The Attorney General, Nonprofits, and Fundraising Law

University of Missouri – St. Louis

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Missouri Attorney General’s Office
Ask questions!
Interrupt freely!
The Attorney General’s Mission & The Public’s Interest

• The Attorney General oversees all charitable entities and solicitations in Missouri
   The Attorney General is the guardian of charitable trusts and assets.
   In short, the Attorney General can pursue almost every violation of the laws governing nonprofits.

Goal: Strengthen Missouri’s nonprofit sector
  • Of course, we need to use our unique powers
Attorney General’s Powers

1. Nonprofit corporations, Chapter 355, RSMo
   – Require or stop a particular action, § 355.141
     • a/k/a Ultra Vires
     • Includes violations of federal law
   – Remove Directors, § 355.356
     • Includes breach of duty
   – Dissolve the corporation, § 355.726
   – Other actions to remedy violations of law

2. Charitable Trusts, Chapter 456, RSMo
   – Remove Trustees, § 456.10-1001
   – Action for breach of fiduciary duty
   – Necessary party for modification, termination, etc.
   – Other actions, common law is quite broad.
Attorney General’s Powers

3. Attorney General oversees charitable solicitations

- As Guardian of Charitable Assets, and
- Under Missouri Merchandising Practices Act, Chpt 407, RSMo (aka consumer fraud laws).
  - Aggressively pursue fraudulent solicitations and other deceptive practices.
  - Maintain registration of nonprofits and professional fundraisers who solicit donations.

4. Endowment Funds, Chpt. 402, RSMo
- Stop mismanagement of endowments
Attorney General’s Powers
More practical list

• Commence investigations
  – Review all records, interview anyone

• Take action against just about anyone who has acted illegally
  – Remedies are as broad as our powers

• IRS rules count too (aka *ultra vires*)
  – Reference for what is reasonable conduct

• Sources can be just about anything: complaints, whistleblowers, media, etc.
What causes AGO involvement?

- Policy goal: Protect the integrity of the sector and maintain donors’ faith in nonprofits

- More Practical Goals:
  - Recover diverted or misapplied assets (and stop the activity that led to the diversion)
  - Prevent nonprofits from ceasing to serve their communities
  - Stop fraudulent solicitation activity

- Constantly triage cases and priorities

- How do we choose? Top 10 list is below
Top 10 ways to get investigated

1. Clear failure to follow mission
2. Conflicts of interest
3. Fraud and Embezzlement, failing to respond and prevent
4. Paying excess compensation
5. Failing to operate with the needed transparency.
Top 10 ways to get investigated

6. Directors & Senior leadership failing to be sufficiently active
7. Not filing what you should with government agencies.
8. Violate fundraising laws.
9. Misusing your endowment and restricted assets.
10. Convert from Nonprofit to For-Profit
#1 Failure to follow mission
“asleep at the wheel”

- Have a duty to actively work towards fulfilling your mission
  - Can you say what your organization does?
  - Examples: the animal shelter and the micro-lender
- Best practice: should have tangible, critical assessments of efficiency and program successes.
- Bad excuse #1 “Technically, it's legal.” (but what will your donors and constituents say).
#2 Conflicts of interest

- A nonprofit corporation should be above reproach.
- If any transaction gives even the appearance of a conflict of interest, it should be avoided.
  - Would the media and your Mom understand?
- Includes any person you would call an insider or family members.
- IRS, donors, media, and the general public all have different views of conflicts.
  - None are good
- Law $\neq$ public perception
Conflict of Interest
Legal definition

• A conflict of interest transaction is a transaction with the corporation in which a director of the corporation has a material interest. § 355.416, RSMo

• A conflict of interest transaction is not voidable or the basis of imposing liability on a non-compensated director if the transaction was not unfair to the corporation or is approved by the board. § 355.416, RSMo
Conflict of Interest
Approval of Conflict

• A transaction in which a non-compensated director has a conflict may be approved in advance if the board, excluding the director with an interest, votes to approve, believes in good faith that the transaction is not unfair and all material facts are known. § 355.416, RSMo
  – Emphasis added
  – It is still a bad idea
#3 Fraud and Embezzlement, Failing to respond and prevent

