2004

Enron.org: Why Sarbanes-Oxley Will Not Ensure Comprehensive Nonprofit Accountability

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Recommended Citation
38 University of California at Davis Law Review 205 (2004)

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INTRODUCTION

Traditionally, commentators on nonprofit law have lamented the unsatisfying level of its enforcement.[1] These critiques have been leveled at state attorneys general (also "AGs"), the Internal Revenue Service, and even nonprofits themselves.[2] Yet, today, a new sensibility is emerging. Enforcers of nonprofit law, particularly state AGs, have developed a taste for exercising their right to remedy nonprofit wrongs. The new vigor for patrolling the accountability of nonprofit organizations is not limited to reactive enforcement through litigation and settlement negotiation. Rather, activist state AGs also are engaging in more proactive efforts. The most notable of these are a few AGs' recent efforts to draft legislation applying financial accountability reforms modeled on

[1] *See* Rob Atkinson, *Unsettled Standing: Who (Else) Should Enforce the Duties of Charitable Fiduciaries?*, 23 J. CORP. L. 655, 657 (1998); James J. Fishman, *Improving Charitable Accountability*, 62 MD. L. REV. 218, 268-69 (2003); Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 606-07 (1981); Kenneth L. Karst, *The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility*, 73 HARV. L. REV. 433, 476-83 (1960). I myself have mentioned this frequent critique in an earlier work. *See* Dana Brakman Reiser, *Decision-Makers Without Duties*, 53 RUTGERS L. REV. 979, 1020-22 (2001).

[2] *See* Hansmann, *supra* note 1, at 600-15 (describing inadequate enforcement of nonprofit laws by state attorneys general, the Internal Revenue Service, as well as nonprofit organizations' patrons); Karst, *supra* note 1, at 436-60.

the federal Sarbanes-Oxley Act (also "Sarbanes-Oxley" or "the Act")[3] to the nonprofit sector.

AGs' increased interest in their nonprofit enforcement role receives mixed reviews from commentators.[4] While a change from complete inaction is certainly welcome, some question how and at whom AGs will target their increased enforcement activities.[5] This Article asserts that concern over increased attorney general activism should not be limited to fears of what AGs may do with their new initiative. Those who care about the nonprofit sector, and who believe in its vitality and importance to our economy and society, must also analyze the priorities of enforcement held by state AGs. Due to their political position and the capacities of their staffs, AGs will fail to monitor vital elements of nonprofit accountability adequately. Supporters of the nonprofit sector must recognize these limitations, and must form strategies to compensate accordingly.

AGs, even activist AGs, first and foremost monitor and police nonprofits' *financial* accountability. They seek to protect donors and nonprofit assets. When activist AGs bring cases to enforce donor intent,[6] to return to nonprofits assets pilfered by disloyal fiduciaries, or to maintain charitable assets within state lines,[7] they are engaging in enforcement of financial accountability. Likewise, the Sarbanes-Oxley type legislation being proposed by activist AGs strives to improve the

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[3] Congress and President Bush enacted the Sarbanes-Oxley Act to reform financial reporting and auditing in publicly-held corporations in the aftermath of the series of for-profit financial scandals that came to light beginning late in 2001. *See* Sarbanes-Oxley Act of 2002, pmbl., §§ 7201-7266, Pub. L. No. 107-204, 116 Stat. 745 (July 30, 2002) (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.) (describing statute as "[a]n Act to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes"); Statement by President of the United States George W. Bush upon Signing H.R. 3763, 38 WKLY. COMP. PRES. DOC. 1286 (July 30, 2002) (describing Act as "adopt[ing] tough new provisions to deter and punish corporate and accounting fraud and corruption, ensure justice for wrongdoers, and protect the interests of workers and shareholders").

[4] *See, e.g.*, Mark Sidel, *Philanthropy and Social Class: Variance Power and the Battle for American Giving*, 36 U.C. DAVIS L. REV. 1145, 1151 (2003) (asserting that the new state activism he identifies in nonprofit regulation is "constructive" but also "engenders substantial doctrinal and political problems").

[5] *See* Evelyn Brody, *Whose Public? Parochialism and Paternalism in State Charity Law Enforcement*, 79 IND. L.J. 937, 939-43 (2004); Sidel, *supra* note 4, at 1151. *See generally* Mark Sidel, *The Nonprofit Sector and the New State Activism*, 100 MICH. L. REV. 1312 (2002) [hereinafter Sidel, *New State Activism*].

[6] *See, e.g.*, Cmty. Serv. Soc'y v. N.Y. Cmty. Trust, 713 N.Y.S.2d 712, 714-22 (N.Y. App. Div. 2000), *aff'd*, 751 N.E.2d 940 (N.Y. 2001).

[7] *See, e.g.*, Health Midwest v. Kline, No. 02-CV-08043, 2003 WL 328845 (Kan. Dist. Ct. Feb. 6, 2003); *In re* Milton Hershey Sch. Trust, 807 A.2d 324 (Pa. Commw. Ct. 2002).

financial transparency and financial integrity of nonprofits. State AGs rightly worry about the misuse or waste of nonprofit assets and their prioritization of this aspect of enforcement may be appropriate. But enforcing nonprofits' financial accountability alone is insufficient.

Simply protecting nonprofit assets from theft and charitable contributions from misdirection is not enough to ensure comprehensive nonprofit accountability. A healthy nonprofit sector also requires organizations to function efficiently and adhere to their missions. Indeed, if they are to remain healthy and continue to make important contributions to society, nonprofit organizations must maintain high levels of financial, mission, and organizational accountability. While AGs have focused on the nonprofit sector's financial accountability, other serious issues, such as mission creep and organizational integrity, require oversight as well. Thus, the nonprofit sector must begin to look for alternative mechanisms to provide this necessary support.

This Article begins with a theoretical examination of the key components of nonprofit accountability and the reasons why state AGs do not enforce them uniformly. Part I deconstructs the comprehensive concept of nonprofit accountability into its constituent parts — financial, mission, and organizational accountability — and addresses why each is important to a healthy nonprofit organization and a vibrant nonprofit sector. Part II evaluates AGs' suitability, competence, and motivation to address each of these types of accountability. Ultimately, it concludes that AGs will pursue their nonprofit enforcement agendas with financial accountability as their principal, if not sole, priority.

The next two Parts detail and analyze recent examples of the upsurge in AGs' nonprofit enforcement, demonstrating that these efforts have focused primarily on financial accountability concerns. Part III canvasses examples of traditional state AG enforcement efforts: regulation, litigation, and settlement intervention involving nonprofits and their fiduciaries. This summary reveals AGs' financial emphasis; they primarily engage in donor and asset protection. To the extent that it occurs, mission and organizational accountability enforcement is a mere by-product of AGs' pursuit of financial accountability goals. Then, Part IV undertakes an extensive evaluation of new nonprofit reform legislation proposed by state AGs, modeled on Sarbanes-Oxley. These AG innovations seek to regulate the nonprofit sector more tightly by enhancing required financial disclosures and mandating changes in governance, especially the use of auditing committees. In the name of improving nonprofit accountability, this Sarbanes-Oxley approach also clearly focuses on financial transparency, with only tangential impact on mission and organizational accountability.

The final portion of the Article offers preliminary thoughts on complements to AG enforcement. Because even activist state AGs will not adequately enforce the important prerogatives of mission and organizational accountability, Part V argues that other mechanisms must be sought out to do so. Rather than advocating additional governmental regulation, this Part suggests that nonprofits might self-regulate to bridge the gap in mission and organizational accountability enforcement. In particular, it suggests that these goals might be furthered if nonprofits contracted with one another for such enforcement, if intermediaries rated nonprofits' relative levels of mission and organizational accountability, or if individual nonprofit actors could be trained and empowered to self-regulate along these lines.

In sum, although state AGs currently may be taking a greater interest in pursuing financial accountability in nonprofit organizations than they have in the past, they still have not and will not comprehensively police nonprofit accountability. Mission and organizational accountability will remain underenforced if policed by AGs alone. This Article identifies the causes of this sub-optimal enforcement, explores the rich case study of this phenomenon provided by the New York and other nonprofit Sarbanes-Oxley proposals, and identifies alternative measures to compensate for its shortcomings.

I. A COMPREHENSIVE VIEW OF NONPROFIT ACCOUNTABILITY

Although the aspects of nonprofit accountability may in a real sense be innumerable, three basic strains cover the lion's share of concerns addressed to the nonprofit sector in these terms.[8] First, nonprofits are exhorted to be financially accountable: to raise and disburse funds responsibly and honestly, to keep accurate financial records, and to make all required disclosures of financial information. Second, nonprofits

[8] Many commentators have addressed the question of defining nonprofit accountability. *See, e.g.*, Evelyn Brody, *Accountability and the Public Trust*, *in* THE STATE OF NONPROFIT AMERICA 471, 475-76 (Lester Salamon ed., 2002) [hereinafter Brody, *Accountability and the Public Trust*]; Evelyn Brody, *Entrance, Voice and Exit: The Constitutional Bounds of the Right of Association*, 35 U.C. DAVIS L. REV. 821, 860 (2002); Fishman, *supra* note 1, at 219-22, 255-57; Peter Swords, *The Form 990 As An Accountability Tool for 501(c)(3) Nonprofits*, 51 TAX LAW. 571, 571-74 (1998). Descriptions of the term differ, but the themes of concern for financial, mission, and organizational integrity persist. *See* Fishman, *supra* note 1, at 255-56; Swords, *supra*, at 571-74. Although accountability is, of course, essential for all kinds of nonprofit organizations, the balance of this Article will focus on public benefit or charitable nonprofits, and leave aside any special accountability issues arising in religious nonprofits or mutual benefit nonprofits, such as social clubs.

must be accountable to their missions. They must act in furtherance of the nonprofit purposes for which they are formed, which continue to qualify them for various subsidies and benefits, and for which they attract support. Third, nonprofits should be accountable as organizations, governing themselves in accordance with the internal rules of order they have adopted. This Part reviews these components of nonprofit accountability,[9] setting the stage for Part II's discussion of why state AGs will not enforce all of them equally well.

A. *Financial Accountability*

Financial accountability is the most straightforward measure of a nonprofit's accountability. As in a for-profit business, one can use the tools of accounting to track a nonprofit's flow of funds and to determine its bottom line. Many issues form part of the picture of whether a particular nonprofit has been financially accountable, including whether it has fulfilled the promises in its solicitations to donors, whether it has followed specific donor instructions (if they have been articulated), whether its agents are honest or are using organizational resources for personal gain, and whether the organization's assets are being safeguarded for the future use and benefit of its community. These issues fall into two general subcategories: donor protection and asset protection.

Donor protection is unquestionably an important goal for nonprofit organizations. Donors are a significant source of financial support for many nonprofits.[10] Failure to follow through on donors' explicit demands, or even on their implicit understandings, can spark intense

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[9] These three subparts of nonprofit accountability may be seen as akin to the strains of duty applied to nonprofit fiduciaries — duties of loyalty, obedience, and care. To a significant extent, the concepts overlap. A large part of the meaning of nonprofit accountability is wrapped up in the need for fiduciaries to meet their obligations. But, this is not the entirety of accountability. Fiduciary obligation measures the performance of individuals, and is enforced through legal liability. This Article seeks to track more than mere fiduciary responsibility; it seeks to unpack a concept of accountability of nonprofit entities, and of the nonprofit sector as a whole. It also attempts to look at enforcement through a broader spectrum of means than the imposition of liability on fiduciaries alone.

[10] *See* THE NEW NONPROFIT ALMANAC & DESK REFERENCE 54-55 (2002) (showing that private contributions represented 23.9% of nonprofits' current operating expenditures in 1998 and ranged from approximately 20-33% of these expenditures over past 30 years). Of course, not all nonprofits obtain substantial financial support from donors, and there is considerable variation across industries. *See id.* at 57 (showing differential receipt of private contributions across range of types of nonprofit organizations, with religious nonprofits receiving the greatest percentage of all such contributions in 1998 (43.6%) and international affairs organizations receiving the least (1.2%)).

feelings on the part of donors who feel duped.[11] A perception in the fund-raising community that a particular nonprofit cannot be trusted can severely damage the organization's fund-raising capabilities, jeopardizing its programs and even its long-term survival.[12] This kind of loss of confidence in an individual nonprofit may also have spillover effects, damaging the fund-raising ability of a wider community of nearby or subject-matter-related nonprofits.[13] Donor protection, or at least maintaining the appearance of protecting donor expectations, is a high priority for individual nonprofits and the nonprofit sector at large.[14]

Protecting the assets of a nonprofit from pilfering or misuse is an even more basic priority for nonprofit organizations. Like any other entity that has plans and programs to maintain, employees to pay, and obligations to meet, a nonprofit simply cannot afford to allow its assets to be secreted away. The need to protect assets, however, may be even more vital for nonprofits than for profit-seeking enterprises, which operate with a greater financial cushion. By their nature, nonprofits cannot raise equity capital,[15] and borrowing can at times be difficult.[16]

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[11] *See, e.g.*, Michael W. Peregrine & James R. Schwartz, *A General Counsel's Guide to Assessing Restricted Gifts*, 29 EXEMPT ORG. TAX REV. 27, 27 (noting that "donor representatives/family members are becoming more sensitive to the use of charitable gifts in a manner that potentially may be inconsistent with the underlying restriction and/or the intention of the donor" and are taking action to challenge such uses); Stephanie Strom, *Donors Add Watchdog Role to Relations With Charities*, N.Y. TIMES, Mar. 29, 2003, at A8 (describing recent efforts of donors challenging what they perceive as misuse of their contributions).

[12] *See* Robert A. Katz, *A Pig in A Python: How the Charitable Response to September 11 Overwhelmed the Law of Disaster Relief*, 36 IND. L. REV. 251, 319 (2003); Robert Strauss, *They're Mad as Hell, and They're Not Making Donations Anymore*, N.Y. TIMES, Nov. 17, 2003, at F17; Paul C. Light, Fact Sheet on the Continued Crisis in Charitable Confidence 2-4 (Sept. 13, 2004) (reporting results of poll demonstrating that in past three years public confidence in nonprofits has not rebounded from its significant drop after Sept. 11, 2001 and that public's most significant lack of confidence is in their ability to "spend money wisely"), *available at* http://www.brookings.edu/views/papers/light/20040913.htm (last visited Oct. 11, 2004).

[13] *See* Henry Goldstein, Opinion, *Another Blow for the Public Image of Charities*, CHRON. OF PHILANTHROPY, May 15, 2003, at 41 (noting that "[w]hen state regulators get attention for their crusade on the evening news, proclaiming, that a 'charity telemarketer scams 85 percent of donations,' nonprofit groups of all kinds get a black eye" in an opinion piece by a fund-raising consultant); Stephanie Strom, *Accountability; New Equation for Charities: More Money, Less Oversight*, N.Y. TIMES, Nov. 17, 2003, at F1.

[14] *See* PETER FRUMKIN, ON BEING NONPROFIT 22, 108-10 (2003). Indeed, nonprofits spend significant resources cultivating contributors and managing relationships with them. MICHAEL O'NEILL, NONPROFIT NATION 21 tbl.1.6 (2002) (providing statistics on nonprofit expenditures).

[15] Henry B. Hansmann, *The Role of the Nonprofit Enterprise*, 89 YALE L.J. 835, 838 (1980).

[16] *See* Henry B. Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54, 73 (1981); *see also* Brad Wolverton, *New Report Finds Nonprofit Groups Are Borrowing Less*, CHRON. OF PHILANTHROPY, Dec. 11, 2003, at 27

Although many nonprofits earn income by providing goods or services,[17] they generally rely as well on the earnings or other assets they can retain and invest.[18] Furthermore, the importance of asset protection relates to concerns of donor protection. Reports that donations have been wasted or stolen by unfaithful fiduciaries will give donors pause about contributing to the victim nonprofit and other nonprofits in the same area or field.[19] For reasons of programmatic integrity, as well as basic marketing, nonprofits need to be financially accountable to survive and flourish.

Thus, it is quite easy to see the importance of financial accountability to nonprofit organizations. As discussed in Part II below, state AGs tend to focus on these financial issues as well. However, financial accountability alone will not suffice to ensure the health of an individual nonprofit or the nonprofit sector at large. To achieve these goals, nonprofits also must be loyal to their missions and possess organizational integrity. The need for mission and organizational accountability is based on subtler arguments than financial accountability, but this need is no less powerful.

B. Mission Accountability

Every nonprofit organization is formed to address some perceived need or goal — its mission. This mission must be stated in the nonprofit's organic documents: the articles of incorporation and bylaws in a nonprofit corporation and the trust document in a charitable trust.[20] In order to qualify as a nonprofit corporation or a charitable trust, this mission is limited to a range of charitable, communal, or at least non-

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(describing how economic downturn and hard financial times have discouraged many nonprofits from seeking credit).

[17] Burton A. Weisbrod, *The Nonprofit Mission and Its Financing, in* TO PROFIT OR NOT TO PROFIT 16-17 (Burton A. Weisbrod ed., 1998); *see also* John D. Colombo, *Commercial Activity and Charitable Tax Exemption*, 44 WM. & MARY L. REV. 487, 525 (2002) (criticizing increased commerciality of tax-exempt nonprofits).

[18] Indeed, tax exemption on investment income has been argued to be a type of subsidy for nonprofit capital formation, because it allows retained earnings to grow larger and faster. *See* Hansmann, *supra* note 16, at 58-62.

[19] *See* Brad Wolverton, *Fighting Charity Fraud*, CHRON. OF PHILANTHROPY, Aug. 7, 2003, at 29 ("Charity officials [faced with financial scandals] say they are far more concerned about how donors will react than they are about the short-term money they lost."); Strauss, *supra* note 12, at F17.

[20] REVISED MODEL NONPROFIT CORP. ACT § 2.02(b)(1) (1987) [hereinafter RMNCA] (requiring nonprofit corporations to state their purposes in their articles of incorporation); AUSTIN W. SCOTT & WILLIAM F. FRATCHER, THE LAW OF TRUSTS §§ 349, 351 (4th ed. 1989).

pecuniary purposes eligible for these legal designations.[21] When individuals opt to become affiliated with a nonprofit, as volunteers, donors, members, staff, or beneficiaries, they expressly or implicitly rely on this and other statements and indications of its mission.

Of course, nonprofits need not be static entities; to this end, governance mechanisms are available to conduct the evolution of a nonprofit mission over time. Within the range of the mission articulated in its statement of purpose, a nonprofit corporation's directors and managers may direct its activities in line with the best interests of the organization. When a change beyond the range of a corporate nonprofit's articulated purposes is desired, the articles of incorporation may be amended. Amending the articles usually requires action by the board and/or members of the nonprofit, if they exist,[22] and may necessitate consent by state actors.[23] In a charitable trust, trustees have discretion in directing the trust's activities within the purposes described by the trust's settlor.[24] When a trustee or other interested parties desire the trust's actions to move away from these stated intentions, a court's approval may be sought in an action for *cy pres*.[25] When the direction and activities of a nonprofit stray from the bounds of its stated mission without scrutiny by any of these internal or external sources — when mission creeps, so to speak — a serious failure of accountability occurs.

Whether one judges the nonprofit sector in economic or sociopolitical terms, protection against unchecked mission transformation is critical. Economic commentators explain that nonprofits exist as optimal

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[21] *See* SCOTT & FRATCHER, *supra* note 20, § 368 (describing limitations on purposes of charitable trusts). The range of permitted purposes varies widely. *Compare, e.g.*, MASS. GEN. LAWS ch. 180, § 4 (1998) (requiring nonprofit corporation to be formed for civic, educational, charitable, benevolent, religious purpose, or for prosecution of any antiquarian, historical, literary, or scientific purpose, etc.), *with* RMNCA, *supra* note 20, § 17.07 (requiring nonprofit corporations to be formed for any public benefit, mutual benefit, or religious purpose), *and with* WIS. STAT. § 701.10 (2003) (requiring charitable trusts to be formed only for relief of poverty, advancement of education, advancement of religion, promotion of health, governmental or municipal purposes, or community benefit purposes).

To be eligible for federal tax exemptions and to receive tax-deductible contributions, nonprofit organizations also must fall within a spectrum of permissible charitable or otherwise exemption-worthy missions. *See* I.R.C. § 501(c)(3) (2000) (granting tax-exempt status to corporations "organized and operated exclusively for religious, charitable, scientific . . . literary or educational purposes"); I.R.C. § 170(c) (similar).

[22] *See, e.g.*, RMNCA, *supra* note 20, § 10.05.

[23] *See, e.g.*, N.Y. NOT-FOR-PROFIT CORP. LAW § 804 (McKinney 1997) (requiring courts to bless changes in articles of incorporation).

[24] SCOTT & FRATCHER, *supra* note 20, §§ 379, 380.

[25] *Id.* § 399.

producers of certain types of goods and services: those subject to market failures due to informational asymmetries among producers, consumers and/or payors, and those subject to government failures of bureaucracy.[26] The nonprofit sector, under this view, is a valuable contributor to the economy because it steps in to provide needed goods and services efficiently, when other categories of producers will not.[27] If a nonprofit's mission is to provide such services, but its activities stray to produce other items offered efficiently by the for-profit or government sectors, the economic rationale for the sector weakens.[28]

Likewise, for those commentators who view the nonprofit sector as a social or political counterweight,[29] a source of societal pluralism,[30] or a foundation of civil society,[31] the role of the sector is endangered when nonprofits stray from that mission which their constituencies support. Nonprofits may be useful to bring together voices that, in a democracy, would never be heard if speaking alone.[32] However, if nonprofits do not faithfully translate these voices, their adherents, and society in general, should question their legitimacy and utility. The value of the nonprofit sector in incubating social innovations or fostering social critique is likewise weakened if groups fail to operate in service of the goals they purport to represent. Such challenges to nonprofits' usefulness also could diminish their popularity, limiting their claim as intermediate organizations important to civil society. If nonprofits have trouble finding willing constituents to bring together in order to generate social capital and learn the skills of citizenship, their contribution to civil

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[26] *See, e.g.*, Hansmann, *supra* note 15, at 843-45 (addressing market failures); Hansmann, *supra* note 1, at 504-06 (similar); James Douglas, *Political Theories of Nonprofit Organization*, *in* THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 43-44 (Walter W. Powell ed., 1987) (addressing government failure); Dennis R. Young, *Government Failure Theory*, *in* THE NATURE OF THE NONPROFIT SECTOR 190 (J. Steven Ott ed., 2001) (similar).

[27] *See* Hansmann, *supra* note 1, at 506-07; Hansmann, *supra* note 15, at 844-45.

[28] Avner Ben-Ner & Theresa Van Hoomissen, *The Governance of Nonprofit Organizations: Law and Public Policy*, 4 NONPROFIT MGMT. & LEADERSHIP 393, 406 (1994).

[29] *See, e.g.*, David Horton Smith, *The Impact of the Volunteer Sector on Society*, *in* THE NONPROFIT ORGANIZATION: ESSENTIAL READINGS 347-55 (David L. Gies et al., eds., 1990); Barbara K. Bucholtz, *Reflections on the Role of Nonprofit Associations in a Representative Democracy*, 7 CORNELL J.L. & PUB. POL'Y 555, 572 (1998).

[30] *See, e.g.*, ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA 513-17 (George Lawrence trans., J.P. Mayer ed., 1969).

[31] *See, e.g.*, Dana Brakman Reiser, *Dismembering Civil Society*, 82 OR. L. REV. 829, 899 (2003).

[32] DE TOCQUEVILLE, *supra* note 30, at 514 ("But among democratic peoples all the citizens are independent and weak. They can do hardly anything for themselves, and none of them is in a position to force his fellows to help him. They would all therefore find themselves helpless if they did not learn to help each other voluntarily.").

society wavers.[33]

Thus, a comprehensive view of nonprofit accountability requires more from nonprofits than financial integrity alone. Nonprofit organizations also must abide by their original missions or use legitimate means to transform those missions over time. When they fail to do so, they compromise their ability to perform the various societal roles assigned to them and threaten the legitimacy of the nonprofit sector at large. Without some presence to monitor and police nonprofits' mission accountability, the nonprofit sector's situation is precarious. If, as this Article argues, AGs will not and probably should not enforce mission accountability, some other policing mechanism must be found.

C. *Organizational Accountability*

The final aspect of truly comprehensive nonprofit accountability is organizational accountability. Each of the thousands of autonomous U.S. nonprofits[34] is impressed with the legal responsibility to govern itself and conduct its affairs within the construct of its organizational form. Maintaining organizational accountability is of both independent and instrumental importance. Legal compliance is independently significant because it serves the inherent values of order and predictability, and allows for individual nonprofits and the nonprofit sector to maintain their claims to autonomy. Legal norms of organizational accountability also serve instrumental goals, by providing mechanisms through which nonprofit actors may seek and enforce financial and mission accountability. For the majority of U.S. nonprofits, which are organized as corporations, these legal norms are expressed through nonprofit corporate law.[35]

The legal governance structure of the nonprofit corporation, modeled on a for-profit corporate template under modern law, is founded on the creation and maintenance of organic documents and the empowerment of fiduciaries. A nonprofit corporation is formed upon the filing of articles of incorporation with an appropriate state official.[36] The articles

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[33] Brakman Reiser, *supra* note 31, at 866-72.

