

## **How to Avoid Everyone Paying for the Mistakes of the Few**

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Washington, DC – Marcial Carlos Ribeiro, M.D. has a dream: to build a medical center in Curitiba, capital city of the State of Paraná, along the lines of the Mayo Clinic, the non-profit complex at Rochester, Minnesota. Ribeiro began working on his plan 22 years ago, when he founded the Koutoulas Ribeiro Foundation for Liver-Disease Studies, which today supports the São Vicente Hospital.

Throughout his decades-long work, however, Ribeiro discovered an obstacle to his dream. Unlike the legal world where everyone is accountable for his mistakes, Ribeiro realized that the rules are quite different when it comes to economics: everybody pays for the mistakes of the few. For this reason, even Brazil's most reliable institutions are insufficiently funded. Indeed, the credibility of Brazil's NGO's has been gravely compromised thanks to the fraudulent practices of certain sector leaders over the past few years.

Problems within Brazil's philanthropic institutions worsened to the point where, in 2007, a Parliamentary Committee of Inquiry (CPI) was formed to investigate alleged fraud within NGOs. To this end, Brazilian authorities were granted the support of an unheard of 74-member majority of the nation's 81 senators. Although work has been slow and no final report forthcoming, the efforts of the CPI for the NGOs represented only one of many coups affecting the credibility of the nation's philanthropic organizations (see attached text on the scandals).

“The sector enjoys no credibility. How could anyone donate to a project when he is unsure whether his contribution will be used properly?” asks Ribeiro. Priding himself on never having to seek government funding for his project, the doctor relies on the foundation and hospital only for consultations and procedures, a far cry from financing required by the “new Mayo” he hopes to build in Curitiba, a relatively well-off city in southern Brazil with a population of almost two million.

“News about sham NGOs committing crimes contaminates the entire industry, which is sullied by a reputation of corruption. But in fact there are many serious organizations that do good work,” notes Vera Masagão, one of the directors of the Brazilian Association of Non-Governmental Organizations (Abong). But why this reputation of dishonesty, and why does misappropriation of resources occur? Experts usually offer two explanations: legislation that is lax and too fragmented and ineffective supervision of NGO activities.

To minimize the problem, an effort is underway in Brazil to institute substantive legislative change that would enable authorities to detect fraud more readily and to punish the offending NGO's. Only through measures such as these will law-abiding NGOs be able to breathe freely and seek funding unencumbered by public mistrust.

Such measures find their inspiration in campaigns underway in the United States and in other countries where anti-fraud efforts have proven more effective.

## **Wrongdoers**

Stopping all fraud is, of course, impossible. Even in the United States, where NGO donations from individuals and corporations totaled US\$ 514 billion for just the year 2008, there will always be someone thinking of illegally pocketing a few extra dollars. The trick is to punish wrongdoers and prevent such fraud from becoming an epidemic that spreads throughout the non-profit sector.

One example of the potential damage inflicted by scandal is the case of United Way of the National Capital Area, which found itself beset by fraud allegations in 2002. Former UWNCA director Oral Suer pleaded guilty to defrauding the charity's accounts and charging the organization for personal expenses. Suer resigned in 2001 after running the United Way for 27 years. The NGO, having taken in US\$ 94.79 million in 2002, suffered a severe financial blow once the scandal was made known. Contributions to the charity plunged 64.69% to US\$ 33.47 million in 2003. Suer was sentenced to 27 months of prison and ordered to pay United Way US\$ 497,000.00 in restitution, but the organization never again achieved the level of donations it enjoyed in the past. In 2009, for example, United Way receipts never exceeded US\$ 33.56 million.

