

United Way of America

BUSINESS OR CHARITY?

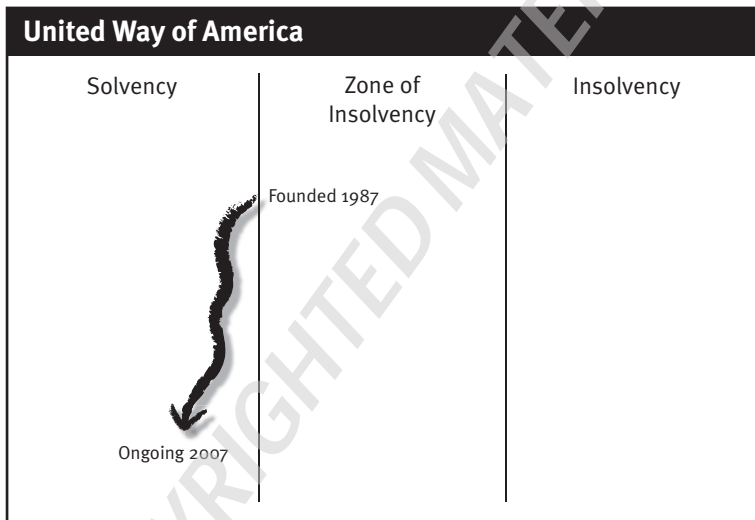


EXHIBIT 1.1 UNITED WAY OF AMERICA FINANCIAL PATH

In June 1995, lawyers pleaded for leniency in the sentencing of former United Way president William Aramony, arguing that his judgment was severely diminished by shrinkage in his brain and castration. Unimpressed, the judge sentenced him to seven years in prison for conspiracy,¹ money laundering, and embezzlement.² Aramony was found to have used over \$600,000 of the charity's funds for high-priced flights on the Concorde,

limousines left idling while he dined in fine restaurants, and consulting fees for his teenage girlfriends.³ He was convicted on six counts of mail fraud, one count of wire fraud, and eight counts of interstate transportation of fraudulently obtained property (see Exhibit 1.1).

The United Way of America (UWA) is the separately incorporated national headquarters that coordinates activities of over 1,300 local United Way chapters, United eWay, United Way International, and the United Way Store. United Way of America's income is based on a formula whereby approximately .75% of the funds raised by local chapters are transferred to UWA to run the national office. Contributions to the United Way peaked at \$3.17 billion in 1991, just before news broke of the Aramony scandal.⁴

A 1992 board-chartered investigation and report by Verner Liipfert IGI indicated that UWA operations had been "handled with an unacceptable degree of informality and deference to the desires of its two principal officers," and identified 10 specific areas of concern:⁵

1. Proliferation of spin-off organizations
2. Unjustified consulting fees paid to close associates of the executive
3. Travel expenses and reimbursement of personal expenses by the CEO and the CFO
4. Insufficient financial controls
5. The board's process for establishing executive compensation
6. Pension oversight failures
7. Inadequate documentation regarding donor-restricted grants
8. Inadequate controls over federal grants
9. Allegations of sexual advances by the CEO toward employees
10. Structure of the board

The Executive Committee of the board met on February 3, 1992, by conference call, to review this report and concluded with a unanimous vote of confidence in Aramony. Several weeks later, the same committee met again, rejected a resignation letter submitted by Aramony, reaffirmed the Executive Committee's unanimous vote of confidence, and requested that Aramony stay on as president and CEO during the board's search for and transition to a new executive. Attorneys subsequently argued that these two votes of confidence were implicit endorsements of Aramony's behavior.

Aramony tried to run the United Way as a business,⁶ and in the process violated the trust of the employees, donors, board, and supported organizations that expected different behavior from the United Way as a non-profit charity. By virtue of its national stature—raising over \$3 billion per year through all of its entities combined—the United Way is blessed with a high-powered board that features many captains of industry and business. As CEO of the United Way, Aramony sought to interact comfortably with board members and donors of considerable wealth, moving in and out of their circles with ease and emulating their high-spending lifestyles.

It is reasonable to suggest that a charity should be run like a business, which involves implementing best practices to control expenses, increase revenue, and enhance the organization's fiscal viability. But non-profit organizations are distinctly different from for-profit corporations, and management and governance must understand the nuances. The United Way, for example, is a mission-driven charity, totally dependent on donor gifts and sponsorship income, with virtually no fee-for-service revenue base.

In contrast, every for-profit corporation is based on some variation of fee-for-service or fee-for-product revenue, which allows for performance metrics based on volume. The nonprofit organization generates gift revenue based on goodwill and trust; the for-profit corporation proves or disproves its value proposition with every purchase. For nonprofits, individual donors feel violated when they see the lead caretaker spending money frivolously.

