

State Legislative Developments Affecting Charitable Organizations

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The attorneys general in certain states – including New York and Massachusetts – have begun to focus increased scrutiny on the corporate governance and fundraising practices of non-profit organizations, in line with similar attention by the U.S. Congress. This trend has been driven by some high-profile cases of misconduct by charity officials, and by concerns over corporate governance generally. As a result, several states have begun to consider special legislation to ensure greater accountability for non-profit organizations and to address perceived abuses in the charitable sector.

These legislative proposals vary greatly, ranging from those that are likely to have only minimal impact to the more rigorous legislation recently adopted in California and currently pending in New York and Massachusetts. Key provisions of the proposals in New York and Massachusetts are highlighted below (a guide to the California legislation as well as frequently asked questions are available on [the attorney general's website](#)). In general, these proposals will apply to organizations incorporated and qualified to do business in the relevant state, and we anticipate that the final legislation (or administrative guidance) will address to what extent they will apply to organizations that solicit contributions but do not conduct other business in state.

New York

In March, New York Attorney General Elliot Spitzer released several proposals designed to strengthen non-profit corporate governance and prevent fraud. The texts of the bills and explanatory memoranda are available on [the attorney general's website](#). Key provisions include:

- **Annual Reports:** Willful or persistent failure to file complete and accurate reports with the attorney general's Charities Bureau is a breach of duty for which directors and officers could be subject to removal.
- **Internal Financial Controls:** Organizations (excluding religious corporations) are required to maintain a system of internal financial controls designed to reasonably ensure the reporting of fraud and the identification of incorrect financial information in their annual reports.
- **Interested Director Transactions:** Compensation arrangements, contracts and transactions between an organization and any of its directors or officers – or any entity in which a director or officer has a substantial financial interest – must be fair and reasonable, and are voidable if they are not. An interested director transaction will be presumed to be fair and reasonable if certain disclosures are made and due diligence is performed.

- **Executive Committee:** An organization with a board of directors having an excess of 25 members is encouraged to designate an executive committee.
- **Audit Committee:** An organization that has gross revenue of at least \$2 million in any year or that has its financial statements audited by a public accountant is encouraged to designate an audit committee.
- **Charitable Solicitation:** The proposed legislation contains numerous provisions amending the charitable solicitation registration and reporting rules, including provisions that seek to clarify which individuals and organizations must register with the attorney general.

Massachusetts

In May, Massachusetts Attorney General Tom Reilly proposed new legislation to strengthen the oversight of charitable organizations. For the text of the bill and related information, see [the attorney general's website](#). The primary provisions of the proposed legislation are:

- **Certification of Annual Reports:** Organizations required to file annual reports with the attorney general's Division of Public Charities must have the reports signed and verified under oath by the chair, president or principal officer of the board of directors and by the organization's CEO, executive director or most senior employee.
- **Audits & Audit Committees:** An organization that has over \$500,000 in revenue or \$5 million in assets must have audited financial statements and must establish audit committees to handle various matters pertaining to the organization's auditors and internal controls. Audit committee members must be independent and a majority must be members of the board of directors.
- **Related Party Transactions:** Federal prohibitions on and penalties for excess benefit transactions, including excessive compensation, are incorporated into Massachusetts law.
- **Whistleblower Protections:** Organizations may not retaliate against whistleblowers and must comply with certain documentation requirements for whistleblower complaints.
- **Penalty Increase:** The current penalty of \$500 for certain violations of an organization's registration and reporting obligations is increased to \$5,000.

We will continue to monitor these and other legislative developments affecting non-profit organizations at the federal and state levels and issue periodic updates. If you have any questions or concerns, please contact:

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