[34] THE NEW NONPROFIT ALMANAC & DESK REFERENCE, *supra* note 10, at 6 (estimating that number of tax-exempt 501(c)(3) charities in 1998 was 733,790).

[35] This Article examines in detail the paths to organizational accountability relevant to the nonprofit corporation, as it is the primary legal organizational form adopted by nonprofits in the modern United States. MARILYN E. PHELAN, NONPROFIT ENTERPRISES § 1.01 (2003). Legal compliance within the other available nonprofit legal forms is important for this same mix of independent and instrumental reasons.

[36] *See, e.g.*, CAL. CORP. CODE § 5133 (West 2002); N.Y. NOT-FOR-PROFIT CORP. LAW § 403

state the purposes of the nonprofit corporation and provide for its governance structure in general terms.[37] The primary governance mechanism is the board of directors, which is empowered to manage the nonprofit corporation directly or to direct its management through the supervision of officers and employees.[38] These directors may be elected by a membership defined in the articles or bylaws of the nonprofit, or, more likely, may be appointed by their predecessor directors.[39] Directors then appoint officers and can hire employees or other agents to undertake the daily operations of the nonprofit, while they retain the authority and obligation to oversee these other nonprofit actors and to make major decisions on behalf of the nonprofit corporation.[40]

Nonprofit corporate law further instructs directors and officers to perform their governance roles in line with fiduciary duties of loyalty and care akin to those of for-profit corporate actors.[41] The duty of loyalty, admonishing nonprofit fiduciaries to avoid conflicts of interest[42] and to further the best interests of their nonprofits rather than their own personal interests,[43] covers much of the ground addressed above in the discussion of financial accountability.[44] The directorial obligation to meet

(McKinney 1997); RMNCA, *supra* note 20, § 2.01-03.

[37] The nonprofit corporation's bylaws provide more detailed description of the governance structures of the nonprofit corporation, its purposes, programs, and various other topics.

[38] Although many nonprofits refer to their board members as trustees, this Article will use the term "directors," in line with common statutory usage. *See, e.g.*, RMNCA, *supra* note 20, § 8.01 (requiring nonprofit corporations to empower board of directors and setting forth their powers, duties, standards of conduct, etc.).

[39] *See* Brakman Reiser, *supra* note 31, at 850.

[40] *See, e.g.*, MASS. GEN. LAWS ch. 180, § 6(c) (1998); N.Y. NOT-FOR-PROFIT CORP. LAW § 713 (McKinney 1997); RMNCA, *supra* note 20, §§ 8.01, 8.30 cmt. 8.

[41] For example, a nonprofit director is required to "discharge his or her duties as a director . . . (1) in good faith; (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) in a manner the director reasonably believes to be in the best interest of the corporation." RMNCA, *supra* note 20, § 8.30(a); *see also* MASS. GEN. LAWS ch. 180, § 6C (1998) (applying similar standard).

[42] *See, e.g.*, FLA. STAT. ANN. § 617.0832 (West 2001); N.H. REV. STAT. ANN. § 293-A:8.31 (2002); RMNCA, *supra* note 20, § 8.31 cmt. 1.

[43] *See* Daniel L. Kurtz & Paula B. Green, *Liabilities and Duties of Nonprofit Directors and Officers*, *in* NEW YORK UNIVERSITY SIXTEENTH CONFERENCE ON TAX PLANNING FOR THE CHARITABLE SECTOR § 11.02[2], at 11-12 (1988).

[44] Various kinds of self-dealing, fraud, the taking of corporate opportunities, misappropriation of assets, and similar transgressions are all prohibited by the duty of loyalty imposed on nonprofit directors. *See* Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers*, 23 J. CORP. L. 631, 646 (1998). State nonprofit statutes typically provide procedural validation mechanisms to protect transactions in which directors have a conflict of interest from later challenges. *See* MARION FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION 219-

one's duty of care, on the other hand, directs nonprofit fiduciaries to the process by which they exercise their authority.[45] This duty compels directors to attend to their responsibilities. They must go to meetings, obtain information necessary to make decisions allocated to them, engage experts to provide them with reliable counsel, and document their activities in the nonprofit's records.[46]

The legal structure of governance offers nonprofits a framework for their operations, and a mechanism for legitimately translating the goals of the individuals, groups, or causes they represent into action. Whatever one's view of the rationales for the existence of nonprofits, the sector cannot perform any of the functions attributed to it if its organizations are shams. Organizational accountability through legal compliance is of independent value because it structures the accomplishment of a nonprofit's purposes and provides it with the attributes of an autonomous entity that can claim various elements of societal largesse.

Legal norms of organizational accountability also serve instrumental goals, by providing mechanisms through which nonprofit actors may seek and enforce financial and mission accountability. Clear records facilitate the tracking of donations and the use and growth of charitable assets. Qualified nonprofit directors and officers who attend regular board and committee meetings have the opportunity to unearth inappropriate diversions of charitable contributions or misconduct by their colleagues. Process alone is rarely a complete cure to a problem,[47] but the structures and mechanisms that organizational accountability

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25 (2004); *see also* Deborah A. DeMott, *Self-Dealing Transactions in Nonprofit Corporations*, 59 BROOK. L. REV. 131, 137-39 (1993) (describing pre-validation technique used in RMNCA, *supra* note 20).

[45] *See* Stern v. Lucy Webb Hayes Nat'l Training Sch. for Deaconesses and Missionaries, 381 F. Supp. 1003, 1013 (D.D.C. 1974) ("[D]irectors of charitable corporations are required to exercise ordinary and reasonable care in the performance of their duties, exhibiting honesty and good faith . . . ."); RMNCA, *supra* note 20, § 8.30(a)(2); Goldschmid, *supra* note 44, at 641.

[46] Some commentators also view nonprofit directors as bound by a discrete duty of obedience, to obey the law and the mission of their corporations. *See* Kurtz & Green, *supra* note 43, § 11.02[2], at 11-12; Jill S. Manny, *Governance Issues for Non-Profit Religious Organizations*, 40 CATH. LAW. 1, 20-21 (2000). Whether a duty of obedience exists as a separate duty of nonprofit directors, or is merely one component of their duties of loyalty or care, the concerns it raises have been addressed in the discussion of the need for mission accountability in nonprofits. *See supra* Part I.B.

[47] Recent for-profit corporate scandals certainly make clear that the mere existence of records and qualified fiduciaries is not alone a sufficient condition for avoiding financial misconduct. Still, to have someone qualified and actually attending to the responsibilities of "minding the store" would seem at least a necessary precursor to financial integrity.

requires can help increase nonprofits' transparency and educate fiduciaries about appropriate management and monitoring of their finances.

Organizational accountability is also closely linked to concerns of mission. There is no clear, independent metric for evaluating fealty to nonprofit mission. Without such a metric, individuals concerned with the mission of a single nonprofit are free to make their own decisions about its performance and can communicate their assessments with words or actions. For example, a longtime volunteer in a community health organization can state her concerns at an event. She might comment: "Our focus on screening for high blood pressure has become too narrow; our mission is to promote long-term health in the community and to do so we need to address health problems with a greater incidence in younger adults as well." She might try to steer the nonprofit's activities toward her perception of its mission by starting a substance abuse awareness program within it or by refusing to volunteer for its blood pressure screening events. She also could remove herself from the organization altogether or cease making donations to it. But, these efforts remain informal and individual.

A governance structure provides a formal mechanism through which this kind of self-assessment can be undertaken at the organizational level. As directors and officers make decisions for their nonprofits and as they supervise employees, the limitations imposed by their nonprofits' organic documents, as well as their own fiduciary obligations, should steer them back to consider mission. Organizational structures also can allow for individuals' assessments of a nonprofit's continuing compliance with its mission to be communicated to and considered by those directors and officers capable of adjusting the nonprofit's course. The deliberative process envisioned by the mandate of organizational monitoring and/or management by a board provides a framework in which these actions can occur.

Of course, the legal framework of governance can only spur financial propriety and mission assessment if it is followed. If officers routinely engage in self-dealing transactions without seeking approval by independent directors, the board provides no method for internal scrutiny of these deals. If directors are merely a high-profile front to mask capture by an individual donor or by staff members, they offer no checks and balances against mission creep. For organizational accountability to serve its instrumental role, it must be enforced; nonprofit actors must attend to their supervisory and decision-making roles and make informed decisions in good faith. The mere existence of a nonprofit governance structure and the exhortations of nonprofit actors' fiduciary obligations may not provide adequate incentives for them to do so.

Regrettably, AG enforcement of organizational accountability will not substantially increase these incentives. AGs may appreciate the value of organizational accountability for nonprofits; however, as Part II will argue, AGs still will devote relatively little of their attention and resources to this aspect of nonprofit enforcement. Even newly activist state AGs prioritize the enforcement of nonprofit financial accountability. The recent legislative proposals for nonprofit reform described in Part IV exemplify the limited manner in which AGs address organizational accountability, namely by attempting enforcement in this area almost exclusively when it is linked to uncovering or preventing financial abuse.

II. WHY AGS PRIORITIZE FINANCIAL ACCOUNTABILITY ENFORCEMENT

Although a comprehensive view of nonprofit accountability includes financial, mission, and organizational components, state AGs are neither equipped nor encouraged to enforce all of them with equal intensity. The combination of AGs' legislative mandates, the institutional competencies of their offices, and the impact of electoral politics propels AGs to prioritize financial accountability. Likewise, these forces combine to marginalize for AGs the importance of mission and organizational accountability, resulting in relative underenforcement of these vital components of nonprofit accountability. This Part analyzes how these forces mold AGs' nonprofit enforcement priorities, to explain the recent state legislative proposals for nonprofit reform and other examples of state AG activism explored later.

A. *Financial Accountability*

In pursuing their nonprofit enforcement responsibilities, state AGs focus on financial accountability, placing a heavy regulatory focus on donor and asset protection.[48] This focus is predictable for several

[48] *See, e.g.*, Office of the Attorney General, State of California, *Frequently Asked Questions, Charities*, *available at* http://caag.state.ca.us/charities/faq.htm (last visited Oct. 6, 2004) (describing AG's role in regulating charities as to "represent[] the public beneficiaries of charities, who cannot sue in their own right [by] . . . investigat[ing] and audit[ing] charities to detect cases in which directors and trustees have mismanaged, diverted, or defrauded the charity" and potentially pursuing litigation); Office of the Attorney General, State of New York, *The Regulatory Role of the Attorney General's Charity Bureau* (describing AG's nonprofit regulatory roles as to "supervise . . . organizations and individuals that

reasons. First, AGs' financial focus can be traced to the terms of their mandates: to protect consumers and charitable assets within their jurisdictions. Second, AGs' existing skill sets and tools of enforcement fit financial accountability enforcement. They historically have tracked deceptive fund-raising practices and financial frauds, and their power to regulate and prosecute nonprofits and their fiduciaries is suited to locating and rectifying financial abuses. Third, and finally, AGs have powerful incentives to prioritize issues that voters will appreciate and the media will report. These same factors limit AGs' ability to engage in the kind of institutional support and policing of mission and organizational structure that successful nonprofits require.

The law does not charge state AGs with the responsibility or authority to maintain the health of the state's nonprofit sector writ large. The mandates issued to AGs to police nonprofit organizations typically speak in terms of safeguarding charitable assets.[49] The delegation of power to the AG to supervise a state's nonprofit sector also may address the need to protect the interests of donors who make charitable contributions.[50] Even in a new era of AG activism, the resources allocated for oversight of the nonprofit sector remain tight and so priorities must be set.[51] One reasonable way for AGs to set these

administer and/or solicit charitable funds or other charitable assets in New York"), *available at* http://www.oag.state.ny.us/charities/role.pdf (last visited Oct. 11, 2004). *See generally* STATE ATTORNEYS GENERAL: POWERS AND RESPONSIBILITIES 183-94 (Lynne M. Ross ed., 1990) (describing one of duties of AGs as "represent[ing] the public's interest in the proper use of funds raised and held by charitable organizations," in introduction to chapter on AGs' role in nonprofit enforcement).

[49] *See, e.g.*, CAL. CORP. CODE § 5250 (West 2004); CAL. GOV'T CODE § 12598 (West 2004) ("The primary responsibility for supervising charitable trusts in California . . . and for protection of assets by charitable trusts and public benefit corporations, resides in the Attorney General."); GA. CODE ANN. § 14-3-170 (2003) ("The Attorney General may petition the superior court to enjoin the proposed unlawful conveyance, transfer, or assignment of assets . . . ."); OR. REV. STAT. § 128.670 (West 2003) (authorizing attorney general to receive periodic reports as to all charitable trust assets and to ascertain whether those assets are properly administered); *see also* Fishman, *supra* note 1, at 259-60.

[50] *See, e.g.*, MASS. GEN. LAWS ch. 12, § 8 (1998) (instructing attorney general to "enforce the due application of funds given or appropriated to public charities within the commonwealth and prevent breaches of trust in the administration thereof"). Alternatively, this responsibility may be a part of the attorney general's comprehensive consumer protection role. *See, e.g.*, IDAHO CODE § 48-1204 (Michie 2003) (giving attorney general under Idaho's Charitable Solicitation Act same powers he has under its Consumer Protection Act); ME. REV. STAT. ANN. tit. 9, § 5014 (West 1977) (establishing that violation of Charitable Solicitations Act is violation of Maine Unfair Trade Practices Act, under which AG may prosecute frauds).

[51] *See* HARRIET BOGRAD, THE ROLE OF STATE ATTORNEYS GENERAL IN RELATION TO TROUBLED NONPROFITS 8-22 (Program on Nonprofit Organizations, Yale University, Working Paper No. 206, Aug. 1994), *available at* http://ponpo.som.yale.edu/work.php (last

priorities is in reference to the responsibilities with which relevant statutes obligate them, and to which they will be held accountable. Furthermore, strictly following the more particularized donor and asset protection grants of authority is likely to be a safe, if conservative, approach to applying the AG's discretion.

AGs' focus on financial accountability is also practical; they are particularly well-suited to pursue this kind of work. AGs are accustomed to tracking corporate and other financial frauds in their general consumer protection and criminal capacities,[52] and can bring these capabilities to bear on investigating nonprofit financial accountability as well. Nonprofits are required to file financial information regarding their charitable solicitation activities periodically, as well as annual asset reports, which provide AGs with the raw data to analyze. On the donor protection front, AGs can track the statements in charitable appeals and written gift instruments and compare them with streams of funding allocated by an individual nonprofit.[53] To enforce financial accountability in terms of asset protection, scrutiny of the financial records and reports of nonprofits will again be a concrete first step. Once abuses have been discovered, AGs are empowered to strip nonprofits of their fund-raising privileges and to sue nonprofit actors for

visited Oct. 20, 2004); Nina J. Crimm, *A Case Study of a Private Foundation's Governance and Self-Interested Fiduciaries Calls for Further Regulation*, 50 EMORY L.J. 1093, 1184-85 (2001). The number of staff attorneys available in states' attorney general offices to supervise all nonprofit organizations varies. *Id.* As of 1998, New York had fourteen attorneys in its charities division, Connecticut had four attorneys and Massachusetts had six attorneys in its charities division. *Id.* Other states such as Georgia, Hawaii, North Dakota, Rhode Island, and South Carolina, however, each had only one assistant attorney general to supervise its entire nonprofit sector. *Id.* Alabama, Arizona, Colorado, Florida, Louisiana, Michigan, Nevada, New Mexico, Tennessee, Virginia, and the District of Columbia did not have any attorneys specifically charged to supervise nonprofits. *Id.*; *see also* FREMONT-SMITH, *supra* note 44, at 351-61 (describing staff size of various AGs' charities bureaus over time).

[52] *See* STATE ATTORNEYS GENERAL, *supra* note 48, at 207-17, 278-90 (describing roles of AGs as "a leading consumer protection force in the nation" and "as the most visible and influential state official[s] in the fight against crime").

[53] Of course, this process will not always be easy. Charitable solicitations frequently use broad, generic language and following the receipt and disbursement of funds within an individual nonprofit may require significant accounting acumen. *See* BRUCE R. HOPKINS, CHARITY UNDER SIEGE: GOVERNMENT REGULATION OF FUNDRAISING 30-32 (1980) (describing important responsibilities of accountant serving charitable organization); EARL WILSON ET AL., ACCOUNTING FOR GOVERNMENTAL AND NONPROFIT ENTITIES 669-71 (12th ed. 2001) (describing fund accounting system available to track gifts' purposes); *id.* at ch. 14 (describing complexity of nonprofit accounting rules). Tracking the use of explicitly restricted gifts may be simpler, although interpretation of restrictions can present challenges, particularly as instructions age.

breaches of their fiduciary obligations.[54] Of course, the efforts of faithless fiduciaries to conceal their wrongdoing or a mere absence of good record-keeping may at times derail the efforts of nonprofit regulators to enforce financial accountability. But financial accountability has the virtue of concreteness, or at least concreteness relative to the other forms of accountability on which AGs might concentrate. Furthermore, ensuring that charitable donations are honestly solicited and used and that the coffers of a nonprofit have been adequately secured are projects at which AGs' current enforcement repertoires may easily be directed.

Moreover, it is practical for AGs to prioritize donor and asset protection in their nonprofit regulatory efforts because the need for attention to these issues is clear and pressing. The internal structure of nonprofit organizations can make the nonprofit arena attractive to individuals who seek to rob or cheat nonprofits or their donors. Consider the situation if such an individual should find her way into a position as an officer or director of a nonprofit corporation, or a trustee of a charitable trust. Then, she seeks out opportunities to engage in unfair self-dealing transactions, to extract excessive compensation, or to misappropriate assets outright. If she does so, only her fellow fiduciaries and the state AG will have standing to challenge her actions.[55]

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[54] *See, e.g.*, FLA. STAT. ANN. § 496.416 (West 2004) (indicating that violations of state's charitable solicitation regulations constitute unfair and deceptive trade practices, such are enforceable by state's attorney, including by action to restrict future fundraising activities by violators); *see also* FREMONT-SMITH, *supra* note 44, at 309 (describing broad range of court actions AG might bring to enforce obligations of nonprofit fiduciaries). It should be noted, however, that state officials other than the AG, most often the secretary of state, are sometimes empowered to enforce all or part of a state's charitable solicitation regulations. *See* FREMONT-SMITH, *supra*, at 317.

[55] *See* Atkinson, *supra* note 1, at 657 (describing traditional charity law's limitation of standing exclusively to co-fiduciaries and AG); Mary Grace Blasko et al., *Standing to Sue in the Charitable Sector*, 28 U.S.F. L. REV. 37, 40-42 (1993) (similar).

If the nonprofit corporation in question has members, the members may have the authority to police financial accountability through their access to corporate records, right to vote for directors (and perhaps vote them out), and standing to sue. However, the institution of membership cannot realistically be relied upon to increase financial accountability in nonprofit corporations. Many nonprofit corporations, particularly charitable ones, have no individual members. And, even in those nonprofit corporations with individual members, they rarely will possess the informational and practical resources to perceive and/or challenge fiduciaries' financial misconduct. In those nonprofits with institutional or corporate members, as is common for nonprofit subsidiaries of nonprofit parents, membership likewise does not increase the potential for financial accountability, but merely pushes the problem up the chain to the directors and officers of the parent nonprofit. I have addressed each of these issues elsewhere. *See* Brakman Reiser, *supra* note 1, at 1005-09 (describing accountability issues in nonprofit parent-subsidiary relationships); Brakman Reiser, *supra* note 31, at 859-64 (describing limited monitoring and enforcement capacities of individual members).

AG enforcement is essential because there are serious limitations on nonprofit corporate actors' ability to police fiduciary lapses. Directors have the authority to fire an officer, and they may be able to dismiss a fellow director, especially one who has engaged in the kind of misconduct hypothesized above. Directors also have standing to bring an action charging the officer or director with breaching her fiduciary duty and to recoup losses incurred by the corporation.[56] But directors may not be aware of all of the facts necessary to root out misconduct. Especially in cases of questionable financial judgment that fall short of blatant theft, directors also may be reticent to challenge the actions of a fellow director or high-ranking officer, for fear of disrupting the dynamics of the board.[57] Directors also may hesitate to publicize allegations of this kind of misconduct for fear that it will damage the nonprofit's reputation, particularly its ability to attract future donations.[58] Officers may or may not be given access to the courts, but they face similar impediments to taking action to enforce financial accountability, along with the additional potential fear of retribution. Therefore, AG enforcement of financial accountability is critical to protect donors and assets in nonprofit corporations.

Even in the context of charitable trusts, where fiduciaries are subject to very strict standards, AGs must engage in significant levels of enforcement to deter wrongdoing. Charitable trustees face the same informational and group psychological obstacles to charging a co-trustee with fiduciary breach as do nonprofit corporate directors. Furthermore, sole charitable trustees are not uncommon. Without an active AG, even strict fiduciary standards will have less than the intended deterrent effect. For example, under a trust law duty of loyalty concept, charitable trustees must not engage in transactions with their trusts even if such transactions will benefit the trust.[59] This is a very high standard,

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[56] *See* James J. Fishman, *The Development of Nonprofit Corporation Law and An Agenda for Reform*, 34 EMORY L.J. 617, 669-70 (1985).

[57] *See* DeMott, *supra* note 44, at 141 (remarking that "[n]onprofit boardrooms seem to be inhospitable venues for challenges to the opinions of fellow directors and the internal and external experts the directors retain"); *c.f.* James A. Fanto, *Whistleblowing and the Monitoring Board: Countering Corporate Inner Circles*, 83 OR. L. REV. (forthcoming 2004) (manuscript at 21-25, on file with author) (arguing that group pressures felt by directors of for-profit corporations help to explain failures in board monitoring brought to light in Enron and other recent corporate scandals).

[58] *See supra* note 19 and accompanying text (noting that nonprofit directors may hesitate to challenge potential misconduct by co-fiduciaries, for fear of scaring away donors).

[59] SCOTT & FRATCHER, *supra* note 20, § 379. *But see* Evelyn Brody, *Charity Governance: What's Trust Law Got To Do With It?*, 80 CHI.-KENT L. REV. (forthcoming 2005) (manuscript

intended as a forceful deterrent against detrimental self-dealing transactions.[60] However, a faithless trustee likely will be undeterred in diverting trust assets if she knows enforcement of this rule is improbable.[61] Therefore, AG enforcement is also vital to maintaining financial accountability in charitable trusts.

The staggering press accounts of scandals in nonprofits of all types and sizes demonstrate that financial abuse in nonprofit entities is not merely hypothetical. Lapses in financial accountability rocked The United Way and Adelphi University in the 1990s.[62] More recently, the collapse of PipeVine, a nonprofit corporation that collected and processed donations for charities in the San Francisco area, has been blamed, in part, on its failure to avoid commingling its own operating funds with charitable contributions to be forwarded to nonprofit clients. Estimates of losses from this debacle vary, ranging from $1 million to $2.8 million.[63] The former President of Goodwill Industries of Santa Clara County was indicted on charges of embezzling millions of dollars worth of in-kind donations and converting them for personal use.[64] Even the tiny Volunteer Fire Department of Scotland, Connecticut has fallen prey to financial abuses; its former treasurer confessed to embezzling over $20,000 from the organization to feed a gambling habit.[65] The need

at 7, 19-20, on file with author) (concluding that corporate standards of loyalty and care have increasingly been applied to fiduciaries of charitable trusts and nonprofit corporations alike).

[60] *See* Fishman, *supra* note 56, at 677 (arguing viability of such higher trust standard in nonprofit corporate context); Michael W. Peregrine, *Charitable Trust Laws and the Evolving Nature of the Nonprofit Hospital Corporation*, 30 J. HEALTH & HOSP. L. 11 (1997) (describing application of charitable trust standard to nonprofit hospitals).

[61] *See* Michael A. Perino, *Enron's Legislative Aftermath: Some Reflections on the Deterrence Aspects of the Sarbanes-Oxley Act of 2002*, 76 ST. JOHN'S L. REV. 671, 675-76 (2002) (describing how strict rules work as deterrents only if there is some belief they will be enforced). *See generally* Paul H. Robinson & John M. Darley, *The Utility of Desert*, 91 NW. U. L. REV. 453, 459-62 (1997) (describing utilitarian calculus of deterrence).

[62] *See* JOHN S. GLASER, THE UNITED WAY SCANDAL: AN INSIDER'S ACCOUNT OF WHAT WENT WRONG AND WHY *passim* (1994); DeMott, *supra* note 44, at 133-34 (discussing United Way scandal as example of self-dealing by nonprofit directors); George Judson, *Inquiry Faults Trustees' Acts at Adelphi U.*, N.Y. TIMES, Apr. 18, 1996, at B5 (reporting that trustees of Adelphi University failed to prevent "extraordinary personal spending" by its president).

[63] *See* Stephanie Strom, *Losses Mount After Collapse of Charity Firm*, N.Y. TIMES, July 3, 2003, at A18.