- Nonprofit corporations, and their directors, have a fiduciary duty to protect their assets.
- Why important?
  - They’re stealing from you!
  - Overall cost, sector-wide, was $40 billion for 2006, or some 13% of the roughly $300 billion given to charity that year. (Source: NY Times, March 29, 2008)
- Many, many organizations are victims and do not know it
#3 Fraud and Embezzlement, Failing to respond and prevent

- Embezzlement can happen to you, examples:
  - Junsei Ito indicted for taking $30,000 from St. Louis Osuwa Taiko, source: stltoday.com 9/4/2013
    - “the group has now tightened financial procedures, which they didn't feel were necessary before ‘since we were all friends and all working for a common cause.’”
  - Taking From School Booster Clubs is A Familiar Form of Theft, stltoday.com 2/16/2015
    - Reported on five thefts within past year
    - These are just the ones charged and reported
#3 Fraud and Embezzlement, Prevention: What we tell nonprofits

Must take all reasonable steps to prevent

1. Depends on organizational size
   - Even the smallest organizations MUST take steps

2. What would Mad Eye Moody do?
   - Constant Vigilance!
   - Culture and small steps go a long way
   - Discuss and create policies.

3. Remember, audits are generally not designed to catch fraud.
#3 Fraud and Embezzlement, Response

- Embezzlement will happen to someone here.
- Must take all reasonable steps in response

1. Punish offender
   - 72% of nonprofits frauds resulted in termination
   - 6% of nonprofits DID NOTHING, source: Greenlee, et al. An Investigation of Fraud in Nonprofit Organizations

2. Report to law enforcement (and cooperate!)

3. Get your money back
   - Close whatever hole was exploited
     - Use opportunity to strengthen your organization
     - ACORN example
#3 Fraud and Embezzlement, failing to respond and prevent

- Bad excuse #3 “We completely trusted_____”
- Bad excuse #3A “We didn’t want our donations to suffer, so we didn’t tell anyone”
- Bad excuse #3B “We thought our auditor would catch that”
- Not a coincidence that #3 has the most bad excuses!
#4 Paying Excess Compensation

- All of your assets must go to your charitable purposes, and compensation must be reasonable.
- Everything should be reasonable and justified.
- Avoid paying substantially more than similar organizations and lavish expense accounts.
  - Remember IRS excess compensation rules
  - Expense accounts matter
- Bad excuse #4 “We had left over money so figured we would go to Vegas, buy a Vette, etc.”
#4 Paying Excess Compensation
Part 2

- IRS forbids “excess benefit transactions”
  - Any transaction in which a nonprofit insider receives more than they should have for a particular task or service.
  - AGO not a fan either.
- Independent Contractors’ compensation must also be reasonable
  - Professional fundraisers who charge a high percentage of funds raised are red flags
#5 Transparency

How donors perceive lack of transparency, complaints, and slip-ups
#5 Transparency

**Expectations**

- Donors and the Public expect complete transparency
  - Expectations get higher and higher
    - Remember the over-sharing friend on Facebook/Twitter/etc.
- Top complaint generator
  - People will leap to conclusions if lack information
- Best Practice: A nonprofit should operate with as much transparency as possible
  - All records should be open AND easily accessible.
    - Example: all minutes, financial statements, and Form 990’s should be posted online and accessible via social media
#5 Transparency

The Law

- The Law (and not necessarily Best Practices)
  - Law: Missouri statutes list required corporate records and inspection rights for members
    - Sections 355.821 – 355.841, RSMo
  - Law: Directors get everything
  - IRS: Make Forms 990 and 1023 publicly available
  - Law = bare minimum
    - The public expects much more than the law requires.
    - Will run out of donors and have embarrassing headlines

- Law is not reflective of current donor expectations
#5 Transparency Example

- Nonprofit created to support Agency on Aging
  - (c)(3) pass-through + own real estate
  - Poorly drafted operating agreements + separate management
- NP refused to provide regular updates on donations and details about real estate to Agency on Aging
- Agency on Aging comes to Attorney General
  - Not sure what is going on, money is going into black hole, can’t get info, think CEO/ED is stealing…
- AG investigates
- Zero laws broken but:
  - NP is now dissolved
  - CEO/ED had horrible press
#6 Directors or Senior leadership failing to be sufficiently active

