, describes specific requirements related to the disclosure of material terms for the related parties involved in corporate transactions. The new law prohibits any non-profit corporation from entering into a related party transaction, "unless such transaction is determined by the board to be fair, reasonable and in the corporation's best interest"⁴.

If the related party transaction with a substantial financial interest occurs, the authorized committee must first consider any alternatives available prior to entering into the transaction, document the basis for the committee's approval, together with all the alternatives considered, as well as the transaction must be approved by the majority vote of the committee members. Additionally, all key employees of the non-profit organization must disclose in good faith all the material facts of such transactions to the authorized committee or a designated board¹. They are also prohibited from participating and voting in respect to approval of related party transactions. The "Act" also emphasizes the Attorney General's power to void or rescind related party transactions, as well as the removal of directors and it further requires an entity to account for any profits earned.

Previous to this new legislation, New York State Law did not require that a non-profit organization adopt a conflict of interest policy to ensure compliance with state and federal laws. The Act, for the first time, mandates that all non-profit organizations implement such policy for the corporation's best interest. Such control will ensure that key employees of the organizations follow and comply with legal requirements, including all the new rules implemented by the Act. The Act provides that the Non-Profit's conflict of interest policy must include the following disclosures: a definition of "what constitutes a conflict of interest; and the procedures for disclosing a conflict of interest to either the Board of

Directors or the Audit Committee; the policy must also disclose any conflict and report on the resolution. The Act requires a detailed description and documentation of the conflict and the resolution in the corporate record. The Directors are also required to sign a written disclosure of any potential conflicts¹.

Another stipulation of the Act mandates that any non-profit organization, with annual revenues of \$1,000,000, must also implement a whistleblower policy, similar to the well-known Sarbanes- Oxley Act of 2002¹. The whistleblower policy protects any employee of the organization who reports improper conduct from harassment, intimidation, discrimination, or retaliation. Any reported suspected violations must be preserved with confidentiality of the reported information.

As we have clearly asserted and similar to the Sarbanes-Oxley Act of 2002, Attorney General AG Schneiderman's New York Non-Profit Revitalization Act of 2013 has brought the sweeping and critical changes that were lagging for New York's vital non-profit sector. This metamorphosis was significantly overdue as there were no changes in four long decades. New York's non-profit organizations will now be succumbed to the changes that its benefactors as well as beneficiaries will undoubtedly welcome with open arms, not to mention the board of directors' that are responsible for these organizations. Additionally, indirect benefits will most definitely be felt by the CPA organizations that are going to be utilized to a much higher degree and increasing their revenue potential from the professional fees that will be achieved. Furthermore, the precedent that New York State is setting by this sweeping legislation will undoubtedly bring changes to our society's political, economic, and social environment.

CONCLUSION

The Non-Profit Revitalization Act seeks to make New York more inviting and attractive for non-profits that incorporate or transact business in New York State. The Act has eliminated or modified a number of burdensome and outdated requirements and makes it easier and more flexible to operate and incorporate. The act enhanced the federal requirements for non-profit entities in areas such as internal control, related party transactions, role of audit committees, conflict of interest and whistleblower policy's.

However, the Act also imposes additional compliance obligations, particularly for the Board of Directors to comply with many of the changes indicated in the Act that the non-profits will have to adopt and comply with; this will result in additional costs and burdens on the non-profit sector.

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