[64] *See* Monte Morin, *Goodwill Scam Is Alleged*, L.A. TIMES, May 29, 2003, at B1; Press Release, United States Attorney's Office, Northern District of California, Liersch (May 27, 2003), *available at* http://www.usdoj.gov/usao/can/press/html/2003_05_27_liersch.html (last visited Oct. 7, 2004).

[65] *See* Andre Bowser, *Funds Stolen from Charity*, THE HARTFORD COURANT, July 12, 2003, at B3.

for enforcement of nonprofits' financial accountability is obvious.[66]

These scandalous examples are linked to the final reason behind AGs' financial focus; they have strong personal incentives to prioritize financial accountability issues in their nonprofit regulatory agendas. State AGs and their staffs are empowered to enforce a variety of state laws and must use prosecutorial discretion to determine where to direct their limited resources. This decision-making process is in part motivated by ideological or policy preferences. Surely, some part of the process also is influenced by more self-interested concerns — securing re-election and advancement.[67] Most AGs are elected officials[68] and all of them must work with state legislatures to obtain resources. Realistically, AGs' beliefs about the preferences of the voters they represent[69] and the legislators to whom they must account[70] influence their enforcement priorities.

Once a state AG allocates resources to establish a nonprofit division or charities bureau, concern over the types of enforcement that appeal to voters and the legislature impacts his enforcement priorities. Misuse of nonprofit assets attracts the attention of the media and of potential voters. Press accounts of nonprofit scandals can be found in newspapers around the country.[71] Dollars returned to charities from criminal or disloyal fiduciaries are tangible benefits to citizens that an AG can point

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[66] *See* Wolverton, *supra* note 19, at 29; Strom, *supra* note 13, at F1.

[67] *Cf.* DAVID MAYHEW, CONGRESS: THE ELECTORAL CONNECTION 13-17 (1974) (articulating re-election goal of U.S. congressmen); William N. Eskridge, Jr., *Politics Without Romance: Implications of Public Choice Theory for Statutory Interpretation*, 74 VA. L. REV. 275, 288 (1988) (similar).

[68] *See* COUNCIL ON STATE GOVERNMENTS, BOOK OF THE STATES 53-54 tbl.2.17 (1996-97 ed.) (noting that AGs are popularly elected in 43 out of 50 states); STATE ATTORNEYS GENERAL, *supra* note 48, at 15 (describing attorney general as "the most prevalent statewide-elected office in state government" other than governor).

[69] The traditional problem that nonprofit regulation and enforcement receives too little attention in busy AGs' offices can be explained in part by this idea. If voters care more that AGs are tough on crime or effective in obtaining large tort settlements than whether they effectively police the nonprofit sector, AGs seeking re-election or political advancement would be foolish to ignore those preferences in making staffing and prosecutorial decisions.

[70] *Cf.* Bennett L. Gershman, *The Prosecutor's Duty to Truth*, 14 GEO. J. LEGAL ETHICS 309, 350 n.223 (2001) (noting pressure prosecutors face to justify their budgets); George T. Felkenes, *The Prosecutor: A Look at Reality*, 7 SW. U. L. REV. 98, 116 (1975) (arguing that prosecutor's political success depends on justifying his use of public expenditures).

[71] A search for "nonprofit! & scandal!" on the LEXIS U.S. Newspaper database generates 1375 hits in one year alone (Lexis-Nexis, Oct. 2004). *See also* Marion R. Fremont-Smith & Andras Kosaras, *Wrongdoing by Officers and Directors of Charities: A Survey of Press Reports 1995-2002*, 42 EXEMPT ORG. TAX REV. 25 (2003). Examples of these scandals are discussed *supra* notes 62-66 and accompanying text.

to in legislative negotiations or on the campaign trail.[72] Successful prosecutions for failures of nonprofit financial accountability provide a concrete and quantifiable means of demonstrating law enforcement effectiveness to state legislatures. And, duped contributors today easily may become thankful voters tomorrow. Thus, to the extent that voters cast their votes for politicians who provide clear, tangible benefits,[73] a focus on protecting charitable donors and assets is good electoral strategy. Indeed, when state AGs tout their accomplishments in the area of nonprofit regulation, they, too, highlight their successes in donor and asset protection.[74]

In sum, the mandates, capabilities and incentives of attorneys general motivate them to focus their enforcement efforts on nonprofits' lapses of financial accountability. Unfortunately, as will be shown below, these same factors discourage AGs from prioritizing enforcement of mission and organizational accountability.

B. *Mission Accountability*

Although mission accountability is of great importance to maintaining healthy nonprofit organizations and the legitimacy of the nonprofit sector, it is exceedingly difficult to police. In most nonprofits, legal authority to bring an enforcement action challenging mission creep is confined to its directors or trustees and the state AG.[75] Directors or trustees may face real or perceived pressure from their colleagues not to challenge each other's actions and their position of control within the organization may make it difficult for them to perceive mission creep when it occurs.[76] AGs lack of resources and political will may keep them from enforcing mission accountability. Furthermore, the same issues of

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[72] *See* Goldstein, *supra* note 13, at 41 (commenting that in charitable solicitation regulation, "[s]tate AGs know they have found themselves a potent political issue").

[73] *See* MAYHEW, *supra* note 67, at 53-59 (describing how incumbent congressional representatives seek to provide "particularized benefits" to their constituents, in order to legitimately claim credit for improving their welfare, in order to secure their votes for re-election).

[74] *See, e.g.*, Michigan Department of Attorney General Web Page (noting charitable giving regulation as one of attorney general's "Key Initiatives"), *available at* http://www.michigan.gov/ag/0,1607,7-164-17334_18095---,00.html (last visited Oct. 11, 2004); Press Release, Office of Pennsylvania Attorney General Jerry Pappert, *AG Pappert Sues Blair County-Based Charity and Operators Over Alleged Illegal Fund-Raising* (Feb. 19, 2004), *available at* http://www.attorneygeneral.gov/press/release.cfm?p=CF02FF0E-F609-5813-AA8AEAB23E10FD30 (last visited Oct. 7, 2004).

[75] Member standing is often unavailable and standing for the general public is limited if not barred. *See* Atkinson, *supra* note 1, at 672.

[76] *See* Brakman Reiser, *supra* note 31, at 857-58.

mandate, practical effectiveness, and political merit that stimulate AG enforcement of financial accountability will limit AG interest in policing mission creep.

The state legislative mandates directing AGs to monitor nonprofits are, at best, an uneasy match with mission accountability imperatives. Again, these mandates speak in terms of protecting donors from fraud and abuse in charitable solicitations as well as protecting and maintaining nonprofit assets.[77] This delegation of authority could be interpreted broadly to require AGs to monitor and enforce the missions of nonprofits, but the enforcement tools at AGs' disposal are best suited for pursuing failures of mission accountability in concert with donor and asset protection. The AG's monitoring tools — registration materials and reports focused on financial issues — may offer information on a nonprofit's activities and programs. The information contained in these materials, however, mainly addresses whether contributions are used appropriately and whether assets are adequately safeguarded by the nonprofit's fiduciaries, rather than on tracking fealty to mission for its own sake. The legal actions available to AGs — suits alleging violations of charitable solicitation regulations, charging breaches of fiduciary duty, or demanding *cy pres* evaluation of changes in asset use — again focus on mission primarily in the context of misspent contributions or misappropriated assets.

These tools also encourage AGs to focus their attention to mission accountability on two subsets of the nonprofit sector: those nonprofits engaging in solicitations, particularly those that do so on a large-scale level, and those nonprofits with assets substantial enough to warrant the expenditure of an AG's investigative and other resources. For nonprofits outside of these two categories, mission creep rarely will register on an AG's radar. Perhaps prioritization of the use of scarce state resources in this way is responsible and wise. But the mission accountability of smaller organizations and those with other sources of funding must still be monitored. Furthermore, even for nonprofits with significant charitable solicitation programs or substantial assets, shifts in mission may be extremely difficult for AGs to identify and regulate.

Attorneys general also are not pre-equipped to evaluate shifts in mission in the way they possess pre-existing capacities in forensic accounting. The sponginess of tracking mission is entirely the opposite of the concreteness that characterizes enforcement in the financial area.

[77] *See supra* notes 49-50 and accompanying text (discussing state legislative mandates directing AGs to monitor nonprofits).

Protecting donors from fraud or abuse and safeguarding charitable assets from theft or misuse can be difficult, but objective methods for policing financial accountability do exist. In contrast, mission accountability is highly contextual and often subjective. For each institution, in addition to reviewing its official statements of purpose, the contours of its history and development may be important in interpreting its mission. Even once the bounds of a particular nonprofit's mission have been delineated, evaluating accountability to this mission requires consideration of whether and to what extent its activities and actions serve that mission. Deviations from mission must be analyzed and a determination must be made as to whether they rise to the level of failures in mission accountability. Alternatively, they might be merely de minimis slippage or, perhaps, part of a nonprofit's legitimate evolution.

Attorneys general could effectively police extreme cases of mission creep, such as the deplorable gap in mission accountability hypothesized by the Massachusetts attorney general in the *Hahnemann Hospital* case.[78] This scenario imagined an animal protection society that morphed into a vivisectionist group.[79] Such a blatant abandonment of one mission in order to embrace the polar opposite of an organization's original ideals might be easily perceived and policed by AGs. Even brief reports to the state AG by such a nonprofit would reflect such a massive change in focus. A reversal of this magnitude also would require court approval to change the use of any assets involved, and might well prompt a successful challenge to fiduciaries' actions in approving it under their duties of care and/or loyalty. However, it is also fairly unrealistic.

Subtler shifts in mission are far more common and more difficult for AGs to appreciate and evaluate. Consider a group founded with the stated purpose "to reduce the drop-out rate in low-income communities," whose activities shift from funding broad-based research and advocacy to running tutoring and counseling programs.[80] Research

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[78] Attorney Gen. v. Hahnemann Hosp., 397 Mass. 820, 836 n.18 (1986). Although this case raised concerns regarding mission accountability, it was instituted in an attempt to deal with the related financial accountability issues regarding the use of donated funds.

[79] *See id.* at 836 n.18.

[80] This discussion puts aside the related financial accountability issues of monitoring the use of funds donated specifically to address one or the other of these priorities and the difficult issue of whether funds donated generally to such a nonprofit are misused or diverted when its activities change. *See generally* George G. Triantis, *Organizations as Internal Capital Markets: The Legal Boundaries of Firms, Collateral, and Trusts in Commercial and Charitable Enterprises*, 117 HARV. L. REV. 1102, 1145-61 (2004) (applying capital market analysis to decisions involving reallocation of charitable assets); Evelyn Brody, The Legal Framework for Restricted Gifts: The Cy Pres Doctrine and Corporate Charities 10-15 (Nov.

and advocacy priorities aid in the reduction of drop-out rates by engaging in the search for more effective educational strategies and by raising political consciousness of the problem. Tutoring and counseling programs also serve the goal of reducing drop-out rates, by focusing on prevention. Does the change in program focus constitute a meaningful deviation from the nonprofit's mission? This determination cannot be made by calculation or objective logic alone, and state AGs' offices are not particularly well-suited to this task.

The political incentives that AGs bring to the task of enforcing financial accountability also are absent or misaligned in the context of mission accountability. Shifts in mission do not make for the splashy news copy that improper use of donated funds or outlandish embezzlement schemes do. An AG who wants to generate journalistic interest in order to move voters can make more political hay by unearthing the misallocation of donated funds than by forcing a nonprofit to account for its move from general community outreach to a focus on adult education.

Moreover, for a variety of reasons, rigorous enforcement of mission accountability by AGs would be quite undesirable. As government actors, involvement by AGs in defining and policing nonprofit mission could come dangerously close to interfering with constitutionally protected rights of free speech and association. The specter of this state involvement in monitoring nonprofit mission also could chill the evolution and development of nonprofits' ideological and political commitments. In addition, as elected officials, there is the additional concern that state AGs might use mission accountability challenges for political purposes, even perhaps by targeting groups affiliated with their opponents.[81]

Therefore, even in their new, more active posture, AGs cannot, and really should not, be relied upon to become vigorous enforcers of

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1, 2003) (unpublished manuscript presented at 2003 ARNOVA Conference, on file with author) (providing detailed analysis of this complex issue). These concerns are obviously related to mission accountability, in the sense that programs do not happen without funds and many nonprofits are funded substantially through donations. However, as addressed above, AGs do have the capacity and motivation to pursue this consumer protection agenda. The issue in this section is whether mission accountability will be adequately enforced outside of its overlap with financial accountability concerns.

[81] *See* Sidel, *New State Activism*, *supra* note 5, at 1333-35; *see also* Brody, *supra* note 5, at 968-70 (arguing that actions of AGs in nonprofit enforcement are influenced by parochial interest of maintaining nonprofit assets within state borders); *cf.* NORMAN I. SILBER, A CORPORATE FORM OF FREEDOM 5-6 (2001) (describing how judges were able to limit access to the nonprofit form to groups with missions that coincided with judges' own policy preferences during an era of mandatory judicial approval of nonprofit incorporation).

mission accountability. Recent litigation by activist AGs and their legislative reform efforts drawing on Sarbanes-Oxley exemplify AGs' lack of attention to matters of mission. And, serious concerns about the consequences for the vibrancy and autonomy of the nonprofit sector counsel against encouraging AGs to play a significantly more active role in enforcing mission. Still, failures of mission accountability threaten the legitimacy of nonprofits' claims that they provide necessary services, a voice for aggregating and advocating individuals' policy preferences, and vehicles to create and maintain civil society. A widespread loss of this kind of accountability would be treacherous for the future of the sector and its reputation. Therefore, it ultimately will be necessary to develop alternative methods for policing mission creep.

C. *Organizational Accountability*

Attorneys general also fail to police organizational accountability with the same vigor as financial accountability. The overall mandate of AGs to uphold and enforce state law should stir them to police nonprofit organizations' compliance with governance requirements imposed by their legal form and to enforce the duty of care that binds nonprofit fiduciaries. The specific grants of authority to AGs regarding the nonprofit sector, however, do not focus regulators explicitly on organizational accountability. Rather, they speak in terms of protecting donors and charitable assets. Failures in organizational accountability — not holding meetings, not keeping records, an inability on the part of directors or officers satisfactorily to perform the duties required of them — may be concrete and simple to identify. Unfortunately, however, remedying these failures through the traditional AG mechanisms of litigation and settlement will be quite difficult.

Attorneys general are empowered to litigate lapses of organizational accountability. They may institute actions against nonprofit directors under the rubric of the duty of care, to prosecute directors' failures to pay attention to their responsibilities or, despite attention, for making poor decisions.[82] Under this duty, a director or group of directors risks

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[82] Statutes express this general sentiment using one of various constructions. *See, e.g.*, CAL. CORP. CODE § 5231 (West 2002) (providing that nonprofit directors owe duties of care by "acting in the best interest of the corporation and with such care as an ordinarily prudent person in a like position would use in similar circumstances"); N.Y. NOT-FOR-PROFIT CORP. LAW § 717 (McKinney 1997) (stating in some detail directorial duty of care, including responsibilities to "discharge their duties in good faith and with that degree of diligence, care, and skill which ordinary prudent men would exercise in similar circumstances in like positions"); RMNCA, *supra* note 20, § 8.30 (assigning duties of

liability and/or having a directorial decision set aside if it is grossly negligent.[83] However, judicial attitudes[84] and legal precedents limit the effectiveness of these litigation remedies.[85]

As in for-profit corporate law, the business judgment rule protects many decisions of nonprofit corporate directors from substantive review.[86] This rule provides that when a director makes a decision with reasonable information, without bad faith, the taint of fraud, conflict of interest, or illegality, courts will uphold the decision under the duty of care without regard for the substance of the decision.[87] In both nonprofit and for-profit contexts, the rule serves to encourage directors to engage in responsible risk-taking, without the fear of liability.[88] However, the

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directors to act "in good faith . . . with the care of an ordinarily prudent person in a like position . . . and in a manner the director reasonably believes to be in the best interests of the corporation").

Of course, in attending to and taking decisions, nonprofit directors need not be experts in every field. They are permitted to delegate many responsibilities and actions to committees of the full board and they may rely on internal or external experts, where such reliance is reasonable. *See, e.g.*, CAL. CORP. CODE § 5231(b) (West 2002); RMNCA, *supra* note 20, § 8.30(b).

[83] *See, e.g.*, Stern v. Lucy Webb Hayes Nat'l Training Sch. for Deaconesses and Missionaries, 381 F. Supp. 1003, 1013, 1015-16 (D.D.C. 1974) (adopting standard of gross negligence in order to find directors of nonprofit hospital breached duty of care and finding such negligence had occurred, due to their lack of any attention to their directorial responsibilities); *see also* Evelyn Brody, *The Legal Framework for Nonprofit Organizations*, *in* THE NONPROFIT SECTOR: A RESEARCH HANDBOOK (Powell & Steinberg eds., 2d ed.) (forthcoming) (manuscript at 16-17, on file with author).

[84] *See, e.g.*, George Pepperdine Found. v. Pepperdine, 271 P.2d 600, 604-05 (Cal. App. 1954) (adopting standard of nonliability for breaches of duty of care unaccompanied by breaches of loyalty, in case in which principal donor/director and other volunteer directors issued promissory notes without necessary permits and grossly mismanaged funds), *overruled in part by* Holt v. Coll. of Osteopathic Physicians and Surgeons, 394 P.2d 932 (Cal. 1964) (holding that trustees, as well as attorney general, may bring action alleging co-trustee or trustees breached their fiduciary obligations).

[85] *See, e.g.*, Beard v. Achenbach Mem'l Hosp., 170 F.2d 859, 862 (10th Cir. 1948) (applying business judgment rule to nonprofit directors).

[86] *See id.*; Oberly v. Kirby, 592 A.2d 445, 462 (Del. 1991) ("A court cannot second-guess the wisdom of facially valid decisions made by charitable fiduciaries, any more than it can question the business judgment of the directors of a for-profit corporation."); *see also* Scheuer Family Found., Inc. v. 61 Assocs., 179 A.D.2d 65 (N.Y. App. Div. 1992) (finding nonprofit directors at issue were engaged in self-dealing and therefore were not eligible for protection of business judgment rule); John v. John, 450 N.W.2d 795 (Wis. Ct. App. 1989) (finding business judgment rule applicable to nonprofits, but unavailable to nonprofit fiduciary at issue due to his gross misconduct); Michael W. Peregrine & James R. Schwartz, *The Business Judgment Rule and Other Protections for the Conduct of Not-for-Profit Directors*, 33 J. HEALTH L. 455, 459-71 (2000) (providing general exposition of current business judgment rule doctrine in nonprofit context).

[87] Peregrine & Schwartz, *supra* note 86, at 459-71.

[88] *See* Goldschmid, *supra* note 44, at 644 (opining that business judgment rule

rule also tends to minimize the practical impact of the duty of care, save for directors who are so conflicted or grossly inattentive that they fail to qualify for its protection. Many states have further confined even this lax standard by eliminating the liability of nonprofit directors for many violations of the duty of care, or by permitting nonprofit corporations to amend their bylaws to do so.[89] This legal environment makes it difficult for AGs to attack nonprofit fiduciaries for failures of organizational accountability through litigation, unless they also have engaged in other kinds of misconduct.[90]

AGs also seem unlikely to engage heavily in non-litigation mechanisms to remedy nonprofits' failures in organizational integrity, unless doing so also exposes or signals shortcomings in financial accountability. State AGs are often empowered to investigate nonprofits, including conducting a review of their books and records, minutes of board meetings, and other documentation of decisions. These records should illustrate aspects of a nonprofit's organizational accountability, such as whether appropriate meetings were held, whether they were attended, and whether proper consideration was given to organizational decisions. But if an AG receives a complaint turning solely on failures of attention or compliance with these organizational formalities, without accompanying indications of financial fraud or waste, her office is unlikely to expend its valuable resources mounting an investigation merely to force an organization to improve its governance prophylaxis. Without suspicions that a nonprofit's directors, officers, or staff are making corrupt decisions, or at least seriously inept ones, would a responsible attorney general allocate his staff to investigate it? AGs operate in an environment where staff and time are always scarce, and an investigation based solely on organizational accountability concerns

"encourages rational risk taking and innovation, limits litigation and unfair exposure, encourages service by quality directors, and limits judicial intrusiveness, [which] applies as much to nonprofit directors and officers as to their for-profit peers").

[89] *See, e.g.*, N.D. CENT. CODE § 32-03-44 (1996) (immunizing unpaid nonprofit directors and officers acting in good faith and in scope of their organizational duties from civil liability for acts or omissions short of willful misconduct or gross negligence); TENN. CODE ANN. § 48-58-601(c) (2001) (immunizing paid or unpaid nonprofit directors from suits arising from conduct of affairs of their organizations, so long as their conduct does not rise to level of "willful, wanton or gross negligence"); *see also* Evelyn Brody, *The Limits of Charity Fiduciary Law*, 57 MD. L. REV. 1400, 1453-55 & nn.247-48 (1998) (describing this trend).

[90] Brody, *supra* note 89, at 1441 (noting that AGs rarely prosecute duty of care violations in the absence of duty of loyalty violations); Denise Ping Lee, Note, *The Business Judgment Rule: Should It Protect NonProfit Directors?*, 103 COLUM. L. REV. 925, 941 (2003) (similar); *see also* Mary Siegel, *The Erosion of the Law of Controlling Shareholders*, 24 DEL. J. CORP. L. 27 (1999) (describing similar dynamic at work in for-profit derivative suits).

may well be viewed as a wasteful allocation of limited resources.[91]

Attorneys general certainly could adopt preventive measures to enforce organizational accountability. They might create educational materials for nonprofit directors, officers, and employees to use to inform and improve their performance. AG staff members might be assigned to train nonprofit actors in the nuts and bolts of planning and running meetings, obtaining and disseminating information needed to make responsible decisions, and structuring debate to ensure adequate consideration of issues. Or, AGs might outsource this role to the veritable army of consultants available to provide education and training to charitable trustees, nonprofit boards and officers, and their staffs.[92] Although a number of AGs have directed resources to these efforts,[93] AGs and their staffs are attorneys, not educators, and they can be expected to allocate their resources accordingly.[94]

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[91] *See* Brody, *Accountability and the Public Trust*, *supra* note 8, at 479 ("While enjoying nearly exclusive authority and discretion to challenge the actions of a charity fiduciary, AGs do not want to take over the business of running charities."); Brody, *supra* note 5, at 976 (describing role of AG in supervising fiduciaries, while not taking over their duties, and commenting that attorney general "is not a 'super' member of the board").

[92] *See, e.g.*, Boardsource, Consulting & Training (offering training materials and consulting services), *available at* http://boardsource.org (last visited Oct. 7, 2004); Support Center for NonProfit Management, Customized Training (offering similar training materials and services), *available at* http://www.supportcenter.org (last visited Oct. 7, 2004); *see also* Association Works, Consultants to Nonprofits (offering consulting services to nonprofits), *available at* http://www.associationworks.com (last visited Oct. 20, 2004); The William J. Copeland Fund, Education and Training (similar), *available at* http://www.copelandfund.org/wjcf/copepriv.nsf/et?OpenForm (last visited Oct. 20, 2004).

[93] *See* New York Attorney General's website (advertising "charities symposia" held in various New York cities to educate nonprofit actors on roles of AG and IRS and on various topics, including session on accountability and internal controls), *available at* http://www.oag.state.ny.us (last visited Oct. 7, 2004). In addition, state AGs active in nonprofit enforcement often provide handbooks for nonprofit fiduciaries on their websites or by request. *See, e.g.*, The Massachusetts Attorney General's website (offering "The Attorney General's Guide for Board Members of Charitable Organizations," an 8-page pamphlet providing summary information on range of topics and directing readers to additional educational materials available from Public Charities Division upon request), *available at* http://www.ago.state.ma.us/filelibrary/board.pdf (last visited Oct. 21, 2004); New York Attorney General's website (posting 7-page book with similar summary information, entitled "Right From the Start: Guidelines for Nonprofit Board Members," under Charities heading), *available at* http://www.oag.state.ny.us (last visited Oct. 8, 2004).

[94] In their role as a state's "chief legal officer," AGs have various powers and responsibilities in state government. STATE ATTORNEYS GENERAL, *supra* note 48, at 40. These include: controlling trial and appellate litigation concerning the state, advising state officers and agencies on legal matters, providing opinions on state law or policy, public advocacy, criminal law enforcement, law reform, performing investigations, and even making policy. *Id.* at 12-14. In some of these functions, AGs have engaged in educational activities, such as conducting consumer education sessions or community outreach on

Finally, electoral concerns are unlikely to motivate AGs to concentrate on organizational accountability. Again, it will be far more difficult to obtain positive media coverage of training efforts than of corruption-busting. Efforts to build capacity for legal and effective governance among nonprofit directors, officers, and staff members are important to the health of the sector. But, they are unlikely to provide content for campaign ads or to move exit polls. The benefits of these training efforts, like the benefits of most educational activities, are long-term and difficult to quantify and communicate to voters.

All of these factors suggest that state AGs will engage in a relatively low level of organizational accountability enforcement, especially when it is not tied to financial accountability concerns.