A media frenzy surrounded the Aramony scandal, making it close to impossible to discern the legitimate issues. His behavior raised questions that went beyond merely matters of "business style." Aramony clearly assumed that he was "entitled" to a plethora of high-end perks. In the mix were legal, moral, and ethical issues as well as conflicts of style. In the end, he was sent to jail not for conflicts of style but for embezzlement, fraud, and money laundering. The issues raised by the media were abhorrent for all businesses, but particularly toxic for nonprofit organizations. He tarnished the image of the United Way and reduced donor trust; as a result, charitable gift revenue decreased significantly.

As a convicted felon resting comfortably in federal prison at Seymour Johnson Air Force Base, Aramony had time to exercise his legal rights, arguing that the United Way of America owed him \$7.2 million for

salary, pension benefits, prejudgment interest, legal expenses, and costs. UWA countered by arguing that Aramony should pay over \$30 million in restitution and damages. U.S. District Judge Shira A. Scheindlin ruled in the case of *William Aramony v. United Way of America* in the U.S. Court for the Southern District of New York.⁷ Judge Scheindlin wisely pointed out that “A felon, no matter how despised, does not lose his right to enforce a contract. On the other hand, his recovery of any contractual benefit does not diminish the seriousness of his criminal conduct.”⁸

Exhibit 1.2 shows that in 1997, just two years after Aramony was sentenced, the United Way of America (headquarters) generated a net gain of \$1,266,511 on total revenue of \$28,343,787, a 5% positive margin. But decreases in gift income in the local chapters were the ultimate outcome of the scandal. In fact, total combined contributions to the local chapters

United Way of America		
Revenues and Expenses: Fiscal Year		
REVENUE	1997	2005
Contributions	\$2,813,037	\$27,722,124
Government Grants	\$0	\$234,118
Program Services	\$4,633,059	\$2,699,811
Investments	\$1,313,755	\$614,735
Special Events	\$0	\$0
Sales	\$615,465	\$713,481
Other	\$18,968,471	\$29,742,859
Total Revenue	\$28,343,787	\$61,727,128
EXPENSES		
Program Services	\$23,284,005	\$40,523,096
Administration	\$3,760,186	\$3,878,878
Other	\$33,085	\$616,158
Total Expenses	\$27,077,276	\$45,018,132
Net Gain/Loss	\$1,266,511	\$16,708,996

EXHIBIT 1.2

UNITED WAY OF AMERICA: REVENUES AND EXPENSES

peaked at \$3.17 billion in 1991, dropping to \$3.04 billion in 1992 and \$3.05 billion in 1993. Furthermore, the scandal was expensive. As part of its final court settlement, UWA argued that the Aramony scandal cost it between \$11.7 million and \$32.2 million in lost dues (i.e., the percentage of funds paid by dues formula from the local chapters to UWA). The argument, ultimately rejected by the judge, linked the decrease in local chapter funding to a decrease in dues paid by local chapters to UWA.

UWA argued in court that it was entitled to up to \$40 million from Aramony, as shown in the next table.

\$ 951,250	Salary Paid Out 1989–1991 During Criminal Activity
\$32,000,000	Lost Dues Income
\$ 1,804,085	Legal Fees
\$ 373,653	Accounting Fees—Coopers & Lybrand
\$ 140,426	Investigation Fees
\$ 144,966	Interest on Loan for Payroll in 1992 Due to Income Reduction
\$ 19,314	Teleconference Expenses
\$ 1,126,767	Employee Resignation Program (i.e., buyouts for cost reductions)
\$ 4,788	Videotapes
\$ 30,089	Public Relations Agency—Hill & Knowlton
\$ 25,748	Photocopy Expenses
\$ 127,268	Cost for New CEO Search

Judge Scheindlin ruled that Aramony had to pay over \$2 million to UWA, as follows:

\$952,250	Repayment of Salary
\$232,138	Payment for Damages Flowing from Criminal Conduct
\$788,555	Pre-Judgment Interest
\$ 50,000	Punitive Damages

In regard to Aramony's argument that he was entitled to pension payments from UWA, the judge ruled that UWA must pay him \$3,221,057 for pension benefits and \$1,177,121 pre-judgment interest.



EXHIBIT 1.3

UNITED WAY OF AMERICA PERFORMANCE DATA

SOURCE: GuideStar, www.guidestar.org.

The performance ratios as indicated in Exhibit 1.3 tell an interesting story about the six-year impact of the scandal. First, note that the fundraising ratios are well below national averages, bouncing between 1% and 4%. The fluctuation over the three-year period could well be indicative of new management or a new campaign strategy. Second, note a significant decrease in program service revenue (i.e., fee-for-service revenue), as well as in the ratio for other income. As these two ratios decreased, the contributions/grant ratio increased to offset the reductions. Interestingly, the contributions/grants ratio increased significantly from 2003 to 2005. Finally, the relatively high debt ratio of 2003 had decreased significantly by 2005.