- Directors have a fiduciary duty to be active and obtain sufficient information to make informed decisions.
- Directors must understand the organization’s financial health.
- There must be regular reporting to the Board.
  - The directors must know all of the nonprofit’s activities
  - Directors must actively seek the information they need.
  - Ask questions!!!!!!
- Bad excuse #6 “We're a volunteer board and don't have the time to __________.”
#6 Directors or Senior leadership failing to be active - example

KCUMB claims former CEO Pletz fraudulently obtained stipends

Kansas City Business Journal - by Mike Sherry Staff Writer

Related News
- Kansas City University of Medicine and Biosciences: Pletz has 'illusions of conspiracies'
- Stanton resigns from Kansas City University of Medicine and Biosciences
- Arts Council of Metropolitan Kansas City misses fund-raising goal
- Kansas City University of Medicine and...
The former president of Kansas City University of Medicine and Biosciences systematically defrauded the university out of millions of dollars for a decade, the school alleged in a civil suit filed Monday in Jackson County Circuit Court.
Grand jury indicts Pletz in alleged $1.5M fraud

Kansas City Business Journal - by Steve Vockrodt, Staff Writer
Date: Thursday, March 31, 2011, 10:21am CDT - Last Modified: Thursday, March 31, 2011, 2:37pm CDT

Related: Banking & Financial Services, Health Care, Insurance, Education, Legal Services

A grand jury has charged Karen Pletz, former CEO of Kansas City University of Medicine and Biosciences, with money laundering and filing fraudulent tax returns, among other charges.

A grand jury returned 24 criminal counts against Pletz, who ran KCUMB from 1995 until her abrupt termination in December 2009, all of which relate to an alleged scheme to obtain more than $1.5 million from the osteopathic university.

TIMELINE: See a timeline of the events concerning Pletz

Hi Guest,

Check out the benefits of registration
MARKETPLACE OF IDEAS

So where was the board during the KCUMB-Pletz debacle?

Premium content from Kansas City Business Journal - by Michael Braude, Contributing Writer

Date: Sunday, April 25, 2010, 11:00pm CDT - Last Modified: Thursday, April 22, 2010, 6:33pm CDT

Related: Education

A number of people have asked me: “Why don’t you write a column about the debacle at the Kansas City University of Medicine and Biosciences and its embattled former president?”

Frankly, an awful lot already has been written in this paper and others about the unfortunate situation surrounding Karen Pletz.
#6 Directors or Senior leadership failing to be active - example

- Directors can be held personally liable
  - Rare, but can happen
- Example: NY AGO v. Educational Housing, Inc.
  - CEO setup shell corporation and took millions.
  - Directors accused of being “willfully negligent” when they allowed the shell company.
  - Five directors to pay total of $1 million.
#7 Not filing what you should with government agencies

• 3 core filings:
  1. Internal Revenue Service: Form 990
     – States review the revocation lists
  2. Secretary of State: Annual report
  3. Attorney General: Registration
     – If your nonprofit solicits donations (will cover in #8)

• Basic, but important
  – Illustrates the digital fishbowl nonprofits operate in
#7 Not filing what you should with government agencies, part 2

- Why important?
  - Severe sanctions from agency
  - Donors, potential donors, clients, and everyone else all see lack of filing.
    - All information is just a click away
    - Public will misinterpret
  - Will harm your digital footprint
    - Rating sites: BBB, Charity Navigator
    - 990 sites: Guidestar, Foundation Center
    - Online giving platforms: First Giving, Crowdrise, etc.
Actual text of email we received

It has come to my attention that the [name] has had its not for profit status revoked by the IRS!!! Yet they are collecting funds for Joplin and just recently had a fundraiser for Haiti!!!??????????? PEOPLE NEED TO BE AWARE THAT THE MONEY THEY ARE GIVING AND HAVE GIVEN THIS PAST YEAR IS NOT TAX DEDUCTIBLE!!!! Anyone with an estate or any amount of money NEEDS TO BE AWARE THAT THEY WILL HAVE TO PAY TAX ON THE "DONATION". I believe that the law states that they cannot continue to act like they are not for profit as this fraudulently represents their position!!! ALL their [donors] need to be made aware of this!!
#8 Violate fundraising laws

1. Misrepresentations in solicitations
   - Fraud and ethics issues

2. Do-Not Call rules
   - Surprisingly easy to violate

3. Registration
   - If you solicit donations, you may need to register
Fraud and ethics

First, why are we talking about ethics in presentation on law?