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In sum, AGs will not apportion their nonprofit enforcement efforts equally among financial, mission, and organizational accountability matters. Rather, they will prioritize their nonprofit enforcement actions with reference to various baselines. Whether they opt to concentrate their efforts where their legislative mandates direct them, where they have the most appropriate existing skills and enforcement tools, or where they will receive the most political value for their actions, financial accountability will be their primary focus. Any efforts toward enforcing mission and organizational accountability will be salutary, but are destined to remain of secondary concern. The review of recent AG nonprofit enforcement efforts provided below, especially, but not exclusively, the efforts to adapt Sarbanes-Oxley's reforms to apply to nonprofits, bears out this prediction.

III. ACTIVIST AGS FOCUS ON FINANCIAL ACCOUNTABILITY

In areas as diverse as internet solicitation regulation, donor control suits, and hospital conversions, AGs around the country are flexing their enforcement muscles. They also have begun to join together to set national priorities in nonprofit enforcement. In these examples of nonprofit enforcement, recently described as evidencing a "new state

topics as diverse as civil rights and farm law. *Id.* at 181, 197, 207; *see also* Christopher Petrie, *The Consumer Protection Unit of the Wyoming Attorney General's Office*, 24 WYO. LAW. 28, 29 (Dec. 2001) (describing stepped up public education efforts in one AG's consumer protection bureau); Kevin Simpson, *Helping Health Care Consumers*, 35 MD. B.J. 22, 25 (Mar./Apr. 2002) (describing AG's use of consumer health care complaints to create educational materials).

activism,"[95] one observes the persistent AG focus on financial accountability related above.

A. Donor Protection

One major category of nonprofit financial accountability enforcement by AGs is donor protection.[96] These efforts focus on securing and enforcing the financial contributions of donors, perceiving these donors as consumers of nonprofit services whom the AG is empowered to protect from fraud. Virtually every state has participated to some degree in this type of financial accountability enforcement, most by instituting mandatory registration and/or financial reporting regimes for nonprofits engaged in charitable solicitation.[97] In addition, some state AGs use their

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[95] Sidel, *New State Activism*, *supra* note 5, at 1313 (coining term and critiquing this development); Michael W. Peregrine & James R. Schwartz, *Key Nonprofit Corporate Law Developments in 2003*, 13 HEALTH L. REP. 1, 5 (Jan. 22, 2004) (concluding that developments of 2003 "reflect greater interest in the application of nonprofit and charitable trust law concepts on a variety of public and private levels"); *see also* Brody, *supra* note 5, at 942-43 (noting that instances of charity law enforcement seem recently to have accelerated, though declining to opine on whether they constitute a trend).

[96] *See* Evelyn Brody, *Institutional Dissonance in the Nonprofit Sector*, 41 VILL. L. REV. 433, 485 (1996) ("Perhaps because a donor's power is strongest before making a contribution, state oversight concentrates on the aspect of charities that deals with the public as donors.").

[97] *See* ALA. CODE § 13A-9-70 (2003); ALASKA STAT. § 45.68.010 (Michie 2003); ARK. CODE ANN. § 4-28-401 (Michie 2003); CAL. GOV'T CODE §§ 12580-12596 (West 2004); COLO. REV. STAT. § 6-16-101 (2004); CONN. GEN. STAT. § 21A-175 (2004); DEL. CODE ANN. tit. 6 § 2595 (2003) (outlawing deceptive solicitation, but not requiring registration); FLA. STAT. § 496.405 (2003); GA. CODE ANN. § 43-17-1 (2003); HI. REV. STAT. § 467B-1 to 13 (2003) (regulating charitable solicitation, but not mandating registration); IDAHO CODE § 48-1201 to 1206 (2003) (regulating charitable solicitation, but not mandating registration); ILL. COMP. STAT. §§ 760-55/1, 225-460/1 (2004); IND. CODE § 23-7-8-2 (West 2003) (paid solicitors only); IOWA CODE § 13C.2 (2000) (professional solicitors only); KAN. STAT. ANN. § 17-1760 (2002); KY. REV. STAT. ANN. § 367.650 (Michie 2002); LA. REV. STAT. ANN. § 51:1901-1904 (West 2003); ME. REV. STAT. ANN. tit. 9, § 5001-5016 (West 2003); MASS. GEN. LAW ch. 12, § 8(e) (2003); MICH. COMP. LAWS § 400.271 (2004); MINN. STAT. ch. 309 (2003); MISS. CODE ANN. § 79-11-501 (2003); MO. REV. STAT. § 407.450 (2003); N.H. REV. STAT. ANN. § 7:19 (2003); N.J. STAT. ANN. § 45:17A (West 2003); N.M. STAT. ANN. § 57-22-1 (Michie 2003); N.Y. EXEC. LAW. § 172 (McKinney 2003); N.C. GEN. STAT. § 131F (2003); N.D. CENT. CODE § 50-22-02 (2003); OHIO REV. CODE. ANN. § 1716.02 (West 2003); OKLA. STAT. tit. 18 § 552 (2003); OR. REV. STAT. § 128.610 (2001); 10 PA. CONS. STAT. ANN. § 162.1 (West 2003); R.I. GEN. LAWS § 5-53.1-2 (2003); S.C. CODE ANN. § 33-56-10 (Law. Co-op. 2003); S.D. CODIFIED LAWS § 37-30-3 (2003) (professional solicitors only); TENN. CODE ANN. § 48-101-501 (2003); TEX. CIV. STAT. ANN. § 9023e (West 2004) (telephone solicitors only); UTAH CODE ANN. § 13-22-1 (2003); VA. CODE ANN. § 57-48 to 57-69 (Michie 2003); VT. STAT. ANN. tit. 9, § 2477 (2000) (professional solicitors only); WASH. REV. CODE § 19.09.065 (2003); W. VA. CODE § 29-19-5 (2003); WIS. ADMIN. CODE R.L. § 5.01-5.08 (2003); *see also* Brody, *supra* note 89, at 1405 & n.28 (describing survey of state charity officials who stated their "biggest problem" in nonprofit enforcement was regulation of charitable solicitations).

authority over nonprofits to enforce the terms of donated gifts, even years after the relevant contribution. This subpart describes some of the more significant of these donor protection efforts in order to provide a sense of AGs' taste for this kind of nonprofit enforcement.

Over the past several decades, almost every state has enacted legislation regulating the solicitation of charitable contributions within its borders.[98] The stated goal of these laws is the protection of donors as consumers,[99] although safeguarding the integrity of the charitable or nonprofit sector may be described as one of their additional benefits. In fact, the statutory language and enforcement mechanisms employed are commonly borrowed from or linked with those of the state's general consumer protection statutes.[100] The choice of regulatory targets also demonstrates this consumer focus. Typically, these statutes apply to all entities seeking charitable contributions within the state or from its citizens, rather than limiting their application to nonprofit organizations domiciled in the state.[101] Entities within this wide regulatory purview typically are required to register with state officials before engaging in any solicitation activity and to file annual reports and financial statements with those officials.[102] The laws also authorize AGs or other

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[98] *See* sources cited *supra* note 97.

[99] FLA. STAT. ch. 496.402 (2003) ("It is also the intent of the Legislature to protect the public by requiring full public disclosure of the identity of persons who solicit contributions from the public."); IDAHO CODE § 48-1201 (Michie 2004) ("It is the intent of the legislature to safeguard the public against deceit and financial hardship . . . ."); N.C. GEN. STAT. § 131F-1 (2003) ("It is the intent of the General Assembly to protect the public by requiring full disclosure by persons who solicit contributions from the public . . . .").

[100] *See, e.g.*, MODEL ACT CONCERNING THE SOLICITATION OF FUNDS FOR CHARITABLE PURPOSES § 16(b) (1986) [hereinafter MODEL ACT] ("In deciding whether an act or practice is unfair or deceptive within the meaning of this subsection, definitions, standards and interpretations relating thereto under the (state consumer protection act) shall apply."), *available at* http://www.nasconet.org/public.php?pubsec=4&sdpid= 21&curdoc=240#16 (last visited Oct. 20, 2004).

[101] *See, e.g.*, ARIZ. REV. STAT. §§ 44-6551, 44-6552 (2002); *see also* MODEL ACT, *supra* note 100, §§ 1, 2 (applying to all organizations qualifying as exempt under I.R.C. § 501(c)(3)). It should be noted, however, that states vary widely in the exceptions they make from their charitable solicitation regime. The impact of charitable solicitation regulation may be blunted when states make broad exceptions to their registration and/or reporting regimes, as some do by excepting whole groups of entities like religious organizations, educational institutions or hospitals, or by exempting those entities that receive relatively low levels of donated funds. *See, e.g.*, GA. CODE ANN. § 43-17-9 (2001); N.Y. EXEC. LAW § 172-a (1), (2)(a), (2)(d), (2)(g) (McKinney 2002).

[102] *See, e.g.*, ARIZ. REV. STAT. §§ 44-6552 (2003); Kansas Charitable Organizations and Solicitations Act, KAN. STAT. ANN. § 17-1763 (2002) (requiring charitable organizations to register prior to soliciting); South Carolina Solicitation of Charitable Funds Act, S.C. CODE ANN. §§ 33-56-30, 33-56-60 (2003) (requiring registration and annual financial reporting). In this kind of ex ante regulation, the creators of charitable solicitation regimes must tread

state officials to use these materials for investigative purposes, to collect complaints from contributors, and otherwise to take action to prevent and punish entities who solicit unfairly or deceptively.[103] Many charitable solicitation regimes show particular concern about abuse of donors when professional fund-raisers are employed to solicit contributions; such regimes include special requirements or additional penalties for these professionals.[104]

Truly large-scale coordination by state AGs of their nonprofit oversight roles also has occurred in the charitable solicitation context. In 1997, the National Association of Attorneys General (NAAG) and the National Association of State Charities Officials (NASCO) brought AGs and charity regulators together from across the country to develop and issue a uniform document to ease the process for nonprofits required to register their intent to solicit charitable contributions in multiple states.[105] Subsequently, NASCO members met in Charleston and agreed to adopt several principles to clarify the applicability of states' charitable solicitation regimes to solicitations made through the internet.[106] The internet allows charities to spread their message much more widely than through traditional means and permits them to reach a larger and more geographically dispersed set of potential donors. State AGs wished to regulate these types of charitable solicitation, as they regulated

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lightly because solicitation by charities is interwoven with highly-protected rights of persuasive and political speech. Only narrowly-tailored regulation of charitable solicitation or canvassing is constitutional, and that regulation must be drawn to protect individuals from crime or undue annoyance with "narrow specificity." Hynes v. Mayor and Council of Borough of Oradell, 425 U.S. 610, 620-23 (1976).

[103] *See, e.g.*, FLA. STAT. ch. 496.419 (2003); MICH. COMP. LAWS § 14.316 (2003). State charity regulators recently scored a victory in a challenge to their right to protect potential donors from unfair or deceptive solicitations in individualized, ex post actions. *See* Illinois *ex rel.* Madigan v. Telemarketing Assocs., Inc., 538 U.S. 600, 606 (2003) (upholding AG's fraud action against individual solicitor).

[104] *See, e.g.*, ME. REV. STAT. ANN. tit. 9, § 5008 (West 2003). There are still, of course, constitutional limits on these enhanced enforcement efforts. *Compare* Riley v. Nat'l Fed'n of the Blind, 487 U.S. 781 (1998) (striking down North Carolina's attempt to set scale of "reasonable" fees for fund-raising professionals and to impose additional disclosure and licensing requirements on them), *with Madigan*, 538 U.S. at 624 ("States may maintain fraud actions when fundraisers make false or misleading representations designed to deceive donors about how their donations will be used.").

[105] *See* The MultiState Filer Project, The Uniform Registration Statement (describing Uniform Registration Statement (URS)), *available at* http://www.multistatefiling.org /index.html (last visited Oct. 20, 2004). The URS is currently accepted by thirty six U.S. jurisdictions, in lieu of their own state-specific registration documents. *See id.*

[106] *See* National Association of State Charity Officials (NASCO), Charleston Principles [hereinafter NASCO], *available at* http://www.nasconet.org/public.php?pubsec=4&curdoc =10 (last visited Oct. 20, 2004).

contribution-seeking in person, by phone, or by mail. Yet, they faced jurisdictional obstacles and coordination problems in applying their charitable solicitation regimes to entities or individuals incorporated or physically operating outside of their state, but which had a virtual in-state presence.[107] In order to regulate internet solicitation more efficiently, these so-called Charleston Principles define and limit the circumstances in which a nonprofit solicitor must register with a given state.[108] However, state AGs were unwilling to cooperate toward efficiency in the context of solicitation fraud. The Charleston Principles boldly claim for each AG the authority to prosecute any entity whose internet solicitations mislead or defraud persons within his or her state, regardless of whether the soliciting entity would be required to register there.[109]

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[107] *See generally* Melissa G. Liazos, Comment, *Can States Impose Registration Requirements on Online Charitable Solicitors?*, 67 U. CHI. L. REV. 1379, 1391-95 (2000) (addressing these issues).

The potential for multi-state enforcement is also of concern to those nonprofits soliciting through the internet. If merely setting up an organizational website that is available nationwide would trigger registration and reporting requirements in every U.S. jurisdiction that imposes them, this would create an insurmountable burden for all but the largest charities. Filing registration materials and periodic reports could swallow up substantial human and financial resources. *See* Renee A. Irvin, *Nonprofit Accountability and State Regulation: Trading a Little Fraud for a Lot of Forms* 3-5, Presentation at the Annual Conference of the Association for Research on Nonprofit Organizations and Voluntary Action (Nov. 16, 2002) (unpublished manuscript, on file with author) (collecting and analyzing reporting requirements across jurisdictions). This burden may be somewhat reduced by the widespread acceptance of the URS to comply with state charitable solicitation registration requirements. *See supra* note 105. However, complying with the registration and filing requirements of the remaining 14 states who do not accept the URS and the additional requirements imposed by several states who do accept it still would require substantial expenditures.

[108] *See generally* Daniel Moore, *The Charleston Principles*, *in* ALI-ABA COURSE OF STUDY ON TAX EXEMPT ORGANIZATIONS 43, 45-50 (2000) (describing development of Principles). State registration and reporting regimes apply only against entities that: (1) are both domiciled within the state and make internet solicitations in that state; (2) are domiciled in that state and have their principal place of business there; (3) are not domiciled there but whose non-internet activities would require registration in the state; (4) are not domiciled there but that solicit through an interactive website and either specifically targets persons in the state or receives contributions from the state on a repeated, ongoing, or substantial basis through the website; or (5) are not domiciled there but that solicit through a non-interactive website that either specifically invites further offline activity to complete contributions or establishes other contacts with the state, such as by sending other communications promoting its website, and receives contributions from the state on a repeated, ongoing, or substantial basis through the website. *See* NASCO, *supra* note 106.

[109] Constitutional restrictions on personal jurisdiction may prevent AGs from prosecuting individuals or entities other than those incorporated, doing business, or otherwise having substantial contacts within their states. *See* Heroes, Inc. v. Heroes Found., 958 F. Supp. 1 (D.C. 1996) (explaining that personal jurisdiction over internet-

AGs also demonstrate their interest in protecting donors as consumers by scrutinizing whether, over time, donations have been misapplied. These cases arise under various circumstances. A charitable trust established for the "needy in Marin County, California and for other non-profit, religious or educational purposes in that county" experienced a tremendous growth in its value and the trustee petitioned a court for permission to distribute the trust funds more widely.[110] The California AG opposed the petition and the case ultimately settled with the donor's geographical restriction essentially intact.[111] In a recent New York case, the AG intervened to seek limitations on the variance power of community foundations, which allows them to apply donated funds for purposes beyond those anticipated by their donors, in response to changing community needs.[112] And, following revelations that the Red Cross planned to use some funds donated in the aftermath of the September 11th terrorist attacks for purposes beyond compensating the victims of those attacks, New York's AG threatened legal action to challenge a misuse of donated funds.[113] Had informal pressures and regulatory changes by the Internal Revenue Service not prompted the Red Cross to change its plans, other AGs likely would have joined in such litigation on behalf of their citizen donors.

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soliciting entity required directed action oriented toward forum state, and finding this requirement met by coordinated newspaper and internet campaign). *But see* Christian Science Bd. v. Robinson, 123 F. Supp. 2d 965, 975 (W.D.N.C. 2000) (stating that "the solicitation of funds over a web site constitutes the transaction of business within the forum" and citing *Heroes, Inc., supra,* for this authority). However the constitutional issues are ultimately resolved, the Charleston Principles make clear that AGs will not quietly relinquish their consumer protection role in cyberspace.

110 Estate of Buck, 35 Cal. Rptr. 2d 442, 443-44 (Ct. App. 1994) (describing original litigation in later, unsuccessful collateral attack on its settlement); Estate of Buck, No. 23259 (Super. Ct. Marin County 1986), *reprinted in* Symposium: *Nonprofit Organizations,* 21 U.S.F. L. REV. 691, 693 (1987).

111 *Estate of Buck,* 35 Cal. Rptr. 2d at 443-45 (describing, in subsequent litigation, attorney general's involvement in settlements reached in original case); *Estate of Buck, No. 23259, reprinted in* 21 U.S.F. L. REV. at *699, 708-09; see also* Ronald Hayes Malone et al., *The Buck Trust Trial —A Litigator's Perspective,* 21 U.S.F. L. REV. 585 (1987); Douglas J. Maloney, *The Aftermath,* 21 U.S.F. L. REV. 681 (1987); John G. Simon, *American Philanthropy and the Buck Trust,* 21 U.S.F. L. REV. 641 (1987).

112 Cmty. Serv. Soc'y v. N.Y. Cmty. Trust, 713 N.Y.S.2d 712 (N.Y. App. Div. 2000), *aff'd,* 751 N.E.2d 940 (N.Y. 2001); *see also* Sidel, *supra* note 4, at 1148; Sidel, *New State Activism, supra* note 5, at 1324-31 (describing New York Community Trust and other cases where New York AG's office has become involved in enforcing donor restrictions).

113 For a comprehensive review of the strengths and weaknesses of this claim, see Katz, *supra* note 12, at 316-19. The article provides an in-depth discussion of the legal predicament of disaster relief organizations following September 11, 2001.

AGs' donor protection activity, through ex ante registration and disclosure requirements for charitable solicitation, as well as ex post litigation on fraud or misallocation theories, is real and may well be growing. This donor protection imperative is a vivid example of AGs' preoccupation with financial accountability. Of course, concerns about diversion of donated funds also raise mission accountability questions. However, it is the possibility of financial missteps, and misuse of donated funds in particular, that appears to bring cases of mission creep into sufficiently sharp relief for nonprofit regulators to take notice. AGs' enforcement efforts regarding asset protection reveal a similar pattern.

B. Asset Protection

When state AGs sue to protect nonprofit and charitable assets from theft or loss, they once again engage in the financial accountability component of nonprofit enforcement. Most obviously, AGs have sued nonprofit fiduciaries for breaches of the duty of loyalty.[114] In their efforts to root out and counter nonprofit scandals, AGs have sought to recoup from nonprofit directors or trustees the funds these fiduciaries have embezzled[115] or received improperly through sweet self-dealing transactions[116] or excessive compensation arrangements.[117] These actions remain a primary concern of nonprofit regulators.[118]

AGs' concern over asset protection also can be seen in their involvement in contests over the conversion of nonprofit health care

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[114] *See generally* Brody, *supra* note 89, at 1440-41 (chronicling several of these challenges).

[115] *See, e.g.*, Brad Wolverton, *Study: Charity Fraud Exceeds $1 Billion*, CHRON. OF PHILANTHROPY, Nov. 27, 2003, at 26; Strom, *supra* note 13, at F1.

[116] *See, e.g.*, Richard Perez-Pena, *Ex-Port Authority Head Settles Conflict-of-Interest Suit Over Role With Hospital*, N.Y. TIMES, May 25, 2001, at B5; Bernard Stamler, *The Gray Area For Nonprofits, Where Legal is Questionable*, N.Y. TIMES, Nov. 17, 2003, at F1; Stephanie Strom, *Battle in Omaha Charitable Group Reflects Issues Raised in Corporate Scandals*, N.Y. TIMES, Jan. 9, 2004, at A13.

[117] *See, e.g.*, Stephen Labaton, *New Rules Lift the Lid on Nonprofit Pay*, N.Y. TIMES, Nov. 17, 1999, at H2; Brad Wolverton, *What Went Wrong?*, CHRON. OF PHILANTHROPY, Sept. 4, 2003, *passim*.

[118] *See, e.g.*, California Office of the Attorney General, *Guide for Charities*, at 39 (describing AG's role to "investigate[] and audit[] charities to detect cases in which directors and trustees have mismanaged, diverted, or defrauded the charity" and to recover any charitable assets lost as result), *available at* http://www.caag.state.ca.us/charities/publications/gfc.pdf (last visited Oct. 20, 2004); Office of the New York State Attorney General Eliot Spitzer, Charities Bureau (stating that AG's Charities Bureau "is responsible for supervising charitable organizations to ensure donors and beneficiaries . . . are protected from unscrupulous practices in the solicitation and management of charitable assets"), *available at* http://www.oag.state.ny.us/charities.html (last visited Oct. 20, 2004).

providers into for-profit businesses.[119] Attorneys general insert themselves into these transactions by diverse methods and at various points in the conversion process.[120] Sometimes, general state nonprofit corporate law requires the AG to approve a sale or dissolution necessitated by a conversion transaction, providing the AG with negotiating power in the transaction or the opportunity to initiate litigation.[121] In addition, at the height of the conversion movement of the mid- to late-1990s, AGs also became involved in drafting and enforcing special statutes regulating the process of nonprofit hospital conversion.[122] These statutes often impose formal involvement by AGs and/or other state officials in order to finalize a conversion transaction, and frequently require nonprofits to report financial aspects of such deals.[123] However AGs' roles are framed, their attention typically targets two types of financial issues: (1) the fairness of the value received by the nonprofit entity in a sale or exchange of assets with the for-profit entity,[124] and (2) the appropriateness of the nonprofit's plans for maintaining funds dedicated to charitable purposes.[125]

Finally, the recent battle between the attorney general of Pennsylvania and the Milton Hershey School Trust ("the Trust") colorfully demonstrates the extremes to which AGs will go in the name of protecting charitable assets.[126] Hershey Foods Corporation founder

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[119] *See* Lawrence E. Singer, *The Conversion Conundrum: The State and Federal Response to Hospitals' Changes in Charitable Status*, 23 AM. J.L. & MED. 221, 236 (1997).

[120] *See* David A. Hyman, *Hospital Conversions: Fact, Fantasy, and Regulatory Follies*, 23 J. CORP. L. 741, 765 (1998).

[121] *See* BARRY R. FURROW ET AL., HEALTH LAW §§ 5-22 (2d ed. 2000).

[122] *See* Lisa M. Fairfax, *Doing Well While Doing Good: Reassessing the Scope of Directors' Fiduciary Obligations in For-Profit Corporations with Nonshareholder Beneficiaries*, 59 WASH. & LEE L. REV. 409, 424-25 (2002); Hyman, *supra* note 120, at 766.

[123] Common points on which the attorney general must be informed or must approve include the price set for the transaction, the entity to which charitable assets will be transferred, and future financial relationships between any such nonprofit entities and the for-profit hospital. *See, e.g.*, ME. REV. STAT. ANN. tit. 5, § 194-C (West 2003); *see also* FURROW ET AL., *supra* note 121, §§ 5-22.

[124] *See* FURROW ET AL., *supra* note 121, §§ 5-22; Richard C. Allen, *The Massachusetts Experience*, HEALTH AFF., Mar.-Apr. 1997, at 85, 87.

[125] Hyman, *supra* note 120, at 764 ("The most common complaint about conversion is that the trustees were snookered, and the for-profit entity bought a valuable asset for pennies on the dollar . . . ."); Singer, *supra* note 119, at 223.

[126] *See, e.g.*, Neil Buckley, *Hershey Kisses Goodbye to Dollars $17m*, FIN. TIMES, Oct. 18, 2002, at 18; Stephanie Strom, *Strong Arm-Shaking of Charities Raises Ethics Qualms*, N.Y. TIMES, May 11, 2003, at 22. Legal academics also have begun to comment on the *Hershey* case; one can find excellent descriptions of the details of the case in Brody, *supra* note 5, and Mark Sidel, *The Struggle for Hershey: Community Accountability and the Law in Modern American Philanthropy*, 65 U. PITT. L. REV. 1 (2003).

