

ISSUE BRIEF:

ASSEMBLY BILL 2327: ENHANCED ENFORCEMENT OVERSIGHT OF NONPROFIT PUBLIC BENEFIT CORPORATIONS (INCLUDING AUXILIARY ORGANIZATIONS)

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Abstract

Under AB 2327, effective January 1, 2013, the Attorney General will have increased enforcement authority over charitable organization (nonprofit public benefit corporation) activities and reporting practices, particularly fundraising and donated assets. Auxiliary organizations are (with a single exception) nonprofit public benefit corporations, registered as charitable organizations. *Source:* State Assembly Analysis, dated 8/22/12. Auxiliary organization boards and management should be prudent in handling its assets and attentive to charitable organization reporting requirements.

I. Background

This *Issue Brief* provides background and a summary analysis of Assembly Bill 2327 (Chapter 483)¹ authored by Assembly Member Feuer, and effective January 1, 2013.

Charitable corporations (including all but one auxiliary organization) as nonprofit public benefit corporations² -- or as trustees, commercial fundraisers, fundraising counsel, or coventurers -- who hold or solidit property for charitable purposes, are required to file initial registration and periodic information statements, articles of incorporation, and annual financial reports with the Attorney General's *Registry of Charitable Trusts* (RCT).

The primary responsibility for supervising these entities in California, for insuring compliance with trusts and articles of incorporation, and for protection of assets they hold, resides in the Attorney General (AG) under the *Supervision of Trustees and Fundraisers for Charitable Purposes Act* (Act).³

The AG is entitled to recover from defendants named in a charitable trust enforcement action all actual costs incurred in conducting that action. All moneys recovered by the AG are deposited into the General Fund and used to offset the costs of future charitable trust AG enforcement actions.

A fine, not to exceed \$1,000 for a first offense under the Act, and a fine not to exceed \$2,500 for all subsequent violations, may be issued. Any person who violates the Act with intent to deceive or defraud any charity or individual is liable for a civil penalty not to exceed \$10,000.

Thus, under existing law, the AG may fine such an entity if it fails to file its annual registration statement, fails to file a report, or fails to correct deficiencies in a report or statement. The AG must first notify the

¹ AB 2327 amends Sections 12591.1 and 12599.6 of, and adds Section 12599.8 to, *California Government Code*, relating to charitable organizations.

² See generally, *Cal. Corp Code* Section 55110 *et seq.*

³ *Cal Gov't Code* Sections 12580-12599.8. Auxiliary organizations are subject to additional oversight. See *Cal Ed Code* Sections 89300 and 89900 *et seq.*

entity of the violation, and give it 30 days to cure the violation before a fine may be issued. The first fine may not exceed \$1,000, and each subsequent fine may not exceed \$2,500. An entity is also liable for a penalty, not to exceed \$10,000, if the AG proves violation of the Act with the intent to defraud.

Recent abuses in charitable fundraising practices suggest these fines are inconsequential, and not functioning as a sufficient deterrent against misuse of charitable assets. Furthermore, allowing an entity 30 days to cure a violation, or 10 days to correct deficiencies in a statement or report before a fine may be issued, creates little incentive to comply with existing requirements.

II. Summary Analysis

AB 2327 amends the Act to provide the following enhanced AG oversight tools for both *non-compliance* and *misstatements*, thus creating incentives to produce accurate and timely reports, as well as Act-compliant transactions:

- Permits the AG to issue a cease and desist order⁴ whenever the AG finds that an *entity* or *person* subject to the provisions of the Act has committed a violation of the Act including:
 - a) Failing or refusing to produce required records of the organization⁵;
 - b) Making a material false statement in any application, statement or report⁶;
 - c) Failing to file financial reports, or filing incomplete financial reports⁷; or,
 - d) Engaging in specified prohibited acts.⁸
- Permits the AG, after giving five days' notice, to impose a civil penalty not to exceed \$1,000 per act or omission, for any act or omission in violation of the Act or regulations.⁹ The penalty will accrue at the rate of \$100 per day for each day of noncompliance, commencing on the fifth day after notice.¹⁰
- Permits the AG to suspend the registration, under the Act, of any *person* or *entity* assessed penalties under the Act.¹¹
- Grants any *person* or *entity* subject to penalties under the Act, a review hearing, as specified, so long as the *person* or *entity* requests the hearing within 30 days of receipt of notice of the AG's action.¹²

⁴ *Ibid* at Section 12591.1(b).

⁵ *Ibid* at Section 12591.1(b)(1).

⁶ *Ibid* at Section 12591.1(b)(2).

⁷ *Ibid* at Section 12591.1(b)(3).

⁸ *Ibid* at Section 12591.1(b)(4).

⁹ Chapter 4 (commencing with Section 300) Division 1 of Title 11 of the *California Code of Regulations*.

¹⁰ *Cal Gov't Code* Section 12591.1(c).

¹¹ *Ibid* at Section 12591.1(d).

¹² *Ibid* at Section 12591.1(e).

- Permits the AG to seek an injunction, order of receivership, restitution or order of accounting to ensure due application of charitable funds.¹³
- Provides that for any year that an entity balance sheet shows that it holds restricted net assets, while reporting negative unrestricted net assets, the organization shall provide an explanation of its compliance with its charitable trust responsibilities and proof of directors' and officers' liability insurance coverage to the AG's RCT.¹⁴

III. Summary and Conclusion

AB 2327 authorizes the AG to fine for both *non-compliance* and *misstatements*, and to issue *cease and desist orders*, which gives the AG an additional enforcement mechanism in the event that fines and penalties are not compelling sufficient compliance. If it becomes probable that an entity is misappropriating charitable assets, the authority to issue a *cease and desist order* will also operate to freeze remaining funds held by the entity, and as a result, maximize the amount of donations that may be returned.

An entity that has been the subject of an enforcement action by the AG may request a hearing review of that enforcement action. Arguably, the availability of a hearing ensures that the due process rights of the entity will be protected.

All auxiliary organizations chartered as nonprofit public benefit corporations are likewise registered with the RCT as charitable organizations.

It is critical to an organization's governance standards and compliance practices that Act requirements be in the forefront of all transactions and activities, including timely, accurate and complete reporting (with all supporting documents) to the AG. Enforcement action by the *Charitable Trust Section* of the AG can move against not only the entity, but individuals connected to perceived non-complaint acts.

¹³ *Ibid* at Section 12591.1(f).

¹⁴ *Ibid* at Section 12599.8.