- Be sure all solicitation and communication materials are accurate and correctly reflect your organizations’ mission and use of solicited funds.
  - If you hire a paid solicitor make sure you review the script and written materials to be used during the campaign.
Misrepresentations in solicitations

• Obviously, misrepresentations in soliciting donations are forbidden
• But can be easy to do, especially with untrained solicitors or over-eager volunteers.
  – % to charity, purpose of donation, how donation will be used, etc.
  – Incorrect response may be a misrepresentation.
• Penalties can be severe
  – Criminal sanctions are possible, ex: *State v. Richard Divers*
Common innocent mistakes
(still violate the law though)

1. We are a charity
   • Ex: fundraisers for a particular person
2. All donations are tax deductible
   • Need to be a (c)(3) & other rules
3. “Every penny will go to ______”
4. Mission Creep
   • Case example: nascent child abuse hotline ≠ teams searching for child smugglers
Ethical Issue #2

• Make sure that contributions received are used in accordance with the language of the appeal.
  – Remember the problems the American Red Cross encountered when it suggested donations received for the victims of Hurricane Sandy might be used for victims of future disasters.
Relief Spark case example

- Solicited donations in Joplin
  1. Rebuild after tornado
  2. Rented house and recruited volunteers to pay to stay. Said: no salary, all funds for rebuild
  3. Donations for Will Norton Toy Drive
- Collected $130,000
- Used $39,000 for personal purposes
- Result on next slide
Attorney General Recovers Money from Joplin Tornado Scam

03/06/2014 08:30 AM  03/06/2014 08:33 AM

Donation Scam Money Recovered

JOPLIN, MO — Missouri Attorney General Chris Koster has recovered $39,000 in donations from tornado-related scams in the Joplin area. The recovery is the result of a coordinated effort between state and local law enforcement agencies.

The Attorney General's Office has received numerous complaints from Joplin residents who were solicited to donate money to relief efforts in the wake of the tornado. Many of these donations were made to scammers who promised to distribute the funds to legitimate relief organizations.

“Relief efforts are critical, but we must ensure that the money goes to those in need,” said Attorney General Koster. “As we continue our efforts to identify and bring to justice those who take advantage of others' generosity, I want to remind everyone to be cautious about whom they donate to and to whom they donate.”

In addition to the $39,000 recovered, state and local law enforcement agencies have identified several additional cases involving donations to tornado relief scams.

If you or someone you know has been approached by someone claiming to be raising funds for the tornado relief effort, please report it to local law enforcement or the Attorney General’s Office.

For more information about these cases or to report a scam, visit the Attorney General’s website at missouriaudit.org or call 1-800-727-9000.
Restricted Gifts and Donations

• Any gift, bequest, or donation received must be used in accordance with the donor’s wishes and for no other purpose no matter how worthy.
  – Resist the temptation to use restricted gifts for the general purposes of the organization.
  – If a purpose becomes impossible or impracticable to carry out, call the Attorney General for information on judicial remedies.
Ethical Issue #3 and #4

• Give donors the opportunity to have their names removed from lists that are sold to, rented to or exchanged with other organizations.

• Make sure your fundraising costs are reasonable and can be justified to potential donors.

• Just how do we know this does not always happen?
2. Violation of Do-Not Call rules

- § 501(c)(3)’s are exempt from many Do Not Call laws.
- **BUT** everyone is subject to federal Telephone Consumer Protection Act, which forbids:
  - Calling a person when:
    - They have advised caller of desire not to be called
    - They have advised caller of non-interest in making donation
- State of Missouri can enforce
  - $5,000 penalty per violation
  - Recent settlement of $100,000, have gone up to $500,000
- All rules apply to cell phones too
3. Who needs to register?