Milton S. Hershey and his wife endowed the Trust principally to benefit a local school to be established for orphans.[127] For over eighty years, the corpus of the Trust consisted largely of shares in Hershey Foods.[128] The dispute between the AG and the Trust began when the Trust announced its intention to explore a sale of its Hershey Foods shares in order to diversify the Trust's investments.[129] Such a sale would offer the buyer a controlling interest in Hershey Foods. The community immediately became concerned that a sale to an outside party would threaten the employment opportunities and stability of the Hershey, Pennsylvania community.[130] The Pennsylvania attorney general filed an action seeking an order that the Trust show cause why such a sale should not be subject to court approval, and obtained an injunction preventing the Trust from selling or committing to sell its interest without such approval.[131] Ultimately, the Trust changed course and abandoned its plans to sell its Hershey Foods stock.[132]

Interestingly, in this case, an AG sought not only to protect the assets of the nonprofit entity involved, but also to maintain within his state the jobs and revenue that the Trust's controlling interest in Hershey Foods represented.[133] In fact, these two roles could be seen as conflicting.[134] Typically, diversification is a laudable goal for charitable trustees, in that it reduces the risk to the assets dedicated to the trust's charitable mission.[135] This case is unusual in that the Pennsylvania AG challenged the trustees' attempts to diversify in order to pursue another possibly laudable and surely electorally-valuable goal — protecting jobs and revenues for his state. Nevertheless, the focus again was on asset protection rather than on evaluating the operations or programmatic functions of the Trust.

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[127] *See In re* Milton Hershey Sch. Trust, 807 A.2d 324, 328 (Pa. Commw. Ct. 2002).

[128] *See id.* at 329.

[129] *See id.* at 328; *see also Court Gets Taste Of Hershey Sale Battle*, NEWSDAY, Aug. 27, 2002, at A51. This was not the first time the Trust had tangled with the attorney general. In 1999, the Pennsylvania courts refused a *cy pres* application by the Trust, requesting permission to apply some of its funds to establish a teacher training center. *See In re Milton Hershey Sch. Trust*, 807 A.2d at 329. The Pennsylvania AG contested the petition. *See id.* at 329-30. His position was ultimately victorious. *See id.* at 332-35.

[130] *See In re Milton Hershey Sch. Trust*, 807 A.2d at 328; *see also* Sidel, *supra* note 126, at 14-16.

[131] *See In re Milton Hershey Sch. Trust*, 807 A.2d at 325.

[132] *See* David Lamb, *Bitterness Taints a Sweet Victory*, L.A. TIMES, Sept. 19, 2002, at 12.

[133] *See* Brody, *supra* note 5, at 992; Sidel, *supra* note 126, at 20-24.

[134] *See* Brody, *supra* note 5, at 998-99; Sidel, *supra* note 126, at 33-34.

[135] UNIFORM PRUDENT INVESTOR ACT § 2 (1994); SCOTT & FRATCHER, *supra* note 20, § 389.

Building from these activist efforts, three state AGs have begun to propose legislation adapting portions of the Sarbanes-Oxley Act to regulate nonprofits. As Part IV shows, these proposed reforms again reveal AGs' almost exclusive interest in the financial aspects of nonprofit accountability.

IV. SARBANES-OXLEY: THE LATEST AG FOCUS ON FINANCIAL CONCERNS

AGs' recent pursuit of nonprofit legislation drawing on Sarbanes-Oxley is the latest example of their tendency to focus their renewed vigor for enforcement on financial accountability. In part, this focus is an unavoidable consequence of AGs' decision to use portions of the Act as a model for nonprofit regulation. Congress passed Sarbanes-Oxley in reaction to the now familiar spate of for-profit corporate scandals involving misleading financial reporting and destruction of financial documentation.[136] The Act directly addresses these specific and high-profile financial abuses[137] and implements a series of general reforms intended to improve the transparency and accuracy of financial reporting by publicly-traded companies.[138] Thus, financial accountability is the chief concern of the federal Sarbanes-Oxley Act.[139]

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[136] *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (July 30, 2002) (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.); William C. Powers, Jr. et al., *Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corp.* (Feb. 1, 2002), *available at* http://news.findlaw.com/hdocs/docs/enron/sicreport/cover.pdf (last visited Oct. 11, 2004).

[137] *See* Sarbanes-Oxley Act, § 401(j) (instructing SEC to issue regulations requiring disclosure of off-balance sheet transactions in annual and quarterly reports of registered companies); *id.* § 1102 (enhancing criminal penalties for destruction of documents).

[138] *See id.*, pmbl. (describing statute as "[a]n Act to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.").

[139] The passage of Sarbanes-Oxley required the promulgation of new rules under the Act by the SEC, and was accompanied by the development of new listing standards by stock exchanges and the recommendation of best practices by business industry groups. *See, e.g.*, SEC, *SEC Final Rule* (listing final rules recently promulgated by the SEC, many of which are pursuant to mandates of the Sarbanes-Oxley Act), *available at* http://www.sec.gov/rules/final.shtml (last visited Oct. 22, 2004); NYSE, *Report of the New York Stock Exchange Corporate Accountability and Listing Standards Committee* (June 6, 2002), *available at* http://www.nyse.com/pdfs/corp_govreport.pdf (last visited Oct. 11, 2004); The Business Roundtable, Principles of Corporate Governance (May 2002), *available at* http://www.businessroundtable.org/pdf/704.pdf (last visited Oct. 11, 2004). This Article will concentrate on the reforms implemented under Sarbanes-Oxley, as the most prominent example of financial accountability reform imposed after the corporate scandals of 2001 and 2002, and the one taken up by nonprofit regulators who have expressed interest in the subject.

Commentators differ on the extent to which Sarbanes-Oxley has altered the

Sarbanes-Oxley does not, by its terms, address the nonprofit sector.[140] However, soon after its enactment, the question arose whether similar reforms would be applied to the nonprofit sector.[141] Purveyors of continuing legal education quickly began offering lectures and courses on Sarbanes-Oxley, specifically targeting counsel for nonprofit organizations.[142] Commentators, as well as the sponsors of these courses,

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landscape of corporate governance and financial disclosure for public companies. *Compare* Kathleen F. Brickey, *From Enron to WorldCom and Beyond: Life and Crime After Sarbanes-Oxley*, 81 WASH. U. L.Q. 357, 381 (2003) (describing Sarbanes-Oxley as "a constructive step in the right direction"), *and* Jonathan R. Macey, *The Future Disclosure System: A Pox on Both Your Houses: Enron, Sarbanes-Oxley and the Debate Concerning the Relative Efficacy of Mandatory Versus Enabling Rules*, 81 WASH. L. Q. 329, 355 (2003) (concluding that although it is not a cure for all of the ills in the American capital markets, "Sarbanes-Oxley was a measured and appropriate response to the abject failures in U.S. corporate governance typified by Enron."), *with* Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn*, 35 CONN. L. REV. 915 (2003) (describing Act as merely incremental, though potentially positive, reform), *and* Perino, *supra* note 61, at 673 (criticizing Act's criminal provisions in particular as mere "political grandstanding"). However, it cannot be disputed that this legislation, along with the efforts of self-regulatory and trade organizations, has focused attention on improving the financial accountability of publicly-traded companies.

140 A few of the Act's more general provisions, such as its heightening of penalties for obstruction of justice, would apply to nonprofits in certain circumstances. However, the vast majority of the Act's provisions apply to the SEC itself, to issuers of securities that register with the SEC, and to the attorneys, accountants, and other financial professionals who service those issuers. *See, e.g.*, Sarbanes-Oxley Act, § 301 (codified at 15 U.S.C. § 78(m)(3) (2002)) (applying new audit committee independence requirements to "issuers"); *id.* § 307 (directing SEC to implement additional professional responsibility requirements for attorneys); *id.* § 203 (requiring accounting firms to rotate audit partners). Nonprofit organizations are prohibited from distributing their net earnings to outsiders. *See, e.g.*, CAL. CORP. CODE §§ 5410, 5049 (West 2002) (prohibiting such distributions to members); RMNCA, *supra* note 20, §§ 13.01, 1.40 (prohibiting payments from nonprofit corporations to their "members, directors, or officers"); *see also* Henry Hansmann, *Economic Theories of Nonprofit Organization*, *in* THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 28 (Walter W. Powell ed., 1987) (describing nondistribution constraint more generally). By operation of this so-called "nondistribution constraint," nonprofits are precluded from issuing equity securities. Thus, they generally will not come within the purview of the Sarbanes-Oxley Act itself.

141 Of course, one may seriously question whether measures modeled on the federal Act will be effective tools to improve nonprofits' financial accountability. These concerns are important, but are beyond the scope of this Article. For a discussion of them, see Dana Brakman Reiser, *There Ought to Be a Law: The Disclosure Focus of Recent Legislative Proposals for Nonprofit Reform*, 80 CHI.-KENT L. REV. (forthcoming 2005); Wendy K. Szymanski, *An Allegory of Good (and Bad) Governance: Applying the Sarbanes-Oxley Act to Nonprofit Organizations*, 2003 UTAH L. REV. 1303, 1315-28 (2003). The balance of this Article leaves aside the issue of whether nonprofit reforms modeled on Sarbanes-Oxley will have the impact their proponents expect, and reviews the content of these efforts instead, to demonstrate that it is indeed financial accountability that these reforms target.

142 *See* Univ. of Washington School of Law, Symposium, *New Developments Affecting Nonprofit and Tax-Exempt Organizations*, *available at* http://www.uwcle.org/nonprofit2003.htm (last visited Oct. 8, 2004); The Alliance for Nonprofit Governance, *Changing*

asserted that Sarbanes-Oxley changed the landscape of business regulation and that its changes would seep into regulation of the nonprofit sector through changing norms and possibly new state-level legislation with wider application.[143] They were right. At NASCO's 2003 annual meeting, charities regulators discussed the potential application of Sarbanes-Oxley type reforms to nonprofit institutions.[144] Various state AGs have expressed an interest in applying these types of reforms to the nonprofit sector, and three have produced legislative proposals.[145]

Nonprofit Accountability (on file with author); A.B.A. Business Law Section, *Protecting Directors of Nonprofit Corporations, available at* http://www.abanet.org/buslaw/corporate responsibility/clearinghouse/03spring/24/protecting_directors.pdf (last visited Oct. 11, 2004); *see also* Michael W. Peregrine & James R. Schwartz, *Taking the Prudent Path: Best Practices for Not-for-Profit Boards*, TRUSTEE, Nov./Dec. 2003, at 24-27 (offering two nonprofit legal experts' ideas on nonprofit best practices after Sarbanes-Oxley).

143 *See, e.g.*, Blum Shapiro, *Implications of Sarbanes Oxley Act on Non-Profit Organizations*, THE COMPETITIVE EDGE, Spring 2003 (advising nonprofits to consider reforms like those required of public companies under Sarbanes-Oxley, although Act would not, by its terms, apply to them); Thomas Silk, *Ten Emerging Principles of Governance of Nonprofit Corporations*, 43 EXEMPT ORG. TAX REV. 35 (2004) (describing ways in which Sarbanes-Oxley's reforms have impacted, and will continue to impact, nonprofit governance, even if state legislative proposals are not ultimately enacted); The Nonprofit Coordinating Committee of New York (NPCC), *Accountability Issues*, NPCC NEWSL., Jan., 1, 2003 (on file with author) (advising members of this nonprofit trade association to be aware of potential impact of Sarbanes-Oxley on nonprofits, through shifts in business culture or new regulation); ABA Coordinating Committee on Nonprofit Governance, *Guide to Current and Emerging Standards of Nonprofit Corporate Governance: Governing and Best Practices in the Wake of Sarbanes–Oxley*, Jan. 2004 (unpublished draft on file with author); BoardSource & Independent Sector, *The Sarbanes-Oxley Act and Implications for Nonprofit Organizations, available at* http://www.independentsector.org (last visited Oct. 11, 2004).

144 *See* National Association of State Charity Officials (NASCO), National Meeting Agenda, Sept. 15, 2003 (on file with author). Accountability concerns of state regulators were also a major focus of the 2003 Annual Meeting of Independent Sector, a national coalition of nonprofit organizations of various kinds. *See* Stephen G. Greene, *Philanthropy's Challenges*, CHRON. OF PHILANTHROPY, Nov. 13, 2003, at 27.

145 *See* Memorandum of Office of Massachusetts Attorney General Tom Reilly, Summary of Draft 1.0, An Act to Promote the Financial Integrity of Public Charities (unpublished summary on file with author) [hereinafter Mass. Summary] (describing efforts of Massachusetts AG to draft bill increasing financial oversight of nonprofits, modeled on Sarbanes-Oxley Act), *available at* http://www.providers.org/Charities%20Fin %20Legis%20Summary%20%2704.pdf (last visited Oct. 21, 2004); Press Release, California Office of the Attorney General, *Attorney General Lockyer Unveils Reforms to Toughen Nonprofit Accountability: Fundraiser Controls, Audit, Disclosure and Compensation Provisions Seek to Protect Charities and Donors* (Feb. 12, 2004) (on file with author) [hereinafter Cal. AG Press Release] (describing AG's reform proposal and its imminent introduction by state Senator Sher); Press Release, Office of the New York State Attorney General Eliot Spitzer, *Spitzer Proposes Reforms of State Corporate Accountability Laws* (Jan. 23, 2003) (on file with author) [hereinafter N.Y. AG Press Release]; *see also* Patrice A. Heinz, *Responding to the Sarbanes-Oxley Act of 2002: The Financial Reporting Practices of Nonprofits* 9 (2003) (published by The Alliance for Children and Families, Milwaukee, WI) (mentioning interest of AGs in Ohio and Minnesota in pursuing such legislation as well); Stephanie Strom, *Questions About Some*

New York Attorney General Eliot Spitzer took the lead on this issue in early 2003,[146] when he recommended to his state legislature a proposal to apply reforms modeled on Sarbanes-Oxley provisions to nonprofit organizations.[147] He stated that the proposal would protect consumers from fraud perpetrated by "not-for-profit entities that have custody of billions of dollars in charitable funds" by "strengthen[ing] state laws to protect [] donors."[148] The AG's proposal was drafted into a bill that, if enacted, would amend various sections of New York's Not-For-Profit Corporation Law.[149] The bill was introduced in the New York State Senate in April 2003,[150] amended two months later, and it remains in committee.[151] In March 2004, a companion bill was introduced and referred to committee in the New York State Assembly.[152] The Massachusetts Attorney General, Tom Reilly, has drafted a comparable bill to apply to public charities in that state, though it has yet to be introduced in the legislature.[153] In February 2004, a similar bill was

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Charities' Activities Lead to a Push for Tighter Regulation, N.Y. TIMES, Mar. 21, 2004, at 23 (describing efforts of New York, Massachusetts, and California AGs to propose new nonprofit accountability legislation, and noting comments by Senator Charles Grassley, chairman of U.S. Senate Finance Committee, that his committee also planned to study issue).

[146] Attorney General Spitzer has been at the forefront in various areas of post-Enron reform, so it is not surprising to find him spearheading the movement to adapt Sarbanes-Oxley to the nonprofit context. *See, e.g.*, Hillary A. Sale, *Delaware's Good Faith*, 89 CORNELL L. REV. 456, 457-58 (2003) (noting that AG Spitzer has been the main state regulator active in post-Enron corporate governance reform); John Cassidy, *How Eliot Spitzer Humbled Wall Street*, THE NEW YORKER, Apr. 7, 2003, at 54; *60 Minutes: The Sheriff of Wall Street* (CBS television broadcast, May 25, 2003) (profiling AG Spitzer's aggressive pursuit of Wall Street following Enron and other corporate scandals).

[147] *See* N.Y. AG Press Release, *supra* note 145, at 1.

[148] *Id.*

[149] As a series of amendments to the state's nonprofit corporation law, the proposed bill will have little if any impact on those nonprofits organized as charitable trusts and unincorporated associations.

[150] At the request of the attorney general, the bill was introduced in the state Senate by Senator Leibell on Apr. 23, 2003, where it was referred to the Committee on Corporations, Authorities and Commissions. *See* S.B 4836, 226th Leg. Sess. (N.Y. 2003); *see also* Szymanski, *supra* note 141, at 1304-06 (analyzing provisions of AG's bill as originally introduced).

[151] The bill was amended in various respects and referred back to the committee on June 10, 2003; it was reassigned there at the opening of the new Senate session on Jan. 7, 2004. *See* S.B. 4836-A, 226th Leg. Sess. (N.Y. 2003). Its most recent amendment changed only its effective date. *See* S.B. 4836-B, 227th Leg. Sess. (N.Y. 2004).

[152] *See* A.B. 10239, 227th Leg. Sess. (N.Y. 2004). The Assembly bill precisely replicates the Senate bill. For brevity, future references to the New York bill will cite to the current Senate version, N.Y. S.B. 4836-B, only.

[153] Office of Massachusetts Attorney General Tom Reilly, An Act to Promote the Financial Integrity of Public Charities: Draft 1.0 (unpublished draft legislation on

introduced in the California state Senate on behalf of its Attorney General, Bill Lockyer.[154] The bill was amended several times and was passed by both houses of the California legislature; the governor signed it into law in September 2004, but warned that the legislature should revisit these issues if the new regulation proved to be overly burdensome.[155] It remains to be seen whether California will revise its legislation or the other states' proposals will be enacted in their current form, if at all. Still, the content of these proposals offers valuable insight into AGs' nonprofit enforcement priorities, including their tendency to emphasize financial accountability.[156]

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file with author) [hereinafter Mass. Draft Leg. 1.0], *available at* http://www.providers.org/Charities%20Fin%20Integrity%20Legis%20Jan%2004.pdf (last visited Oct. 20, 2004).

[154] The Nonprofit Integrity Act, S.B. 1262, 2003-2004 Leg. Sess. (Cal. 2004) (version introduced in California Senate on Feb. 13, 2004), *available at* ftp://www.leginfo.ca.gov/pub/bill/sen/sb_1251-300/sb_1262_bill_20040213_introduced.pdf (last visited Oct. 11, 2004); *see also* Cal. AG Press Release, *supra* note 145, at 1 (describing AG's reform proposal and its imminent introduction by state Senator Sher). The California bill was more limited than the New York and Massachusetts bills in its application of disclosure and governance reforms to nonprofits, but the California bill also included significant reforms related to the state's charitable solicitation regime.

[155] *See* The Nonprofit Integrity Act, 2004 Cal. Stat. ch. 919 (as signed by governor Sept. 29, 2004), *available at* http://www.leginfo.ca.gov/pub/bill/sen/sb_1251-1300/sb_1262_bill_20040930_chaptered.pdf (last visited Oct. 20, 2004); Grant Williams, *Calif. Passes New Law on Charity Accountability*, CHRON. OF PHILANTHROPY, Oct. 14, 2004, at 32 [hereinafter Williams, *Calif. Passes New Law*] (describing the law's passage and the governor's message); *see also* Grant Williams, *California Legislature Approves Measure Opposed by Many of the State's Charities*, CHRON. OF PHILANTHROPY, Sept. 15, 2004 (describing measure's passage in the legislature and several groups' efforts to persuade governor to veto it).

[156] In June 2004, the U.S. Senate Finance Committee held a hearing on charity oversight and reform. *See Charity Oversight and Reform: Keeping Bad Things From Happening to Good Charities: Hearings Before the Senate Comm. on Finance*, 108th Cong. (2004) (written materials and streaming video *available at* http://finance.senate.gov/sitepages/hearing062204.htm (last visited Oct. 11, 2004)). In connection with the hearing, the Committee released a bipartisan staff discussion draft proposing, by one estimate, over 200 potential reforms addressed to nonprofit organizations and to be implemented primarily through amendments to the federal tax code. *See* STAFF OF SENATE COMM. ON FINANCE, 108TH CONG., STAFF DISCUSSION DRAFT (2004) [hereinafter SFC White Paper], *available at* http://finance.senate.gov/hearings/testimony/2004test/062204stfdis.pdf (last visited Oct. 7, 2004); Brad Wolverton, *Rethinking Charity Rules*, CHRON. OF PHILANTHROPY, July 22, 2004, *passim*.

In September 2004, Senate Finance Committee Chairman Charles Grassley and Ranking Member Max Baucus asked Independent Sector to convene a panel to review and make recommendations on the discussion draft's proposals. *See* Letter from U.S. Senate Committee on Finance to Diana Aviv (Sept. 22, 2004), *available at* http://www.independentsector.org/PDFs/SFCltr.pdf (last visited Oct. 20, 2004). Independent Sector agreed to do so, named a panel and plans to make final recommendations in the spring of 2005. *See* Independent Sector (IS), *IS Response to Senate Finance Committee*, *available at* http://www.independentsector.org/panel/response.htm (last visited Oct. 20, 2004).

The federal Sarbanes-Oxley Act contains a long list of reforms, at least two categories of which are ripe for imitation by AGs intent upon enforcing nonprofits' financial accountability.[157] First, AGs could copy the Act's enhancement of required financial disclosures by public companies. Second, AGs might mimic some of its attempts to shore up corporate governance to prevent financial frauds.[158] All three current state nonprofit Sarbanes-Oxley analogues include these types of reforms. The AGs' proposals show some glimmers of concern for organizational integrity. However, as this Part will show, the reforms concentrate principally on financial issues: tracking contributions and safeguarding nonprofit assets. And, they do not address issues of mission accountability at all.

A. *Enhanced Financial Disclosure*

In a brief preamble, the Sarbanes-Oxley Act states its goal of "protect[ing] investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws."[159] In pursuit of this goal, the Act instructs the SEC to enact regulations mandating that top officers of publicly-traded companies personally review their

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A full description and analysis of the SFC White Paper's proposals is beyond the scope of this paper. However, a financial accountability focus can be detected in these reforms as well. For an extensive discussion of the federal proposals, see Symposium, *Who Guards the Guardians? Monitoring and Enforcement of Charity Governance*, 80 CHI.-KENT L. REV. (forthcoming 2005) (including discussion of proposals for disclosure, enforcement by federal and state regulators, governance, expansion of equity powers of federal courts, and accreditation).

[157] Some of the Act's provisions deal with issues that do not arise in the nonprofit context or are so tailored to the context of for-profit, publicly-traded companies that they simply could not be used as a model for nonprofit reform efforts. *See, e.g.*, Sarbanes-Oxley Act of 2002, tit. V, Pub. L. No. 107-204, 116 Stat. 745 (July 30, 2002) (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.) (requiring promulgation of rules to protect objectivity of securities research analysts).

[158] *See* Szymanski, *supra* note 141, at 1312 (predicting similar migration of Sarbanes-Oxley concepts to nonprofit arena, but separating them into three categories: disclosures, corporate governance, and auditing).

AGs also might have adapted other Sarbanes-Oxley reforms to the nonprofit context. Perhaps the greatest share of the legislative reforms imposed by Sarbanes-Oxley is dedicated to establishing new agencies and empowering existing agencies to enforce auditing, disclosure, and corporate governance standards. *See, e.g.*, Sarbanes-Oxley Act §§ 101, 107, 208. State AGs might have followed this model to call for new regulatory bodies or the injection of funding into existing ones, in an attempt to increase nonprofit accountability. However, no current state nonprofit law reform proposal establishes a new enforcement agency or authorizes additional funding for AGs.

[159] Sarbanes-Oxley Act pmbl. The Act does make clear that it is also intended "for other purposes," though these are not directly stated in the preamble. *Id.*

companies' financial reports and certify their veracity and foundation.[160] This certification attests that: the signing officer has reviewed the report; the report does not contain material untruths, misstatements, or omissions; and the financial information in the report "fairly present[s] in all material respects the financial condition and results of operations of the issuer. . . ."[161]

The signing officer's seal of approval is only one part of Sarbanes-Oxley's elaborate certification procedure. The signing officer also must provide the SEC with information regarding the processes used to obtain and verify information contained in the reports. Specifically, a signing officer is charged with the responsibility of establishing and maintaining internal controls designed to ensure that he and his fellow managers will obtain accurate information about the company, its finances, and operation.[162] In addition, the Act uses the certification process to ensure that important disclosures are made to other internal and external parties. The signing officer must certify that he has disclosed to the auditors and audit committee all significant deficiencies and material weakness in internal controls[163] and any fraud involving management or employees who play a significant role in operating those controls.[164]

[160] *Id.* § 302(a). The inclusion of this certification requirement has been a mainstay of press reports and commentary on Sarbanes-Oxley. *See, e.g.*, Lisa M. Fairfax, *Form Over Substance? Officer Certification and the Promise of Enhanced Personal Accountability under Sarbanes-Oxley Act*, 55 RUTGERS L. REV. 1 (2001) (describing and challenging claims of certification supporters that it will improve corporate accountability); Larry E. Ribstein, *Market Versus Regulatory Responses to Corporate Fraud*, 28 J. CORP. L. 1, 13 (2002); Steven Marlin, *Absolutely Accountable*, INFORMATION WEEK, Oct. 6, 2003, at 51; *Price of Change Will Pay Off in Long Term–William Donaldson, Chairman of the U.S. Securities and Exchange Commission, Argues that the Costs of Sarbanes-Oxley and Other Reforms are Opportunities from Which Companies Can Benefit*, THE BANKER, Nov. 1, 2003. Even President Bush's brief one-page statement accompanying his signature of the Sarbanes-Oxley Act highlighted the importance of the certification requirement and its role in improving corporate disclosures. *See* Statement by President, *supra* note 3 ("The legislative purpose of sections 302, 401, and 906 of the Act, relating to certification and accuracy of reports, is to strengthen the existing corporate reporting system . . . .").

[161] Sarbanes-Oxley Act § 302(a)(1)-(3).