So punishing the guilty to exculpate the rest still seems to be a working strategy. And the outcome, according to the Association of Certified Fraud Examiners (ACFE), has been a positive one. ACFE, an organization comprising professionals charged with pointing out accounting errors and fraud in institutions and private for-profit and non-profit organizations, reports that these enterprises lose an average of five percent of their annual receipts to fraud. And although this figure applies to both types of organization, according to ACFE education director Allan Bachmann it is the not-for-profit ones that in the U.S. enjoy the better reputation. "People place more trust in not-for-profit institutions than in private corporations," says Bachmann. "Does it make sense to trust one type of organization more than another? No, but this is what happens," he adds.

But, alas, what is the difference in the legislations of the two countries? According to informed sources the difference is substantial. Brazilian law, in contrast to that in the U.S., is fragmented and fails to properly identify an authority responsible for overseeing a given administrative activity. Furthermore, Brazil's legislation falls short in its requirements for documentation necessary in tracking whether funds are applied in accordance with rules governing the non-profit sector.

The U.S. experience that shaped its current legal system has been lengthy and is still in the making, and, according to District of Columbia State's Attorney Peter J. Nickles, its federal and state laws were developed in the wake of large-scale scandals involving fraudulent practices within non-governmental institutions. For the past six months, says Nickles, concern about the misappropriation of public resources invested in local not-for-profit enterprises has turned into a veritable rules-manual for contracts. "On this basis we monitor whether the rules are being followed," he explains. "If rules are not followed the prosecutor can even freeze budget outlays, a measure that can ensure that funds are not forever lost."

As U.S. legislation can vary from state to state, some areas have greater controls over not-for-profit organizations than others. “States like Pennsylvania, New York and California have a more rigorous system in place. In general, laws are fine-tuned after a particularly egregious case is uncovered,” according to Thomas Pollack of the Urban Institute.

Transparency is one of the most important factors that differentiate the two countries. Tax Form 990, which all NGOs must submit to the IRS once a year, is public record and subject to the scrutiny of any citizen. And should anyone have trouble deciphering an NGO’s form 990, he can rely on the assistance of such organizations as Charity Navigator and Guidestar that gather and analyze the financial data that NGOs provide. As Pollack explains, “There’s specific research that looks into, for example, whether salaries and benefits are above the national average.”

This oversight contrasts sharply with the experience of Brazil, where even government authorities have difficulty obtaining access to information on not-for-profit organizations. “When we begin an investigation,” reports prosecutor Maria Natalina Santorosa of the Paraná State Public Prosecutor’s Center for NGO Prosecutorial Support, “we ask the organization to sign an authorization allowing a tax-information confidentiality waiver. However, if the organization is unwilling to cooperate, our only recourse is through the courts.”

The National Registry of Public Service Organizations (CNES), instituted by Brazil’s justice ministry, sought to shine a light on information pertaining to federally-certified organizations, information in the form of documents required for tax-exemption privileges. But a survey based on justice ministry data shows for the State of Paraná, for example, 541 enterprises registered under Public Interest Civil-Society Organization (Osip) – a category created by the justice ministry allowing its organizations to enter into partnership associations with the government. Now why did only 98 of these render account to the appropriate government agency? It is because such rendering of account is voluntary.

In the United States, there are laws in place that guarantee transparency and establish criteria for official oversight of institutions seeking to receive and expend public resources and donations from corporations and individuals. U.S. law also calls for an administrative council charged with resolving any instance of alleged NGO fraud. Santarosa explains that in Brazil organizing such a body presupposes the establishment of a deliberative council, but in practice responsibility for sorting out cases of fraud is in the hands of the employee having signed for payment of the misused funds.

An empowered council of administrators, then, is essential if fraud is to be prevented. Indeed, the NGO sector promotes the idea of best practices in government as one of its primary means of combating problems of this sort. According to Tim Delaney, president and CEO of the National Council of Nonprofits, “We offer courses so that council members are better prepared to oversee the organization’s work.”

