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“Stunning” Negligence: Trustees Must Personally Pay \$1M in Fraud Case

By RUTH MCCAMBRIDGE | December 11, 2012

December 10, 2012; **Source:** New York Times (<http://www.nytimes.com/2012/12/10/nyregion/george-scott-renter-to-nyc-students-settles-fraud-case.html>)

Here is a good story to tell boards to impress upon them the advisability of strong fiscal stewardship. Educational Housing Services, established in 1987, is a New York City-based nonprofit that rents affordable housing to students. On Monday, New York State Attorney General Eric Schneiderman disclosed that George Scott, the founder and former president of the group's board of directors, has agreed to a \$5.5 million settlement (http://www.ag.ny.gov/pdfs/EHS_AOD.pdf) resolving an investigation that Schneiderman said found “stunning” negligence on the part of the board.

According to the attorney general's findings, the board breached its duties of loyalty and care between the years of 2003 and 2009 by contracting with Student Services, Inc. (SSI), a corporation founded and controlled by Scott and his wife which he says charged Educational Housing millions of dollars for intermediating cable, phone and Internet services for the building at a large mark-up. The attorney general's office asserts that SSI provided no meaningful benefit and sees the situation as a case of civil fraud that was approved by the board of directors. Therefore it is not pursuing criminal charges against Scott but it is tapping the personal assets of Scott, the organization, and the trustees.

“We have no tolerance for officers and directors who treat a nonprofit organization as a vehicle for personal enrichment,” Schneiderman said in a statement. The AG's findings state that board members received salaries simply for being trustees and that some had well-compensated consulting contracts that provided “little value” to EHS. As a result of the settlement, which includes no admission of any wrongdoing whatsoever, the five board members must pay \$1 million from their own personal funds and they have resigned and been forever banned from sitting on the board of any New York charity. Scott has also resigned and is required to make restitution of \$2.5 million personally, while Scott and SSI will jointly waive their rights to an additional \$2 million expected under the EHS-SSI agreement, and the board will pay \$1 million.

An important additional point: although the attorney general's report found that the board had been in part misled by Scott, it found that the board did know that Scott was involved with SSI and so this was a “related party transaction.” Therefore it was the board's responsibility to place the situation under careful scrutiny to ensure that the deal was in the best interests of EHS. Instead, they delegated to Scott the job of getting legal advice and competitive bids in this situation. Thus, the board allowed Scott to control the information going to advisors and relinquished its ability to objectively assess the integrity of the situation. –Ruth McCambridge