[162] *Id.* § 302(a)(4)(A)-(B). To ensure such controls are effective and maintained over time, signing officers must evaluate the internal controls within 90 days of signing any relevant report. *Id.* § 302(a)(4)(C). Moreover, the reports must present a conclusion as to the effectiveness of the controls over the relevant period, as well as any significant changes in the controls subsequent to the signing officer's evaluation. *Id.* § 302(a)(4)(D), (a)(6).

[163] *Id.* § 302(a)(5).

[164] *Id.* § 302. The Act's call for the SEC to establish minimum standards of professional conduct for attorneys practicing before it plays a complementary role. The Commission's mandate includes establishing a rule requiring attorneys to report evidence of securities and fiduciary law violations by an issuer to its chief legal counsel or CEO, and to report it to the audit committee or another committee of independent directors if appropriate action

Thereby, Sarbanes-Oxley certification also strives to assure that individuals and groups, beyond the signing officers, obtain the information they need to act as an effective backstop.

1. AGs Apply Disclosure Reforms to Nonprofits

Existing statutory and regulatory regimes in most states already require nonprofits to produce and/or file up to three types of reports, to which Sarbanes-Oxley-type disclosure enhancements and certification requirements could be added. Nonprofit corporations typically must: (1) produce annual internal reports,[165] (2) file with the attorney general at least summary annual reports regarding their charitable assets,[166] and (3) register with state officials and file annual financial information with them regarding any charitable solicitation efforts they undertake.[167] The certification requirements of Sarbanes-Oxley could easily be mimicked to enhance some or all of these existing nonprofit disclosure mechanisms. The New York bill provides a useful case study of one activist AG's attempt to do so.[168]

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is not taken in response. *Id.* § 307. The SEC adopted such rules by final regulation in Aug. 2003. *See* SEC Final Rule: Implementation of Standards of Professional Conduct for Attorneys, 17 C.F.R. § 205.1-7 (2004). The details of these rules of professional conduct have been the subject of significant discussion in the academic and popular legal press. *See, e.g.*, Jill E. Fisch & Kenneth M. Rosen, *Is there a Role for Lawyers in Preventing Future Enrons?*, 48 VILL. L. REV. 1097 (2003); Chi Soo Kim & Elizabeth Laffitte, *The Potential Effects of SEC Regulation of Attorney Conduct Under the Sarbanes-Oxley Act*, 16 GEO. J. LEGAL ETHICS 707, 716-21 (2003); E. Norman Veasey, *The Ethical & Professional Responsibilities of the Lawyer for the Corporation in Responding to Fraudulent Conduct by Corporate Officers or Agents*, 70 TENN. L. REV. 1, 21-23 (2002); Darrel W. Cole, *Confidentiality Rule Expanded*, DEL. L. WKLY., Apr. 16, 2003, at D1; George D. Royster, *The Sarbanes-Oxley Solution*, BEST'S REV., Sept. 1, 2003, at 45; *Withdrawal Pains*, THE AM. LAW., Apr. 2003, *passim*.

[165] *See, e.g.*, RMNCA, *supra* note 20, § 7.01(d)(1) (requiring president and chief financial officer of nonprofit corporation with members to "report on the activities and financial condition of the corporation" at its annual member meeting).

[166] *See* PHELAN, *supra* note 35, §§ 2:23, 1:04 (describing asset reporting requirements applied to nonprofit corporations and charitable trusts).

[167] *See supra* notes 97-102 and accompanying text; *see also* Irvin, *supra* note 107, at 3-5 (collecting and analyzing reporting requirements across jurisdictions).

[168] The Massachusetts effort generally tracks the New York bill; the following discussion will address the points on which they differ materially. As mentioned above, the California legislation is somewhat more limited with regard to its adoption of Sarbanes-Oxley-inspired reforms, but its provisions will be addressed when relevant.

a. Internal Reporting

Under current New York law, the directors of a nonprofit corporation must prepare an internal annual financial report.[169] This report must be "verified" by the president and treasurer, by a majority of the nonprofit's directors, or by an independent public accountant, certified public accountant, or accounting firm.[170] The report must state the assets and liabilities of the corporation, changes in those assets and liabilities during the relevant period, information on revenues received and expenditures disbursed, as well as a current count of the organization's members, if any.[171]

The New York proposal imposes additional verification requirements for this internal report, tracking both the language of Sarbanes-Oxley and its financial focus. Indeed, the proposal varies the level of analysis and disclosure required in these reports, based upon the financial magnitude of a given nonprofit. The largest nonprofit corporations, those with assets of at least $3 million or annual revenues or support of at least $1 million, must add the most comprehensive verifications to their internal reports.[172] Under the proposal, the president or CEO as well as the treasurer or CFO of such nonprofits must sign their internal reports. By their signatures, they must make three types of verifications clearly drawn from Sarbanes-Oxley. They must verify the truth of the information disclosed, the reliability of their internal controls, and the disclosure to appropriate parties of any deficiencies in these controls and any relevant frauds.[173] The bill requires officers of financially smaller nonprofit corporations to make more limited verifications.[174]

As may already be appreciated, the New York proposal's reliance on Sarbanes-Oxley as a model for its verification requirements is striking.

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[169] N.Y. NOT-FOR-PROFIT CORP. LAW § 519 (McKinney 1997).

[170] *Id.* § 519(a).

[171] *Id.* § 519(a)(1)-(5). This report must be filed in the records of the corporation, it must be presented at the annual members' meeting, if any, or at an annual meeting of the board, and the report, or an abstract of it, must be filed with the minutes of the meeting at which it is presented. *Id.* § 519 (b)-(c).

[172] S.B. 4836-B, 227th Leg. Sess. § 1(e) (N.Y. 2004). The bill subjects private foundations, essentially grant-making institutions, to specialized provisions that incorporate federal tax requirements applicable to them. *Id.* § 1(f)-(g).

[173] *Id.* § 1(e)(1)-(4).

[174] *Id.* § 1(d) (requiring officers of nonprofits with less than $3 million in assets and less than $1 million in annual gross revenues and support to verify only that they have reviewed report and believe it fairly presents financial position and operations of nonprofit); *see also id.* § 1(e)(5) (exempting entirely from new verification and reporting standards nonprofits that neither hold charitable assets nor engage in charitable solicitation, further demonstrating bill's emphasis on financial accountability).

Although the Sarbanes-Oxley Act requires officer "certification," while the New York bill demands "verification," this distinction appears to create no substantive difference.[175] In describing the specific verifications to be made in the internal reports of large nonprofits, the New York bill adopts significant text, verbatim, from Sarbanes-Oxley's certification requirements for issuers' annual and periodic reports to the SEC, and changes other language only slightly. The bill's standards of completeness and accuracy track the Sarbanes-Oxley language in all significant respects.[176] The New York bill's language regarding "internal financial controls,"[177] echoes the certifications regarding "internal

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[175] Presumably, the verification language was chosen to conform with the existing verification requirements in the New York statute. *See* N.Y. NOT-FOR-PROFIT CORP. LAW § 519(a) (McKinney 1997) (requiring "verification" of internal financial reports).

[176] *Compare* N.Y. S.B. 4836-B § 1(e)(1), *with* Sarbanes-Oxley Act of 2002, § 302(2)-(3), Pub. L. No. 107-204, 116 Stat. 745 (July 30, 2002) (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.) (revealing only following differences: (1) New York bill omits reference to "financial statements," in addition to "financial information," included in relevant reports; and (2) New York bill refers to "corporation," rather than "issuer").

[177] The New York bill does not define "internal financial controls," although the New York AG's Charities Bureau recently published a pamphlet offering guidance on the meaning and appropriate scope of internal controls in nonprofits. *See* New York Attorney General Eliot Spitzer, Internal Controls and Financial Accountability for Not-for-Profit Boards (2004), *available at* www.oag.state.ny.us/charities/charities.html (last visited Oct. 11, 2004). The Massachusetts draft legislation, which adopts Sarbanes-Oxley's precise language in this context, does provide an extended definition of "internal controls" for nonprofits. *See* Mass. Draft Leg. 1.0, *supra* note 153, § 1.

The SEC has dealt with the definition of "internal controls" in several rule-making contexts. The term appears to have originated in standards of the accounting profession. *See* American Institute of Certified Public Accountants (AICPA) Codification of Statements on Auditing Standards, AU § 319 (1995). In its rule-making under section 302 of the Sarbanes-Oxley Act, the SEC required signing officers to describe and assess their "disclosure controls," a new term defined specially for this purpose.

> [T]he term "disclosure controls and procedures" means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Act (15 U.S.C. 78a et seq.) is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer's management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

17 C.F.R. § 240.13a-15(e) (2004). A definition of "internal control over financial reporting" also can be found in 17 C.F.R. § 240.13a-15(f) (2004). The concept of internal control has more generally been defined as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of

controls" required by Sarbanes-Oxley.[178] And the New York bill, like the federal Act, requires signing officers to attest that they have made various disclosures to other corporate officers and to the nonprofit's audit committee or its entire board of directors.[179]

b. Asset Reports

Current New York law also demands that most nonprofit corporations produce and file annual reports with the AG's office if they "hold and administer property for charitable purposes."[180] All nonprofit

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operations, reliability of financial reporting, and compliance with applicable laws and regulations. *See* The Committee of Sponsoring Organizations of the Treadway Commission, *COSO Definition of Internal Control, available at* http://www.coso.org/key.htm (last visited Oct. 11, 2004).

[178] *Compare* N.Y. S.B. 4836-B § 1(e)(2), *with* Sarbanes-Oxley Act § 302(4)(A)-(B). The New York bill's requirement that signing officers address the existence and accuracy of "internal financial controls" is in substance very similar to federal Act's certifications as to the existence and accuracy of internal controls. *Compare* N.Y. S.B. 4836-B § 1(e)(3), *with* Sarbanes-Oxley Act § 302(a)(4)(C)-(D). The New York bill's requirements that signing officers evaluate their nonprofits' internal financial controls and present conclusions as to their efficacy are again substantively identical to certifications required by Sarbanes-Oxley.

The original version of the New York bill even more precisely mirrored the federal statute, using the "internal controls" language and assigning to the signing officers the responsibility for "establishing and maintaining internal controls" as well as for their design. *See* S.B. 4836, 226th Leg. Sess., § 1(e)(4)(A)-(B) (N.Y. 2003). Correspondence between the AG's office and a New York nonprofit trade association suggests that this change was intended to address concerns of the nonprofit community with this language. *See* Letter from David M. Nocenti, Counsel to the New York Attorney General, to Jon Small, Chair of the Government Relations Committee of the NPCC, 2 (May 20, 2003) (on file with author).

[179] *Compare* N.Y. S.B. 4836-B § 1(e)(4)(A), *with* Sarbanes-Oxley Act § 302(a)(5)(A). The disclosures as to weaknesses in internal controls demanded by the New York proposal are more general than those required under Sarbanes-Oxley, but address the same basic issue of whether the controls in place adequately protect data from inaccuracies or fraud. *Compare* N.Y. S.B. 4836-B § 1(e)(4)(A), *with* Sarbanes-Oxley Act § 302(a)(5)(A). Similarly, the New York bill's language mandating disclosures of management or employee fraud is exactly the same as that in the federal Act, save the reference to "internal *financial* controls." *See* N.Y. S.B. 4836-B § 1(4)(A) (emphasis added). *Compare id., with* Sarbanes-Oxley Act § 302(a)(5)(A) (referring only to "internal controls").

Although the New York proposal significantly expands the verifications currently required in nonprofits' internal reports, it adds little to the penalties for failure to comply with these provisions. Under existing law, a nonprofit corporation already is liable for damages sustained by any person as a consequence of its failures to comply, in good faith, with internal reporting requirements. *See* N.Y. NOT-FOR-PROFIT CORP. LAW § 521 (McKinney 1997). The bill specifically declines to create any new private rights of action against officers, based on their verifications. N.Y. S.B. 4836-B, § 1(h). Standing to challenge such failures, then, will remain principally with the attorney general.

[180] N.Y. EST. POWERS & TRUSTS LAW § 8-1.4(d), (f), (r) (McKinney 2003). Entities required to register and report also must certify that they have done so in order to apply for or receive funds from state agencies and departments. *Id.* § 8-1.4(s). Various types of

corporations required to report must initially register with the AG[181] and each year must file signed annual financial reports with the AG's office.[182] AG Spitzer might have proposed officer certifications for these asset reports as well. In fact, requiring certifications of such official, external reports, filed with nonprofit regulators and available to donors, would follow more closely the strategy of Sarbanes-Oxley, which demands certifications in reports filed with SEC regulators and available to investors. The Massachusetts draft legislation takes just such an approach. It requires nonprofit officers to make essentially the same certifications the New York bill requires for internal reports instead of the annual financial reports nonprofit corporations must file with the AG.[183] The current New York proposal declines to take this step and

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entities, most of which are required to register and report similar financial information to other government entities, are excepted from all of the registration and reporting requirements imposed by this section. *Id.* § 8-1.4(b). Those corporations receiving less than $25,000 in gross receipts and holding $25,000 or less in assets during a given year also need not submit asset reports. *Id.* § 8-1.4(q).

[181] *Id.* § 8-1.4 (d) (requiring most corporations that hold and administer property for charitable purposes to register with attorney general "within six months after any property held by [it] is required to be applied to charitable purposes"); N.Y. COMP. CODES R. & REGS. tit. 13, § 91.2(a), (b) (2004) (specifying timing and format of registration forms). Registration forms must be signed under penalties of perjury by the president or other officer and the chief fiscal officer of the organization. *Id.* § 91.2(c). Registrants may use New York-specific forms provided by the attorney general or they may file the URS. *Id.* § 91.2(b)(1)(i).

[182] N.Y. EST. POWERS & TRUSTS LAW § 8-1.4(f) (requiring annual reports of charitable assets to be filed with attorney general and that they be signed under penalties of perjury). These reports generally will include a copy of the organization's Form 990, the informational tax return that a tax-exempt nonprofit must file with the IRS, and a schedule of securities held by the organization during the relevant period. N.Y. COMP. CODES R. & REGS. tit. 13, § 91.3.

[183] *See* Mass. Draft Leg. 1.0, *supra* note 153, § 2(3)-(4); *see also id.* § 5 (addressing penalties available for use against nonprofits and fiduciaries who fail to comply with certification regime). Like the New York Senate bill, the text of the Massachusetts draft legislation adopts or tracks significant portions of the Sarbanes-Oxley certification requirements, and applies two tiers of certification requirements, demanding more rigorous certifications from officers of nonprofits with greater levels of revenue and support. *See id.* § 2.

Although it does not impose an officer certification requirement, California's new legislation also enhances the disclosures required in nonprofit asset reports by mandating that large revenue nonprofits prepare and file annual audited financial reports with the attorney general. *See* The Nonprofit Integrity Act, 2004 Cal. Stat. ch. 919, § 7(e)(1) (requiring nonprofits that receive or accrue in any fiscal year gross revenues of $2 million or more to prepare annual reports), *available at* http://www.leginfo.ca.gov/pub/bill/sen/sb_1251-1300/sb_1262_bill_20040930_chaptered.pdf (last visited Oct. 20, 2004). This legislation also seeks to improve public access to nonprofits' financial reports. *See id.* §§ 7(e)(1), 7(f) (requiring nonprofits to make available for public inspection any audited financial statements they possess, whether prepared for submission to attorney general with annual asset reports or for other reasons).

limits its verification requirements and remedies to the context of nonprofits' internal reports.

c. Charitable Solicitation Reports

Finally, New York imposes registration and reporting requirements on charitable organizations that solicit contributions from persons in the state or from governmental agencies.[184] Again, relevant organizations must first register with the AG[185] and then file annual written financial reports with the AG's office.[186] Along with these reports, large revenue organizations and those nonprofits relying on fund-raising professionals must submit to the AG audited annual financial statements accompanied by the opinion of an independent certified public accountant.[187]

The New York proposal neither enhances the content of these filings nor adds certification requirements to them.[188] The New York bill would impact these filings in only two respects. It would amplify the current law's mandate of complete and accurate filings[189] and increase penalties

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[184] N.Y. EXEC. LAW §§ 172, 172-b (McKinney 2003). The law also applies to foreign nonprofit corporations authorized to conduct their activities in New York, if they intend to solicit contributions or grants in the state. *Id.* §§ 172, 172-b. Despite its broad reach, several categories of organizations are exempted from registration and reporting under the charitable solicitation regulations. Religious organizations, certain organizations soliciting from a limited group of patrons or members, organizations with very limited financial resources, and some organizations that file similar reports with other governmental agencies, are exempt. *See, e.g., id.* §§ 172-a(1), (2)(a)-(b), (2)(d), (2)(h).

[185] *Id.* § 172(1).

[186] *Id.* § 172-b.

[187] *Id.* § 172-b(1) (requiring registered organizations with revenues of over $250,000 to file annual financial statements, including audit report by independent certified public accountant, opining that financial statements fairly present financial position of organization and are prepared in accordance with generally accepted accounting principles). *Compare id.* § 172-b(2) (requiring registered organizations with revenues of $100,000 to $250,000 annually to file signed and certified materials, but annual financial statement may include only "independent certified public accountant's review report" rather than full opinion), *with id.* § 172-b(2)(a) (permitting registered organizations with gross revenues between $25,000 and $100,000 to file unaudited financial reports without financial statements, although reports must still be signed and certified by president or other officer and chief fiscal officer as "true and correct to the best of their knowledge"), *and id.* § 172-a(2)(d) (exempting soliciting organizations that earn annual revenues of less than $25,000 from registration and reporting entirely).

[188] Notably, the financial reports that large revenue nonprofits or those using professional fund-raisers must submit already include verifications similar to some in the AG's proposal. N.Y. EXEC. LAW § 172-b(1) (McKinney 2003) (requiring required report to be signed by president or other officer and chief fiscal officer of organization, certifying under penalties of perjury that statements in report are, to best of their knowledge, true and correct).

[189] New language emphasizes that it is the duty of nonprofit corporations not merely to

for failures to comply.[190]

2. The Financial Focus of AG Nonprofit Disclosure Reforms

The enhancements of nonprofit disclosure in these recent state proposals are patently targeted to increase financial transparency. The priority of financial accountability can be seen first in the bills' linkage of the level of required disclosure to a nonprofit's financial magnitude. Those nonprofits with greater assets or revenues are required to engage in more disclosure and their fiduciaries must produce more detailed certifications.[191] Nonprofits of all sizes suffer losses due to misappropriation of corporate assets or the misallocation of charitable contributions. However, AGs display a willingness to devote more regulatory resources to nonprofits where more money is at stake from such missteps. The proposals demand only generic assurances from organizations with smaller levels of assets, while large-asset nonprofits must engage in a level of self-analysis clearly modeled on Sarbanes-Oxley, demonstrating the focus of these AGs on financial concerns.[192]

The items that nonprofit fiduciaries must verify under the New York and Massachusetts proposals also focus on financial questions. Under the New York bill, nonprofit fiduciaries and employees must vouch for the accuracy and authenticity of the financial information contained in

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file, but to file "complete and accurate reports." S.B. 4836-B, 227th Leg. Sess. § 2 (N.Y. 2004). Further, current law states that only willful failure to file a required report constitutes a breach of a director's duty to the corporation. N.Y. NOT-FOR-PROFIT CORP. LAW § 520 (McKinney 1997). The AG's proposal would provide that either willful or persistent failure to file complete and accurate reports would constitute a breach of duty by a nonprofit's directors *and its officers*. N.Y. S.B. 4836-B § 2.

190 *See* N.Y. S.B. 4836-B § 2 (granting attorney general rights to sue directors or officers for such failures, and even to seek their removal).

191 *Compare* N.Y. S.B. 4836-B § 1(d), *and* Mass. Draft Leg. 1.0, *supra* note 153, § 2(3), *with* N.Y. S.B. 4836-B § 1(e), *and* Mass. Draft Leg. 1.0, *supra*, § 2(4).); *see also* The Nonprofit Integrity Act, 2004 Cal. Stat. ch. 919, § 7(e)(1) (enhancing disclosures required under the new California legislation only for large revenue nonprofits), *available at* http://www.leginfo.ca.gov/pub/bill/sen/sb_1251-1300/sb_1262_bill_20040930_chaptered.pdf (last visited Oct. 20, 2004).

192 Of course, the decision to vary nonprofit disclosure duties with asset and/or revenue size is not solely a function of the priority of financial accountability. Lower disclosure requirements for small asset/revenue nonprofits also respond to the inability of small-scale nonprofit enterprises to engage in the comprehensive reporting and certifications required by Sarbanes-Oxley type reforms. In fact, the significant increase in asset/revenue size required to trigger greater disclosure requirements from the original to the amended New York bill was a response to the outcry from nonprofit organizations and their counsel that small nonprofits would be overcome by heavy disclosure responsibilities. *See* Letter from David M. Nocenti, *supra* note 178, at 2; *Sarbanes-Oxley for Nonprofits*, NEW YORK NONPROFITS, (NPCC) Aug. 5, 2003, at 1-2 (on file with author).

the reports they verify.[193] In large asset/revenue nonprofits, officers must further verify the existence and reliability of internal *financial* controls and that any fraud involving management or employees with a role in those controls has been reported to the audit committee.[194] The Massachusetts draft is similar.[195] None of the proposals expands the level of disclosure regarding the activities or qualifications of directors or officers, which might aid in tracking organizational accountability. Nor do they amplify the disclosures nonprofits must make regarding their activities or goals, which might assist in tracing mission accountability. Instead, the disclosure requirements focus on financial information necessary to track and protect solicited contributions and nonprofit assets.

The New York proposal's requirement that officer verifications be attached only to internal reports might be seen as a tip toward organizational accountability. By forcing verification of internal reports alone, the bill may encourage nonprofit fiduciaries to run more efficient and accountable organizations. If nonprofit officers take their verification roles seriously, this responsibility might prompt them to investigate the financial integrity of their organizations. However, this encouragement need not be heeded. The CEO and CFO, often paid staff, are permissible signatories of these reports. Thus, under this bill, not all nonprofit fiduciaries need be involved in the project of improving nonprofit governance, undercutting the proposal's capacity to improve organizational accountability.[196]

One could argue, of course, that at least some mission or organizational accountability might be achieved through spillover effects of the proposals' certification requirements, at least for large-asset nonprofits. Demanding that these nonprofits establish internal control mechanisms could encourage organizations to invest in the infrastructure necessary to police financial and nonfinancial operations alike. This may result in organizational and even mission accountability gains. But these effects are far from certain, and full compliance with the

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193 N.Y. S.B. 4836-B § 1(d), (e)(1)(B).

194 *Id.* § 1(e)(4)(A).

195 Mass. Draft Leg. 1.0, *supra* note 153, § 2(4).

196 The executive certification requirements of Sarbanes-Oxley have been touted by their proponents as apt medicine for corporate misconduct because they demand that executives stand behind their numbers. *See supra* note 160. The state nonprofit proposals in fact reveal a general tendency to regulate officers, rather than directors. This focus on officers is no doubt drawn from Sarbanes-Oxley. But, it is notable and troubling in the nonprofit context because it will fail to create incentives to bring directors into the governance process.

regime imposed by the AGs' bills seems to require attention only to financial matters.

The AGs' proposed reforms to enhance nonprofit disclosures unmistakably emulate the means and ends of Sarbanes-Oxley. The New York and Massachusetts reforms impose officer certification requirements almost identical to those in the federal Act and designate strikingly similar financial substance for officers to certify. The financial accountability focus of these reforms is equally obvious. The financial orientation of Sarbanes-Oxley is not surprising; its reforms target the for-profit sector, where recent events suggest that obtaining financial integrity alone would be a significant improvement. Since comprehensive nonprofit accountability requires mission and organizational accountability in addition to this financial component, one might hope for the governance agenda of AGs' nonprofit reform proposals to address these other important issues. Unfortunately, these reforms fall short of this aspiration.

B. *Governance Reforms*

Sarbanes-Oxley responds in various ways to the perceived failures in governance that allowed the financial frauds at Enron and elsewhere to go unchecked, with a particular focus on auditing. It adds new requirements for service on public company audit committees, in the interest of ensuring that they have sufficient expertise and independence to produce reliable financial information,[197] and it assigns to these committees significant new responsibilities.[198] The Act also prohibits issuers of registered securities from making personal loans to directors and contemplates the adoption by issuers of a code of ethics for senior financial officers.[199] To back up these governance mechanisms, the Act enhances civil and criminal sanctions available to punish offenders.[200] These governance reforms instituted by Sarbanes-Oxley also might be adapted for use in nonprofit regulation, and some of them have been

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[197] The law also imposes new limitations on auditors themselves. *See, e.g.*, Sarbanes-Oxley Act of 2002, § 201, Pub. L. No. 107-204, 116 Stat. 745 (July 30, 2002) (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

[198] *See, e.g.*, *id.* §§ 202, 204.

[199] *Id.* § 406 (instructing SEC to issue rules requiring issuers to disclose whether or not they have adopted code of ethics for senior financial officers, and if not, why not).

[200] *Id.* § 1107; 18 U.S.C. § 1514A (West 2000); *see also* Brickey, *supra* note 139, at 378-82; Mary Kreiner Ramirez, *Just in Crime: Guiding Economic Crime Reform after the Sarbanes-Oxley Act of 2002*, 34 LOY. U. CHI. L.J. 359, 387 (2003); Geraldine Szott Moohr, *An Enron Lesson: The Modest Role of Criminal Law in Preventing Corporate Crime*, 55 FLA. L. REV. 937, 954-64 (2003).

adopted in the New York and Massachusetts proposals, and the new California legislation.