1. All charitable organizations that solicit donations
   - **Definition**: Any person or entity who solicits funds for any charitable purpose. § 407.453(2)
   - Many exceptions (see next slide)

2. All Professional Fundraisers
   - **Definition**: anyone compensated by a charitable organization primarily for the purpose of soliciting funds. § 407.453(4)
   - Does NOT include: bona fide employees who receive regular compensation and aren’t primarily employed for the purpose of soliciting funds. § 407.453(4)
   - Salaried development directors are usually exempt
   - Few exceptions here
Who does NOT have to register
§ 407.456.2, RSMo

1. Organizations recognized under §§ 501(c)(3), (c)(7) or (c)(8)
   • Only in Missouri, other states still require registration

2. Religious organizations - (see next slide)

3. Educational institutions (and their related foundations)
   • An institution with a defined curriculum, student body and faculty, and which conducts classes on a regular basis

4. Fraternal, benevolent, social, and historical organizations,
   • When solicitation is confined to the membership

5. Hospitals
   • Provided all fund-raising activities and solicitations are carried on by employees and not by any professional fund-raiser.
Religious organizations

Section 456.453(5), RSMo

1. Any society, sect, persuasion, mission, church, parish, congregation, temple, or organization, that is exempt under 501(c)(3), that either:

   a) Meets at more or less regular intervals for worship of a supreme being or higher power, or for mutual support or edification in piety or with respect to the idea that a minimum standard of behavior from the standpoint of overall morality is to be observed; or

   b) Any nursing, retirement, children's or orphan's home, or any foundation, commission, hospital, school, college, seminary, or other entity, which is owned, operated, controlled, or principally supported by, or associated with through the sharing of common religious bonds and convictions.
Purpose of Registration Laws

• Help donors make informed choices as to which charitable causes should be supported.
• Portion of donation that goes to charitable organization disclosed.
• Increase the goodwill and confidence of contributors
• Deter abuse without discouraging legitimate charitable activities.
How to register

• In Missouri
  – Fill out forms and mail in
    • www.ago.mo.gov/checkacharity/charityregistration
  – Contact Donna Rodenbaugh
    • 573-751-1197
    • donna.rodenbaugh@ago.mo.gov

• Other states
  – Contact them!
Registration in other States

• Other states have different requirements
  • Most require 501(c)(3)’s to register
  • Missouri requires little compared to others

• Just because you’ve satisfied Missouri, does NOT mean you’re registered elsewhere.

• Consequences may be severe.
  • On September 2, 2008 Pennsylvania obtained a judgment of over $1,290,000 for failure to register
1. Other states require registration for charities exempt under 501(c)(3).

2. Registration of Fundraising Consultants or Fundraising Counsel
   - Example: New Hampshire’s definition: “Fund raising counsel" means a person who plans, manages, advises, consults, or prepares material for… the solicitation of contributions for a [charity], but who does not solicit contributions and who does not employ any person to solicit contributions.

   - Example: South Carolina’s definition: “Commercial co-venturer” is a person that regularly, for the benefit of an organization, may raise funds by advertising that the purchase or use of goods, services, entertainment, or other thing of value benefits the charitable organization, if it is offered at a price comparable to similar goods or services.  S.C. Code § 33-56-20

Note: other definitions may vary from state to state
Registration in other states

- Other potential requirements
  - Bond for professional fundraisers
  - Registered agent within the state
  - Mandatory contract language
    - i.e. charity has right to rescind
  - More information than Missouri
- Listed as examples of complex world
If my nonprofit solicits online, where do we need to register?

• States created the Charleston Principles
  – Written in 2001, i.e. well before Mark Zuckerberg got shot down on a date, went back to his dorm, and created Facebook while drinking away his sorrows

• Principles are still good, need to register if:
  1. In state where your nonprofit is *domiciled* (HQ, etc.)
  2. In other states if:
     A. **Specifically target** persons physically located in the state for solicitation, or
     B. Receives contributions from the state on a repeated and ongoing basis or a substantial basis

• What does specifically target mean on Facebook, Twitter, and other social media
Concerned about #Enterovirus or the #flu? Tips on preventing the spread of #disease
rdcrss.org/EVD68

Stop the spread of Germs

Avoid touching your eyes, nose and mouth

Cover your mouth and nose with tissues when you cough or sneeze

Drain all water, throw away meals that were made in the home, wash all dishes, utensils and equipment

Stay away from children who have diarrhea

Wash your hands and use disinfectant

No new cases of #Ebola treatment center in Sierra Leone.
Read more: rdcrss.org/1x9ss4s
Dah! @STLFoodbank is slipping in the ranks! PLS #STL - remember to vote daily at bit.ly/200kmealsforstl! PLS RT!