The reasoning behind such measures is a simple one, according to Barbara Bramble, senior international consultant at the National Wildlife Federation (NWF). Bramble, though a NWF employee, is also a council member at another environmental not-for-profit organization. “Many council members also donate money to the organization or

actively participate in its funding campaigns,” says Bramble. “So it’s in our interest that this money be well spent.”

The regulatory framework that is being implemented in Brazil is designed to rectify all of the aforementioned problems. The standard introduces comprehensive legislation that would reflect an understanding of how public authorities should proceed in overseeing the NGO sector. “It was an effort involving nine months of research, reflection on the experience of other countries, and writing,” says Gustavo Justino, foremost expert in Brazil’s NGO law and the chief coordinator in the writing of the proposed legislation. The framework will be under the aegis of the Ministry of Justice and should be presented before congress.

### **Self-Supervision**

In the United States, the major constraint against corruption in non-profit organizations can be found within the organizations themselves. As Tim Delaney of the National Council of Nonprofits sees it, “It’s bad for the entire sector when a fraud scandal breaks.” Delaney believes that unfavorable media coverage arising from resource misappropriation within NGOs can discourage both individual and corporate donations. “In these cases,” Delaney points out, “you will rarely hear anyone saying that, in spite of the fraud scandals, there are many organizations that actually take their work seriously.”

Roslyn Hees, senior program advisor for humanitarian assistance at Transparency International, agrees that self-supervision essential. To Hees, people must be educated to recognize what is illegal and to whom they should report cases of fraud. To this end, she led a Transparency study on corruption within humanitarian relief operations that found that many workers in such missions “have a narrow view of what corruption actually involves.”

The problem of corruption within relief organizations is a complicated one, mainly because substantial resources are invested in emergency responses to large-scale crises, like the recent earthquake in Haiti and the tsunami that ravaged parts of Southeast Asia in 2004. Hees points out that “the main concern of relief workers in these cases is for food, medicine, and assistance to reach the affected population.” She adds, however, that “the problem of corruption is important because many relief agencies rely on donations garnered through appeals to the population at large, and unfavorable publicity arising from funds misallocations can diminish the public’s faith in their work.”

As no reliable fraud-prevention scheme is in place in Brazil, the only recourse is to count on what is closest at hand. Barbara Bramble reminds us that personal relationships are what ultimately ensure the proper utilization of funds. “Our Brazilian partners,” Bramble explains, “are organizations we have been working with for twenty or twenty-five years, so we know these people and also know how they account for their funds.”

Trust in the professionals and the organizations with which they have a history of collaboration works in the case of the NWF, which claims never to have had a problem with its Brazilian partners. Such trust, however, is not universally reliable. Indeed, since the 18<sup>th</sup> century we have been aware of the dictum proclaimed by Montesquieu when he warned: “A society cannot be built on the foundation of human virtue but rather on the

strength of its institutions.” By choosing to ignore this teaching Brazil may find the NGO sector headed towards ever-worsening circumstances.

The problem may be that international organizations provide a significant portion of the funding for Brazil’s NGOs. Abong calculates that, for the year 2008, 40.2% of its affiliates relied on international institutions for at least 60% of their receipts. And as one would expect, not all of these organizations were inclined to rely on personal friendships to make Brazilian NGOs worthy of their trust. The fact that Brazil’s economic policies discourage donations of this kind within the country further compounds the problem.

According to Vera Masagão, Brazil has in the last few years gained much visibility abroad as a more developed country where inequality has diminished. “We are no longer a priority in the eyes of international donors as we’re seen as a country able to handle its own problems,” explains Masagão. USAID, for instance, announced in 2007 a reduction in funding for Brazil after 45 years of service in the country. .

Denied this funding and with much work ahead, Brazilian NGOs face the challenge of becoming ever more trustworthy if they hope to receive sufficient resources to finance their work. Should the nation’s laws and the NGOs’ reputation remain unchanged, these organizations may have a problem. The dream of a Mayo in the tropics will then become an illusion, remote and ever harder to attain.