1. AGs Apply Governance Reforms to Nonprofits

The current AG proposals are somewhat less reliant on the Sarbanes-Oxley model in their enunciation of governance reforms than they are in adopting certification requirements. Still, even when state AGs veer slightly from the Sarbanes-Oxley pattern in their attempts at nonprofit reform, the terms of the federal Act and its financial focus remain the clear starting point for their proposals. Again, the New York proposal provides the most comprehensive case study.[201]

a. Default Rules for Committees

The most significant committee-related reforms in both the federal Act and the New York proposal address the establishment of audit committees and standards for their performance.[202] Sarbanes-Oxley assigns various audit-related responsibilities to all issuers and mandates that audit committees, or the full board of directors in lieu of such a committee, must perform these duties.[203] The New York bill's substantive auditing reforms apply only to a limited class of nonprofits: those with a significant level of financial magnitude or sophistication.[204] Therefore, it requires only these nonprofits to establish audit committees.[205] Individual nonprofits also can contract around this

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[201] Portions of the Massachusetts draft legislation and the new California enactment will be discussed to the extent they provide relevant contrasts.

[202] At least one commentator advocated for requiring charities to have an audit committee function prior to the adoption of Sarbanes-Oxley. *See* Karyn R. Vanderwarren, Note, *Financial Accountability in Charitable Organizations: Mandating an Audit Committee Function*, 77 CHI.-KENT L. REV. 963, 976-78 (2002).

[203] Sarbanes-Oxley Act § 205(a)(58); *see also* Final NYSE Corporate Governance Standards, at 9-10 (Nov. 4, 2003) (imposing audit committee requirement for listed companies), *available at* http://www.nyse.com/pdfs/finalcorpgovrules.pdf (last visited Oct. 11, 2004); The Nasdaq Stock Market, Marketplace Rule 4350(d1) (imposing similar requirement), *available at* http://cchwallstreet.com/nasd/nasdviewer.asp? SelectedNode=4&FileName=/nasd/nasd_rules/RulesoftheAssociation_mg.xml#chp_1_4 (last visited Oct. 11, 2004).

[204] *See* S.B. 4836-B, 227th Leg. Sess. § 4(g)(1) (N.Y. 2004) (imposing new auditing duties on those nonprofits whose financial reports are audited by certified public accountant, that have at least $3 million in assets, or that receive at least $1 million in gross revenue and support in any fiscal year). For a discussion of the substance of these responsibilities, see *infra* Part IV.B.1.b.

[205] N.Y. S.B. 4836-B § 4(g)(1). The original version of the New York bill imposed auditing responsibilities and the audit committee requirement on nonprofits of

requirement.[206] However, as under Sarbanes-Oxley, organizations without audit committees will not escape the audit responsibilities the New York bill imposes. In such cases, the full board of directors assumes these duties.[207]

The New York proposal also borrows heavily from Sarbanes-Oxley in drawing its criteria for audit committee independence. The federal Act issues a directive that all audit committee members must be independent — which it defines as financial independence.[208] To be considered independent, a member of the audit committee must not "accept any consulting, advisory, or other compensatory fee from the issuer," other than compensation as a member of the board or the audit committee, and must not be otherwise affiliated with the issuer or any of its subsidiaries.[209] The New York bill demands similar measures of financial independence for audit committee members. Audit committee members cannot "accept any consulting fee, advisory fee, or other compensation or other benefits from the corporation," except compensation received as a member of the board or its committees.[210] Furthermore, to qualify to serve on an audit committee, a director must not have participated as an interested party in any transactions with the nonprofit within the prior year.[211]

Although Sarbanes-Oxley and the state AG proposals share many tactics, they do part company on some committee-related reforms. For instance, the New York bill requires nonprofits with large boards to

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significantly less financial magnitude. *See* S.B. 4836, 226th Leg. Sess. § 4(f) (N.Y. 2003) (triggering audit committee requirement at annual "gross revenue and support in excess of two hundred fifty thousand dollars"). The Massachusetts draft legislation and new California enactment also impose audit committee requirements linked to a nonprofit's financial magnitude. *See* Mass. Draft Leg. 1.0, *supra* note 153, § 3(1) (requiring audit committees only for public charities that "receive or accrue in any fiscal year gross revenue and support of at least" $750,000); The Nonprofit Integrity Act, 2004 Cal. Stat. ch. 919, § 7(e)(2) (as signed by governor Sept. 29, 2004) (imposing audit committee requirement on any charitable corporations that "receives or accrues in any fiscal year gross revenue of . . . $2,000,000 or more"), *available at* http://www.leginfo.ca.gov/pub/bill/sen/sb_1251-1300/sb_1262_bill_20040930_chaptered.pdf (last visited Oct. 20, 2004).

206 N.Y. S.B. 4836-B § 4(g)(1) (excepting from audit committee requirement those nonprofits whose organic documents forbid use of such committee).

207 *Id.* § 4(g)(2); *see also* Sarbanes-Oxley Act § 205(a)(58)(B) (requiring audit responsibilities to be carried out by "the entire board of directors of the issuer" if issuer does not have audit committee).

208 *See* Sarbanes-Oxley Act § 301(3)(A)-(B).

209 *Id.* § 301(3)(B). These independence criteria can be waived by the SEC. *Id.* § 301(3)(C).

210 N.Y. S.B. 4836-B § 4(g)(3)(A).

211 *Id.* § 4(g)(3)(B). These same criteria are adopted in the Massachusetts draft legislation. Mass. Draft Leg. 1.0, *supra* note 153, § 3(2).

name an executive committee, a reform that has no corollary in Sarbanes-Oxley, the new California statute, or the Massachusetts draft legislation.[212] On the other hand, the state proposals are silent on some other committee-related requirements that Sarbanes-Oxley does impose. For example, none of the proposals demand disclosures regarding the financial expertise of audit committee members, as the federal Act requires.[213]

b. New Substantive Auditing Duties

Both Sarbanes-Oxley and the state proposals also impose new substantive duties on audit committees. Again, however, the two sets of legislation differ in scope. The federal Act imposes its new auditing responsibilities on all issuers, while the New York, Massachusetts, and California reforms' enhanced auditing duties are imposed only on large nonprofit corporations and those smaller nonprofits that already engage in audits.[214] However, one still can trace much of the substance of the auditing responsibilities prescribed in the state bills directly to Sarbanes-Oxley. The New York bill speaks in somewhat more general terms than the federal Act, requiring the audit committee to appoint any accounting professionals employed to engage in auditing work, to set the accountants' compensation, and to oversee their work.[215] The bill also directs the audit committee to receive reports of failures in internal

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[212] N.Y. S.B. 4836-B § 4(f) (imposing an executive committee requirement on nonprofits with boards of directors of twenty-five or more members, unless a particular nonprofit's bylaws prohibit use of such committee).

[213] *See* Sarbanes-Oxley Act § 407(a) (directing SEC to adopt rules within months of Act's adoption to require issuers to disclose in reports to SEC whether their audit committees include one or more financial experts); 17 C.F.R. § 229.401(h) (2004) (adopting such rules). An earlier version of the California proposal actually did contain a financial competence requirement for audit committee members — one that was even stronger than Sarbanes-Oxley's disclosure rule. This language does not appear in the version ultimately enacted. *Compare* Attorney General, State of California, Proposed Amendments to Government Code, Section 12580, at 3 (unpublished memorandum on file with author) (requiring at least one audit committee member to "have sufficient financial training or experience" to understand accounting techniques and financial statements and to understand, analyze, and assess audited financial statements and auditor's competence), *with* The Nonprofit Integrity Act, 2004 Cal. Stat. ch. 919, § 7(e)(2) (as signed by governor Sept. 29, 2004) (including no such requirement), *available* http://www.leginfo.ca.gov/pub/bill/sen/sb_1251-1300/sb_1262_bill_20040930_chaptered.pdf (last visited Oct. 20, 2004).

[214] *See* 2004 Cal. Stat. ch. 919, § 7(e), *available at* http://www.leginfo.ca.gov/pub/bill/sen/sb_1251-1300/sb_1262_bill_20040930_chaptered.pdf (last visited Oct. 20, 2004); N.Y. S.B. 4836-B § 4(g)(1)-(2); Mass. Draft Leg. 1.0, *supra* note 153, § 3.

[215] N.Y. S.B. 4836-B § 4(g)(2). The Massachusetts draft legislation and California enactment set similar tasks for audit committees. *See* Mass. Draft Leg. 1.0, *supra* note 153, § 3(2).

controls from officers signing required certifications and from accounting professionals engaged in audit functions.[216] The establishment of these responsibilities mirrors the instructions by Sarbanes-Oxley that issuers' audit committees must preapprove auditing services[217] and receive various mandatory reports and disclosures by a firm's auditors.[218]

The New York and Massachusetts proposals also adopt Sarbanes-Oxley's position that audit committees should enable whistleblowing. In language virtually identical to that of the federal Act, the New York bill charges the audit committee with creating a process for receiving complaints, including the anonymous concerns of employees, regarding accounting, accounting controls, auditing, and other financial matters.[219] Unlike Sarbanes-Oxley, however, the New York bill's protection of whistleblowers stops there. In an attempt to protect individuals who might bring future scandals to light, the federal Act creates civil and even criminal penalties for interference with the employment of corporate whistleblowers.[220] The New York proposal limits its protection of whistleblowers to the instruction that nonprofit audit committees must provide avenues for them to disclose relevant suspicions or information. In this regard, the Massachusetts draft legislation more closely approximates Sarbanes-Oxley. Although it does not authorize criminal sanctions, it would permit the AG to seek various civil remedies on behalf of a whistleblower who has experienced retaliation.[221]

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[216] N.Y. S.B. 4836-B §§ 1(e)(4), 4(g)(2).

[217] Sarbanes-Oxley Act § 202 (demanding that issuer's audit committee preapprove all auditing and non-auditing services provided to issuer, with only de minimis exception).

[218] *Id.* § 204(k) (directing auditors to report to audit committee accounting policies, practices, and alternative treatments of financial information used or considered in audit, and any material communications between auditing firm and management of issuer).

[219] N.Y. S.B. 4836-B § 4(g)(4). *Compare id., with* Sarbanes-Oxley Act § 301(4) (instructing issuers' audit committees to "establish procedures for (A) the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and (B) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters"). The Massachusetts draft legislation goes one step further; in addition to requiring audit committees to establish procedures to receive, retain, and treat these complaints, they are also instructed to forward such complaints to the attorney general on at least an annual basis. *See* Mass. Draft Leg. 1.0, *supra* note 153, § 3(4)-(5). The California enactment does not impose a whistleblowing function on nonprofit audit committees.

[220] *See* Sarbanes-Oxley Act § 1107.

[221] *See* Mass. Draft Leg. 1.0, *supra* note 153, § 5(a) (providing for employee to be reinstated and receive compensation and backpay, as well as allowing for imposition of order prohibiting recurrence of unlawful retaliatory conduct at issue). Notably, New York's general whistleblower law will make many of the same remedies available to an employee who brings a civil action, but it does not invoke the attorney general's authority.

c. Regulation of Directors and Officers

Finally, both the New York bill and Sarbanes-Oxley substantively regulate the loyalty of corporate fiduciaries.[222] Sarbanes-Oxley does so by prohibiting issuers from extending credit to their officers or directors.[223] New York nonprofit law already imposes such a ban on personal loans to nonprofit directors and officers.[224] But AG Spitzer again took a cue from Sarbanes-Oxley by including within his reform proposal a substantial overhaul of the state's legal framework for regulating interested party transactions.[225]

Currently, New York law protects transactions between a nonprofit corporation and one or more of its directors or officers,[226] so long as they are approved by a sufficient vote of disinterested directors or members, after full disclosure of any relevant conflicts of interest.[227] This vote alone

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See N.Y. LAB. LAW § 740 (McKinney 2002).

[222] Stand-alone legislation addressing interested party transactions in nonprofit corporations also was introduced in the New York State Assembly in 2004. *See* S.B. 7219A, 227th Leg. Sess. (N.Y. 2004); A.B. 11292A, 227th Leg. Sess. (N.Y. 2004). The provisions of these bills are identical to Section 5 of AG Spitzer's nonprofit Sarbanes-Oxley proposal, which would repeal N.Y. NOT-FOR-PROFIT CORP. LAW § 715 (McKinney 1997), and substitute it with the new language and provisions described *infra* notes 228-32 and accompanying text.

[223] *See* Sarbanes-Oxley Act § 402; *see also* Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 859, 877 (2003).

[224] N.Y. NOT-FOR-PROFIT CORP. LAW § 716 (McKinney 1997).

[225] The Massachusetts draft legislation likewise takes this opportunity to revise its legal regime governing related party transactions and compensation. *See* Mass. Draft Leg. 1.0, *supra* note 153, § 4. The California enactment adds just one new requirement, that boards of directors must review the compensation of their president/CEO and treasurer/CFO upon initial employment and at each new employment contract, contract renewal, or modification. *See* The Nonprofit Integrity Act, 2004 Cal. Stat. ch. 919, § 7(g) (as signed by governor Sept. 29, 2004), *available at* http://www.leginfo.ca.gov/pub/bill/sen/sb_1251-1300/sb_1262_bill_20040930_chaptered.pdf (last visited Oct. 20, 2004).

The New York bill also includes various modifications to nonprofit indemnification law. *See* S.B. 4836-B, 227th Leg. Sess. § 6 (N.Y. 2004). The original bill included a more "thorough-going revision" of the state's indemnification regime for nonprofits, but the AG's office trimmed its indemnification proposals in response to a wary reception from nonprofit organizations and their counsel. *See* Remarks of William Josephson, Assistant Attorney General-in-Charge, Charities Bureau, to the Funders Alliance of Upstate New York 8 (Sept. 30, 2003) (on file with author).

[226] In addition to these classic interested transactions, the proposed new statute includes as an interested transaction any contract or transaction, entered into directly or indirectly, between a nonprofit corporation and a director or officer of one of its affiliates or between an entity in which an affiliate's director or officer is a fiduciary or has a substantial financial interest. N.Y. S.B. 4836-B § 5(a).

[227] N.Y. NOT-FOR-PROFIT CORP. LAW § 715(a) (McKinney 1997). If appropriate disclosure and/or voting does not occur to bless the transaction, the statute states that the

would appear to protect self-dealing transactions from avoidance. The current statute imposes no explicit additional requirement of substantive fairness to safeguard a procedurally correct transaction. The New York proposal would add such a fairness and reasonableness requirement in order to protect any interested transaction.[228] It also would provide a safe harbor; an interested transaction will be presumed to be fair and reasonable to a corporation if additional procedures are followed.[229] In addition to a vote of disinterested directors after full disclosure, the additional procedures require approving directors to obtain and use comparability data to evaluate the transaction prior to approving it and to document the basis for their approval.[230] Under the proposal, either the relevant nonprofit or the AG may move to void or modify noncompliant interested transactions, so long as doing so would not further damage the nonprofit.[231] The corporation or the AG also may seek monetary compensation from the interested parties and approving directors, if they are unable to prove the fairness and reasonableness of the challenged transaction.[232]

The New York proposal also imposes a new and stricter approval process for director and officer compensation.[233] Presently, state law does not specifically address nonprofit director compensation other than

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transaction will be voidable unless the interested parties can affirmatively establish it to have been fair and reasonable to the corporation at the time it was undertaken. *Id.* § 715(b).

[228] N.Y. S.B. 4836-B § 5(a). Interestingly, the proposed bill requires that the interested party *and any approving director* must establish the fairness and reasonableness of any relevant transaction, in order to preclude its avoidance. *Id.*

[229] *Id.* § 5(b).

[230] *Id.* § 5(b)(1)-(3). The bill requires that nonprofit corporations specifically document the date and terms of interested transactions, the members of the board or committee who approve them, the comparability data used to evaluate the transactions and the provenance of such data, and any actions by interested directors regarding consideration of these transactions. *Id.* § 5(b)(3).

Rather than mimicking the federal Sarbanes-Oxley Act, these sections of the New York bill borrow from another area of federal law, Internal Revenue Code § 4958 and its accompanying regulations, which impose a framework for approving and sanctioning self-dealing transactions in certain tax-exempt entities. *Compare* N.Y. S.B. 4836-B § 5(b), *with* 26 C.F.R. § 53.4958-6(a) (2002). This framework was suggested by nonprofit organizations in response to the similar, but somewhat more complex, safe harbor provided by the original bill. *See* Draft Memorandum to Eliot Spitzer et al., from NPCC Government Relations Committee Attached to Letter from Jon Small, Chair of the NPCC Government Relations Committee to Eliot Spitzer et al., 22-23 (Mar. 14, 2003) (on file with author); Letter from David M. Nocenti, *supra* note 178, at 3.

[231] N.Y. S.B. 4836-B § 5(c).

[232] This compensation is determined by reference to penalties imposed under the federal tax regime described, *supra* note 230, regardless of whether the IRS could or does take action under that regime. *See* N.Y. S.B. 4836-B § 5(c).

[233] *See* N.Y. S.B. 4836-B § 5(e)-(f).

to permit the board to set it,[234] though as a transaction between a corporation and its directors, it would be covered by the general requirements for interested transactions. The new proposal requires director compensation for board service to be set by an affirmative vote of a *majority of the entire board* and to be fair and reasonable.[235] Compensation decisions are subject to these rules regardless of their magnitude, although other types of interested transactions are exempt from the new safe harbor procedures if the interested party is unaware of the transaction and it is of relatively small financial value.[236] Moreover, the bill imposes monetary liability on approving board or committee members if they fail to follow the special procedures it dictates for compensation decisions.[237]

2. The Financial Focus of AG Nonprofit Governance Reforms

The state proposals' mandated changes to governance structures may have some effect on organizational accountability, but the regulatory impact of these changes remains concentrated on financial accountability. The executive committee requirement for large boards is perhaps the New York bill's best example of pure organizational accountability reform. It takes as its starting point the proposition that the mere size of a very large board inhibits its ability to function as a demanding supervisor of organizational affairs.[238] Therefore, the bill requires the designation of a subgroup more able to play that vital organizational role, so long as the nonprofit's organic documents do not prohibit it from doing so. This mandate forces nonprofits to alter their structures in order to improve the likelihood of director attention and effectiveness, seemingly in an attempt to strengthen organizational

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[234] *See* N.Y. NOT-FOR-PROFIT CORP. LAW § 715(e) (McKinney 1997). As to officer compensation, current law merely requires an affirmative vote by a majority of the board, unless some higher voting threshold is provided by the corporation's charter or bylaws. *Id.* § 715(f).

[235] N.Y. S.B. 4836-B § 5(f). Director and officer compensation for services other than those as directors or officers may be set by the board, by a vote of the members, or by a board committee, provided that committee members may not be compensated by the corporation other than as directors. *Id.* § 5(e). Throughout the compensation context, the New York proposal defines fairness and reasonableness by reference to federal tax requirements described, *supra* note 230. *See* N.Y. S.B. 4836-B § 5.

[236] N.Y. S.B. 4836-B § 5(h) (exempting from interested transaction regime those non-compensation transactions of which relevant fiduciary has no actual knowledge and that are valued at $100,000 or less than 1% of nonprofit's gross receipts for prior year, whichever is lower).

[237] *Id.* § 5(c). Liability is again determined by reference to the federal tax regime. *Id.*

[238] *See* Remarks of William Josephson, *supra* note 225, at 12-13.

accountability. However, interestingly, the original bill triggered the executive committee requirement not on the basis of board size, but rather on the basis of the nonprofit's annual revenues, suggesting that the initial motive was financial.[239]

Unfortunately, even utilizing board size as the trigger for a required executive committee, the impact of this requirement is blunted because the New York bill does not actually assign any tasks to these committees. This is not to say the reform is useless, just short of ideal. Requiring large boards to designate this committee expresses concern for the problems of very large boards and forces them to confront the problem of size at least once. If executive committees exist in name only, they are unlikely to achieve any organizational accountability gains. But once executive committees are formed, at least in some cases, they will take on tasks and improve the performance of nonprofits.

The auditing reforms in all of the state proposals also include elements of organizational accountability reform. These reforms take the lesson from Sarbanes-Oxley that audit functions are important and that their independence from other functions of directors and officers is necessary to produce reliable audit information. Thus, the reforms require nonprofits of a certain financial size or level of sophistication to institute audit committees to serve this function. By creating a governance structure and establishing qualifications for participation within it, these reforms seek organizational accountability. They attempt to increase directors' attention, objectivity, and effectiveness. And the audit committee reforms in the proposals are a significant improvement over the executive committee requirement in the New York bill in this regard, because they assign several significant tasks to audit committees.

However, the auditing reforms' attempts to improve organizational accountability exist primarily in service of financial accountability goals. The proposals target specific groups of nonprofits upon which to impose the audit committee structure; these groups line up precisely with financial accountability's twin aims of asset and donor protection.[240] Each requires an audit committee for nonprofits with significant assets, revenues, or support, targeting those nonprofits with the greatest

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[239] *Compare* N.Y. S.B. 4836-B § 4(f) (requiring executive committee for nonprofits with more than 25 directors), *with* S.B. 4836, 226th Leg. Sess. § 4(f) (N.Y. 2003) (requiring executive committee for nonprofits with more than $250,000 in annual gross revenue and support).

[240]. Again, concern over the capacity of small asset/revenue nonprofits to comply with complex committee structures also likely played a role in setting these financial triggers. *See supra* note 192.

amount of assets to protect. The New York bill also requires an audit committee to be established within nonprofits that already obtain audited financial statements, which likely do so to comply with regulatory requirements regarding charitable solicitation.[241] Furthermore, the office for which each proposal demands more accountable organizational structures is quintessentially financial. The AGs' proposals charge audit committees with keeping track of their nonprofits' financial assets by acquiring auditors' reports, disclosures regarding weaknesses in internal financial controls and internal frauds, and collecting whistleblower complaints regarding accounting, auditing, and other financial matters.

Finally, even the reforms of interested party transaction law target financial accountability. The New York and Massachusetts proposals focus on nonprofit directors and officers and establish board procedures for safeguarding various transactions from attack. However, the transactions in question are those that threaten a nonprofit's assets — loyalty breaches, with all three bills particularly focusing on executive compensation. These reforms invoke governance solutions, but they do not appear to do so in order to make boards function better or to focus nonprofit fiduciaries on issues of mission. Rather, the proposals use governance solutions in order to achieve financial accountability: to protect nonprofit assets and, by extension, donors.

In working their governance reforms, the AGs' proposals closely follow relevant portions of Sarbanes-Oxley. The adaptations of the federal Act's provisions in this context are not uniformly as direct as in the proposals' disclosure reforms, but the influence of Sarbanes-Oxley on their drafters is clear. The governance reforms introduced by these proposals again demonstrate the precedence of financial accountability in the AGs' nonprofit enforcement agenda. They require enhanced committee structures in financially significant and sophisticated nonprofits, but not in their smaller counterparts. The proposals impose their most aggressive reforms of governance structure in the context of auditing, concentrating these additional governance resources on tracking nonprofits' finances. In their reforms of fiduciary law, the proposals address those situations where nonprofit assets are most at risk: instances of self-dealing transactions and compensation. In all of these respects, these proposals repeat the financial accountability focus seen in AGs' efforts across the spectrum of nonprofit enforcement.

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[241] Existing state law requires an audit for those nonprofits that engage in charitable solicitation of more than $250,000 annually or that use a professional fundraiser. N.Y. EXEC. LAW § 172-b(1) (McKinney 2003).

C. *Conclusions from State Efforts to Adapt Sarbanes-Oxley to Nonprofits*

The commonality among all of Sarbanes-Oxley's disclosure and governance reforms is that each addresses financial accountability as its principal, if not its exclusive, aim. The recent nonprofit reform legislation proposed by activist state AGs adopts the same financial orientation. Some of the reform measures may affect organizational accountability, but a careful analysis of the proposals reveals that their priority is to protect donors and nonprofit assets. Any impact on mission accountability achieved by these reforms will occur merely by happenstance.

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AGs do indeed seem to be ramping up their enforcement efforts in the nonprofit context. They are using their authority to initiate litigation and their regulatory powers to expand monitoring of nonprofits. At the vanguard, a few AGs have advocated for new nonprofit legislation using Sarbanes-Oxley as a model. In each of these efforts, the priority of financial accountability to AGs is apparent. The New York Attorney General's Office has billed its reforms for the nonprofit sector as consumer protection, though this time for donors, and its safeguards are specifically described as protection against the dissipation of charitable assets.[242] Massachusetts Attorney General Tom Reilly described his draft legislation as addressing the need for charities "to restore the trust and confidence of donors, the public and regulators in their financial competence and integrity;" California Attorney General Bill Lockyer likewise hopes his legislation will "shore up donor confidence."[243] The substance of these proposed reforms demonstrates, once again, that financial accountability concerns dominate AGs' nonprofit enforcement agendas, bearing out the predictions of AG priorities made in Part II. Thus, even activist state AGs will fail to assure comprehensive nonprofit accountability. With this in mind, Part V begins the process of considering alternative mechanisms by which nonprofits' mission and organizational accountability might be enforced effectively.