KEY LESSONS

Value of Board and Committee Minutes

Aramony, a convicted felon and a former employee of the United Way, was battling to recoup over \$7 million from UWA. The biggest single item in contention was payment of pension funds, complicated by a change in the pension contract approved by the Executive Committee 10 years earlier. With over \$3 million in play on this item alone, the Executive Committee minutes were a critical source of information for the court as it pieced together the intent of the committee in regard to the change in the pension plan.

Implications of Board Delegation

The Executive Committee minutes of 1984 made it clear that the committee had approved the pension plan change in concept and had delegated to CFO Stephen Paulachauk authority to handle the details of finalizing and signing the contract. The concept paper approved by the board included a forfeiture clause in the event of fraud, embezzlement, or felony on the part of the participant, but the final contract signed by Paulachauk did not include the forfeiture clause. Ten years later, Paulachauk was indicted and Aramony was in jail, but the U.S. District judge ruled that the agreement was governed by the signed contract rather than the board-approved concept paper, because the committee had delegated signing authority to the CFO. Because the board had legally empowered the CFO to finalize the paperwork and execute the deal on its behalf, the judge ruled that UWA must pay Aramony \$3,221,000 in pension funds, even though the board believed in retrospect that the work of the CFO did not reflect its original intent.

Critical Need for Board Skepticism

“It was always clear to staff who supported him that he was a special, unique, and gifted person who had every right to set his own rules and standards.”⁹ The staff and board deferred to Aramony, and let him do so. Aramony could have benefited greatly from a dose of board skepticism along with a commitment to hold him accountable. Instead, board members who were outstanding in their own fields deferred to Aramony

as the expert in all affairs of nonprofit charities and relied on him to bring the right issues to the board. As far back as 1990, several Executive Committee members received copies of an anonymous letter accusing Aramony of various improprieties. There is no evidence that they investigated the matter. Subsequently, immediately upon the 1992 release of the Verner-Liipfert IGI report, the Executive Committee offered a unanimous vote of confidence in Aramony, rather than delving into the issues identified in the report. Instead of taking a proactive stance investigating issues, the board appears to have repeatedly been in the position of reacting to the media and defending their man.

This tragic sequence of events resulted in an erosion of donor confidence in the United Way, accompanied by a reduction in total giving. Dealing with the aftermath of the scandal, UWA then spent millions of dollars on investigators, special audits, public relations agencies, and legal expenses while losing millions from reductions in charitable giving and chapter dues. But through it all, the UWA managed the financial distress and avoided the Zone of Insolvency. What followed was a complete overhaul of the United Way at all levels. As a result of the reduction in charitable gifts to local chapters and the reduction in dues paid by the local chapters to headquarters, the UWA was cash challenged, forced to borrow money to make payroll, and forced to offer termination incentives to reduce the size of the workforce.

FIVE GREAT QUESTIONS FOR YOUR NEXT BOARD MEETING

1. Are we as a board diligent in holding our CEO accountable?
2. Do we have appropriate policies delegating specific authorities to key executives?
3. Do we exercise a healthy dose of skepticism in carrying out our fiduciary responsibilities?
4. Do we accept full responsibility to independently understand and exercise our legal responsibilities as a board, or do we defer to executive staff?
5. If faced with a major crisis, could our organization avoid the Zone of Insolvency?

■ NOTES

1. Charles, Hall, “Ex-Charity Chief’s Sentence Plea Cites Surgery, Shrinking Brain,” *Washington Post*, June 22, 1995, section B, p. 4.
2. “Ex-Leader Guilty of Taking \$600,000 from United Way, Witnesses Depict a Womanizer Who Spent Lavishly,” *The Virginia Pilot*, April 4, 1995, front section.
3. David Cay, Johnston, “Court Rejects Former United Way President’s Pension Claim,” *New York Times*, June 22, 2001, section A, p. 14.
4. Karen, Arenson, “United Way Holds Steady in Donations,” *New York Times*, August 19, 1995, section 1, p. 8.
5. *William Aramony v. United Way of America*, 96 Civ. 3962, August 4, 1998, pp. 8–9.
6. John S., Glaser, *An Insider’s Account of the United Way Scandal: What Went Wrong and Why*. New York: Wiley, 1994.
7. *William Aramony v. United Way of America*, 96 Civ. 3962, August 4, 1998.
8. *Ibid.*
9. Glaser, *An Insider’s Account of the United Way Scandal*, p. 192.