If it wasn't for the food pantry, we'd have to make a choice between food and medicine.
Carrie Donaldson is Polar Bearing it again!

Thank you for visiting my 2015 Polar Bear Plunge fundraising page. I'm collecting donations to support the more than 3,700 Delawareans who proudly call themselves Special Olympics athletes. Your donation impacts, and ultimately improves, the lives of individuals with intellectual disabilities and, in turn, the lives of everyone they touch.

On Sunday, February 1, 2015, I am joining thousands of “Bears” who freeze their tush off by jumping into the frigid Atlantic Ocean!

Donating through this site is simple, fast and totally secure. It is also the most efficient way to make a contribution to the Polar Bear Plunge for Special Olympics Delaware.

Many thanks for your support – a big bear hug for donating and don’t forget to forward this to anyone who you think might want to donate too! (Or join me by Plunging!!)

This fundraiser is very important to me and I appreciate your support.
• Colorado Rule 10.1.3
• “To receive contributions from Colorado on a repeated and ongoing basis or a substantial basis” means:
  – At least 50 online contributions during a fiscal year.
  – The lesser of $25,000 or 1% of its total contributions in online contributions during a fiscal year.
Single Portal is coming

• Single Portal concept: a single online portal where all nonprofits can go for state registration and, possibly, federal filings.

• Status
  – Issued RFP – Urban Institute won
  – Created nonprofit
  – Trying to raise funds
  – Initial XML mapping
#9 Misusing your endowment

- Must follow restrictions on donations
  - Attorney General can enforce
  - Donors can choose to not give
- Must prudently invest
  - Duty to diversify assets
    - Don’t put your eggs in one basket
      - Example: Mortgage backed securities were once viewed as very safe
  - Duty to prudently invest
    - Invest assets with all reasonable skill, care and caution
    - Review ALL investments, especially in a turbulent market
    - Duty to minimize costs
  - Duty to supervise investments and investors
    - Why? One word: Madoff
Active and engaged boards are the only way to assure rational and informed decision-making. But a law could read like this:

• Section 1. Board members cannot suggest that the institution invest in funds or assets that they learned about in the locker room or on TV.
• Section 2. Boards should not sit in dark rooms watching PowerPoint presentations by consultants while eating morning buns and sipping coffee.
• Section 3. Board members should not be permitted to brag about how their institution placed money with a hot money manager.
• Section 4. Membership on an institution’s investment committee doesn’t give the member the right to experiment with or test a new investment theory that the member wants to apply to his personal investments.
• Section 5. Just because an institution has high-paid in-house investment managers does not mean those investment managers should be setting the risk parameters.
• Section 6. Maximizing return cannot be an end in itself. Return should be maximized in light of pre-defined risk tolerances.

From: Jack Siegel, March 12, 2009, www.charitygovernance.com
#10 Convert from Nonprofit to For-Profit

- Assets committed to nonprofit causes must remain so.
  - Generally, can’t convert from nonprofit to for-profit.
- Must notify the Attorney General of fundamental changes 20 days in advance
  1. Dissolution
     - When dissolving all assets must go to other nonprofits
  2. Merger
  3. Sale or transfer of “substantially all” assets (+ 51%)
#10 Convert from Nonprofit to For-Profit Asset Sales or Transfers

- Take duty quite seriously
  - Rather intense review for larger transfers
  - Health assets even more so
    - Have reviewed 10,000 pages and had public hearings for medium-sized transactions
  - Larger transactions will take more time

- Reviews are unique but look at 3 core issues
  1. Price – is the sales fair?
  2. Process – was process used legally sufficient?
  3. Proceeds – what will the proceeds be used for?
Contact Information

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