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[242] *See* N.Y. AG Press Release, *supra* note 145, at 1.

[243] Mass. Summary, *supra* note 145, at 1; Williams, *Calif. Passes New Law*, *supra* note 155, at 32 (quoting AG Lockyer's comments on the California legislation).

V. THOUGHTS ON COMPLEMENTS TO AG ENFORCEMENT

Renewed vigor by AGs to regulate charitable solicitation, to litigate duty of loyalty violations, or to legislate additional disclosure or auditing mechanisms does not address mission and organizational accountability — or impacts them only as unintended, if positive, consequences. Thus, some other mechanisms must be found or created to tackle these real, though often less concrete, challenges. Various commentators have advocated the establishment of new government entities or the use of other governmental or regulatory pathways in order to deter failures of nonprofit accountability.[244] This Part takes a different approach and instead offers initial thoughts on the extent to which self-regulatory means of addressing accountability problems may be used to improve organizational integrity and control mission creep in the nonprofit sector. Of course, a full evaluation of these techniques is a topic for another day. The purpose of this Article is to explain the financial accountability bias of state AGs and the need for additional enforcement mechanisms to complement AG efforts. The discussion that follows is intended only to begin the quest to find these complementary methods of enforcing nonprofit accountability.

A. *Contracting for Accountability*

One means of attaining any goal familiar to lawyers and legal scholars is through contract. For contracting to improve nonprofit mission and organizational accountability, at least three preconditions are necessary. First, some institution or institutions must be available and interested in contracting with nonprofits for mission and organizational accountability. Second, nonprofits must have some interest in engaging in these contracts. These first two preconditions essentially require parties to serve as willing buyers or sellers. In addition to an interest in

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[244] *See, e.g.*, Fishman, *supra* note 1, at 272 (proposing establishment of citizen advisory commissions to assist AGs in their oversight of charities by receiving and reviewing complaints regarding activities of charities, their fiduciaries, and employees); Joel L. Fleishman, *Public Trust in Not-for-Profit Organizations and the Need for Regulatory Reform*, *in* PHILANTHROPY AND THE NONPROFIT SECTOR IN A CHANGING AMERICA 188-91 (C.T. Clotfelter & T. Erlich eds., 1999) (advancing idea that independent federal agency should be created to deal with all aspects of nonprofit regulation); Hansmann, *supra* note 1, at 568-73, 606-22 (advocating comprehensive statutory reform program, including, *inter alia*, heightened standards for nonprofit fiduciaries, broadened standing to litigate alleged violations of nonprofit fiduciaries, and enhanced disclosure obligations); Karst, *supra* note 1, at 476-83 (proposing establishment of new state regulatory agencies to supervise charities, including monitoring and investigation of fiduciaries and enforcement of their obligations).

participating in a contracting solution, achievement or enhancement of organizational or mission accountability through contract also requires some means of contractual enforcement, the third precondition. Each side must be able to enforce the contracts it makes.

Professor Geoffrey Manne has suggested a creative contractual solution to nonprofit accountability.[245] He advocates the establishment of contract plaintiffs with standing to sue nonprofit fiduciaries for violations of their duties and nonprofit corporations for violations of their charters. He envisions a market for these contracts, where various for-profit monitoring agencies would vie to serve paying nonprofits in a contract plaintiff capacity. Manne's contract plaintiffs could thereby challenge violations of all three types of nonprofit accountability, without the political constraints experienced by AGs and without spurring waves of vexatious litigation. If such a market were to develop, it might well operate as a useful supplement to the finance-focused enforcement efforts of AGs. Of course, because such a market has not yet developed, one cannot be certain of the viability of this proposal in general. Further, the utility of adopting Manne's solution specifically to compensate for AGs' failures to enforce mission and organizational accountability is questionable. For-profit purveyors of contract plaintiff services might well concentrate their litigation efforts on failures of financial accountability for the same practical reasons government litigators do so.

However, at least for the subset of nonprofits that receive grant funding, private and government funders comprise an existing set of potentially interested contracting parties. These funders already engage in tracking nonprofits' financial accountability, to some extent. Recipients of funding from the federal government must provide significant documentation along with their applications and renewals, often including detailed financial auditing.[246] Foundations also require grantees to prepare reports tracking how and where grant distributions are spent.[247] Government and private foundation funders might be convinced that it is in their interest to contract for mission and organizational accountability as well. If these funders did begin to desire

[245] *See* Geoffrey A. Manne, *Agency Costs and the Oversight of Charitable Organizations*, 1999 WIS. L. REV. 227, 253 (1999).

[246] *See, e.g.*, U.S. Office of Management and Budget, Circular A-110 (Sept. 30, 1999) (requiring nonprofit recipients of federal grants to file annual Financial Status Reports), *available at* http://www.whitehouse.gov/omb/circulars/a110/a110.html (last visited Oct. 11, 2004); *see also* Brody, *Accountability and the Public Trust*, *supra* note 8, at 486-87.

[247] Paul N. Ylvisaker, *Foundations and Nonprofit Organizations*, *in* THE NONPROFIT SECTOR, *supra* note 140, at 360, 365.

or demand mission and organizational accountability from grant recipients, grantee nonprofits would have a very basic incentive to produce it: their need for funds.

There is some potential for useful contracting to occur in this context because funders have a vested interest in the mission and organizational accountability of the nonprofits they fund. Funders choose grantees with the hope of enabling a successful program or set of programs, in support of a range of goals and purposes the grantor and grantee share. If, through mission creep, a grantee's focus drifts from the range of shared purposes, the efficacy of the grant in achieving the funders' goals may be diminished. Further, when a funder makes a grant to a nonprofit, it must rely on the capacity and competence of the organization to transform these funds, in concert with its other resources, into some program or activity. Rather than running programs or activities on their own, grantmakers outsource the operation of programs they desire. If the nonprofit to whom they entrust their goals is sloppily managed, achievement of these goals is endangered. And, of course, nonprofits that attend to their mission and the integrity of their organizations may be better stewards or users of granted funds. Therefore, funders may be willing to contract for mission and organizational accountability, both for the independent utility of these kinds of accountability and as a means toward improving financial accountability.

Furthermore, both sides of a grantor-grantee arrangement have mechanisms by which to enforce contracts regarding organizational and mission accountability. Funders already condition their grants on various terms, often requiring grant applicants to describe how they would meet these terms and to report on their progress during grant administration or to obtain a renewal.[248] Grantors seeking to contract for organizational accountability might simply require new representations as to grantees' governance in the application process, and demand periodic reporting on governance activities during a grant or upon application for renewal. Tracking mission would be more difficult, but creative grantmakers could find the means to do so. Perhaps they could contract for a grantee to provide intermittent reports explaining how its activities continue to support its mission, or for briefings on how a grantee's mission is legitimately evolving.

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[248] *See* GRANTS MANAGEMENT NETWORK, BEST PRACTICES IN GRANTS MANAGEMENT (2001).

Funders could, therefore, perhaps operate as a useful contracting adjunct to the enforcement provided by AGs. However, this is not a solution without obstacles. On a practical level, funders must be persuaded that tracking these additional accountability measures offers benefits to them that exceed the cost of administration, likely a difficult task with funders anxious to keep administrative costs low. Indeed, recent media reports and Congressional efforts have challenged the level of foundation costs of administration as already too high.[249] In these days of budget deficits, the political branches also may be unwilling to allocate the resources necessary to improve public grant administration.

Perhaps more fundamentally, however, setting funders to the task of improving mission and organizational accountability may be a mismatch to even their best capabilities because funders' priorities may, at times, *cause* illegitimate mission creep. With grants in short supply, nonprofit directors or managers may informally shift their activities and priorities to match those funding streams available to them. Foundations and government entities might be convinced of the utility of policing their grantees' fidelity to the purposes for which they have received foundation or government funds. However, monitoring accountability to grantees' organizational purposes would demand greater objectivity and would require these funders to act out of more than enlightened self-interest. Further, relying on private foundations to monitor and enforce nonprofit accountability may be perceived as quite odd, since the private foundation segment of the nonprofit sector is often singled out as most prone to accountability failures and fiduciary misbehavior.[250] These caveats suggest that while this kind of contract solution to enforcing nonprofit mission and organizational accountability might develop to some extent, it is doubtful that grantor-grantee contracting alone can fill these serious gaps in AG enforcement.

B. *Signaling Intermediaries*

Another potential avenue for enforcement is to establish an apparatus that would provide signals of nonprofits' relative organizational and

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[249] Susan Carey Dempsey, *Points of View on Foundation Payout Increase*, ON PHILANTHROPY (May 31, 2003), *available at* http://www.onphilanthropy.com/tren_comm/tc2003-05-31a.html (last visited Oct. 7, 2004); Independent Sector, *Position Statement on Section 105, Reform of Certain Excise Taxes Related to Private Foundations, of The Charitable Giving Act of 2003 (H.R. 7), available at* http://www.independentsector.org/media/105statement.html (last visited Oct. 20, 2004).

[250] Crimm, *supra* note 51, at 1132; Stamler, *supra* note 116, at F1; Remarks of William Josephson, *supra* note 225, at 7.

mission accountability to which donors, patrons, and nonprofits themselves might respond.[251] Perhaps intermediaries could be established to review nonprofits' performance in these areas, and award them ratings to use in marketing themselves, particularly to donors. Through their Wise Giving Alliance program, the Better Business Bureau ("BBB") and the National Charities Information Bureau ("NCIB") joined together to investigate and offer reports on the operations of charities in 2001.[252] Other public and private entities also have entered the marketplace to engage in this kind of charity rating, often with a particular focus on financial issues.[253] The Maryland Association of Nonprofit Organizations has launched an accreditation program for its members and has replicated the program in several other states.[254] The Wise Giving Alliance has focused broadly on the various types of accountability issues discussed here, and recently began offering to charities the opportunity to obtain its National Charity Seal.[255] In effect,

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[251] For a general discussion and evaluation of standard-setting and accreditation efforts in the nonprofit sector, see Brody, *Accountability and the Public Trust*, *supra* note 8, at 480-82. *See also* Mark Sidel, *The Guardians Guarding Themselves: A Comparative Perspective on Nonprofit Self-Regulation*, 80 CHI.-KENT L. REV. (forthcoming 2005) (offering comparative analysis of accreditation techniques in Asia and United States).

[252] *See* Give.org, *About the BBB Wise Giving Alliance*, *available at* http://www.give.org/about/ index.asp (last visited Oct. 20, 2004).

[253] *See, e.g.*, American Institute of Philanthropy, *Charity Rating and Watchdog Report*, *available at* http://www.charitywatch.org (last visited Oct. 20, 2004); Charity Navigator, *How Do We Rate Charities*, *available at* http://www.charitynavigator.org/index.cfm/bay/ content.view/catid/2/cpid/35.htm (last visited Oct. 20, 2004); Office of New York State Attorney General Eliot Spitzer, *Pennies for Charities 2003*, *available at* http://www.oag.state.ny.us/charities/pennies03/penintro.html (last visited Oct. 20, 2004); *see also Taking Aim at Foundation Accountability*, STAN. SOC. INNOVATION REV. 52 (Winter 2003) (describing Surdna Foundation's current consideration of preparing "Zagat's guide" to foundations). *See generally* Independent Sector, *Accountability: Who's Doing What?* (collecting and describing accountability code and standard-setting efforts of large range of organizations), *available at* http://www.independentsector.org/issues/accountability /standards2.html (last visited Oct. 20, 2004).

[254] *See* Maryland Association of Nonprofit Organizations, *Earn the Standards for Excellence Seal: An Introduction to the Standards for Excellence* (describing group's Standards for Excellence program, in which nonprofits submit to review of various aspects of their operations, in order to obtain accreditation), *available at* http://www.marylandnonprofits.org/html/standards/index.asp (last visited Oct. 11, 2004). This program has received substantial attention from the press, and recently from the U.S. Senate Finance Committee, which advocated substantial use of accreditation programs in several of the proposals in its bipartisan staff discussion draft. *See* SFC White Paper, *supra* note 156, at 14-15; Rachel Emma Silverman, *Charities Start to Grade Themselves*, WALL ST. J., Aug. 18, 2004, at D1.

[255] Give.org, BBB Wise Giving Alliance, *Questions and Answers About the Seal for National Charities*, *available at* http://www.give.org/seal/faq.asp (last visited Oct. 20, 2004). The Alliance looks at four areas when it rates charities: governance and oversight, measuring

part of Professor Manne's contract plaintiff solution also provides a signaling function. He explains, "a donative charity perceived as uncontrolled in the midst of well-controlled alternative charities will be at a competitive disadvantage for the scarce dollars that are given to nonprofits."[256]

Signaling is certainly an option worthy of consideration and review. Yet, signaling works only if consumers will change their behavior in response to the signal, and will do so to an extent that motivates producers to change their behavior to improve their rating. Donors do seem interested in information regarding the percentage of donated funds used for charitable purposes, as opposed to administrative costs.[257] Similarly, they might like to know whether an organization to which they plan to contribute adheres to its mission and operates in line with its legal governance structure.[258] But, would a high rating on these metrics actually induce a donor to give or to give more? Perhaps donors would prefer mission to creep and make their contributions in order to secure change. Maybe donors consider legal governance to be costly and unimportant proceduralism, and would prefer organizations not to expend resources on it. Or, donors simply may value other information more in determining whether and how much to give, for their own idiosyncratic or non-rational reasons. It is not yet certain whether donors would respond sufficiently to a rating of mission and organizational accountability to inspire nonprofits supported by

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effectiveness, finances, and fundraising and informational materials. The first two areas address issues of organizational and mission accountability, respectively, while the latter two deal with financial concerns. The Alliance touts its comprehensive approach, explaining that it is different from other intermediaries because it:

> [L]ooks beyond "the numbers" while many other charity watchdogs confine their reports and conclusions solely to the charity's finances. The Alliance evaluates the charity's governance, fund raising practices, solicitations and informational materials, as well as how it spends its money. Therefore, compliance with this seal will send a more complete confirmation of the charity's accountability.

Id. The Maryland Standards for Excellence accreditation program also takes a wide-ranging approach, listing "Mission and Programs" as its first area for review and setting several governance benchmarks. *See* Maryland Association of Nonprofit Organizations, *supra* note 254.

[256] *See* Manne, *supra* note 245, at 254.

[257] *See* Stamler, *supra* note 116, at F1; Strauss, *supra* note 12, at F17.

[258] *Cf.* Laura B. Chisolm, *Accountability of Nonprofit Organizations and Those Who Control Them: The Legal Framework*, 6 NONPROFIT MGMT. & LEADERSHIP 141, 154 (1995) (asserting that "[t]he aggregation of informed individual judgments about what constitutes 'public benefit' results is more likely to give us what we want from our nonprofit sector than will attempts to legislate the ideal.").

contributions to improve.[259]

Furthermore, before signaling can improve mission and organizational accountability across the nonprofit sector, constituencies beyond donors also must be persuaded to heed such signals. Many fee-based nonprofits rely more heavily on consumer patronage than on donors for their financial well-being. In some industries where many commercial nonprofits operate, accreditation organizations signal the quality of the services nonprofits provide.[260] Particularly in the health care and education industries, accreditation can be a key tool in obtaining and maintaining substantial consumer bases.[261] To the extent that these or other valued accreditation systems include an analysis of the mission and organizational accountability in their evaluations and ratings of a nonprofit health care or educational institution, they provide a signal to which consumers and nonprofit producers could respond. Many such accrediting organizations explicitly inquire into the mission of the nonprofits they evaluate, how it is articulated and serviced by the institution's programs, and ask serious questions about governance mechanisms.[262] However, for this type of signaling solution to work in the commercial nonprofit arena, students, patients, and payors must be persuaded that following signals regarding mission and organizational accountability would serve their purposes. It remains to be seen whether these non-donor groups can be effectively persuaded to respond to these signals.

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[259] *See* David Bornstein, *Let's Make Sure Worthy Groups Get Aid,* CHRON. OF PHILANTHROPY, Jan. 22, 2004, at 37 (opining that "most donors . . . pay little attention to the comparative performance of the organizations they support," based on the limited information currently available, and advocating establishment of nonprofit research analysts to provide more).

[260] *See, e.g.,* Joint Commission on Accreditation of Health Care Organizations (JCAHO), *What is JCAHO?* (describing JCAHO accreditation process for health care organizations), *available at* http://www.jcaho.org/general+public/who+jc/index.htm (last visited Oct. 11, 2004).

[261] *See* Council for Higher Education (CHEA), *Informing the Public About Accreditation* (describing purposes and process of higher education accreditation), *available at* http://www.chea.org/public_info/index.asp#what (last visited Oct. 11, 2004); JCAHO, *Hospitals, How to Become Accredited, Benefits of Accreditation* (noting that JCAHO accreditation can facilitate approval to receive payment from Medicare and Medicaid, as well as from third party insurers), *available at* http://www.jcaho.org/htba/hospitals/benefits+of+accreditation.htm (last visited Oct. 11, 2004).

[262] *See, e.g.,* MIDDLE STATES COMMISSION ON HIGHER EDUCATION, CHARACTERISTICS OF EXCELLENCE IN HIGHER EDUCATION 1-3, 10-15 (2002) (describing requirements for meeting MCHE's standards for "Mission, Goals and Objectives" and "Leadership and Governance"), *available at* www.msache.org (last visited Oct. 11, 2004).

Lastly, for signaling to work, honest and effective raters of nonprofits must exist. An adaptation of Manne's contract plaintiff proposal to this purpose would envision a private market for these intermediaries. In this marketplace, intermediaries would offer rating services to nonprofits for a fee, in a model similar to that of health care or educational accreditation. Alternatively, as already has been seen, nonprofit private or public institutions might volunteer to serve as raters of mission and organizational accountability, financed by contributions or government funds. Either funding method would, of course, require the outlay of resources from typically strapped nonprofits or the public. The resource requirements of a signaling solution, like all of the potential complementary mechanisms presented here, may undercut its feasibility. Even if the resource requirements could be met, additional research is necessary to understand how accrediting organizations conduct their programs and to evaluate the effectiveness of the techniques they employ. In addition, some provision would need to be made to monitor the accreditors.

C. *Training and Empowering Nonprofit Actors*

A final method to complement AG enforcement of nonprofits' financial accountability is for the state or the nonprofit sector itself to commit to train those individuals involved with nonprofits in the importance of mission and organizational accountability, and to empower them to self-regulate.[263] In a practical sense, self-regulation is already the norm in these areas, because AGs have little incentive or ability to focus on them. However, committing resources to educating nonprofit actors in how to achieve and maintain these underenforced, but critical, aspects of accountability and empowering them to self-enforce, could enhance the effectiveness of self-regulation.[264] A commitment of educational resources might be obtained from AGs.[265] If nonprofit regulators could, as a group, be convinced to allocate a portion

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[263] Others have noted the importance of self-regulation as a complement to attorney general enforcement in more general terms. *See, e.g.*, Fleishman, *supra* note 244, at 186-87 (advocating creation of self-monitoring institutions within nonprofit sector, in order to complement governmental enforcement).

[264] *See* Swords, *supra* note 8, at 607-09.

[265] In a recent speech, AG Spitzer noted the importance of educating and training nonprofit fiduciaries in their financial role in promoting nonprofit accountability. Attorney General Eliot Spitzer, Keynote Address at Baruch College Conference, "New Pressures on Nonprofit Boards," (Feb. 19, 2004) (notes of speech on file with author) (stating concerns that some directors are unaware of their responsibilities to "look at financial statements" and "know where the money went" and asserting that "best thing" to do is "to educate).

of their budgets to providing or purchasing training services for nonprofits in their jurisdictions, that would be a grand solution. However, the incentive structure in which AGs operate, as discussed in Part II, makes it unlikely AG education efforts alone will sufficiently promote mission and organizational accountability.

But, one must not simply throw up one's hands in the face of a lack of interest by AGs. To remain thriving, important, and trusted, the nonprofit sector needs its organizations to demonstrate and cherish mission and organizational accountability. Therefore, the nonprofit sector itself should commit to compensating for a lack of government enforcement of these important components of nonprofit accountability. It can perhaps best do so through a commitment to training, capacity building, and institutional support. Many existing nonprofit trade associations have the knowledge and skills to offer training in improving mission and organizational accountability. They already offer programs and products to train nonprofit directors, officers, and employees in accounting, technology, and fund-raising.[266] They should also provide or increase their provision of legal and practical training on how to govern a nonprofit in compliance with its organizational form.[267] And, they should broaden their existing offerings to include or increase training for these nonprofit actors in how to evaluate and track mission.[268] Other approaches might attempt to restructure governance or standing rules to empower employees,[269] members,[270] or even the public[271] to monitor

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[266] *See* Support Center for Nonprofit Management, Customized and On Site Training Services, *available at* http://www.supportctr.org/customized-training.php (last visited Oct. 20, 2004); Technical Assistance for Community Services (TACS), Training and Consulting Resources for Nonprofit Organizations, *available at* http://www.tacs.org /training/dirtemplate.asp?pID=42 (last visited Oct. 20, 2004); *see also* Council of Community Services of New York State, Inc., Helping Nonprofits–Training (advertising training offered to nonprofit directors by consortium of state agencies other than attorney general), *available at* http://www.ccsnys.org/np_train_sbtc.htm (last visited Oct. 20, 2004). Recent reports of universities offering courses to foundation employees suggest that fairly rigorous training is becoming available, at least for some segments of the nonprofit community willing and able to pay for it. *See* Scott Westcott, *Two Universities Start Efforts to Provide Formal Training to Grant Makers*, CHRON. OF PHILANTHROPY, Sept. 15, 2004, *passim*.

[267] *See* Swords, *supra* note 8, at 578-80 (advocating training on nonprofit tax filings).

[268] The recent model code of ethics released by Independent Sector evidences a small step in this direction. Most of its content remains focused on financial accountability issues, but the importance of mission and governance are highlighted as well. *See* Independent Sector, *Statement of Values and Code of Ethics for Nonprofit and Philanthropic Organizations*, *available at* http://www.independent sector.org/members/code_main.html (last visited Oct. 20, 2004).

[269] *See, e.g.*, Peggy Sasso, Comment, *Searching for Trust in the Not-for-Profit Boardroom: Looking Beyond the Duty of Obedience to Ensure Accountability*, 50 UCLA L. REV. 1485, 1533-44 (2003) (describing changes to governance and standing law to empower nonprofit CEOs

organizational and mission accountability.

Of course, the resources necessary to provide nonprofit training programs always are limited. But perhaps there are methods available to counteract this scarcity problem. Investments in training technology ultimately may make educational efforts more affordable.[272] The government might be persuaded to mandate fiduciaries' attendance at such training sessions, in a scheme akin to the continuing education requirements imposed by many states on their professionals.[273] Maybe nonprofits could be convinced to agree to a sliding scale of self-imposed fees to provide training, as small businesses agree to self-taxation to fund improved services to a foundering business district.[274] Or those associations of nonprofits that exist to represent the nonprofit sector might be prevailed upon to prioritize training focused on mission and organizational accountability, in recognition of their importance to sector-wide health and their unavailability elsewhere. More planning and consideration of options then is possible here will be required to create an effective commitment to self-enforcement of mission and

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and other professional staff members to monitor mission).

[270] Individual members currently face serious legal, collective action, and other obstacles in enforcing nonprofit accountability. I have addressed these in detail elsewhere. *See* Brakman Reiser, *supra* note 31, at 859-64. However, when members do exist, they have advantages in perceiving mission creep, and for some types of nonprofits, training and empowering members may allow for mission accountability gains. *See id.* at 844.

[271] *See, e.g.*, Blasko et al., *supra* note 55, at 52-78 (describing growing availability of private standing to enforce duties of charitable entities and fiduciaries); Susan N. Gary, *Regulating the Management of Charities: Trust Law, Corporate Law, and Tax Law*, 21 U. HAW. L. REV. 593, 647-48 (1999) (describing potential use of the public to enforce nonprofit accountability, in suits as relators).

[272] At least one interactive computer program has been created and marketed to guide nonprofit fiduciaries and employees through decision-making simulations, providing information on their legal responsibilities and giving them exposure to difficult situations before they arise in their organizations. *See* AUTODIDACTIX LLC, AVOIDING TROUBLE WHILE DOING GOOD: A GUIDE FOR NONPROFIT DIRECTORS AND OFFICERS (2004) (CD-ROM *available at* http://www.charitygovernance.com (last visited Oct. 11, 2004)). Tools like these can offer flexible, and perhaps less expensive, training experiences to nonprofit fiduciaries.

[273] *See, e.g.*, State Medical Licensure Requirements and Statistics, 2003, *Continuing Medical Education for Licensure Reregistration, at* http://www.ama-assn.org/ (last visited Oct. 11, 2004); Arizona State Board of Accountancy, *CPE Requirements, at* http://www.accountancy.state.az.us/cpe.asp (last visited Oct. 11, 2004); Supreme Court of Ohio, Commission on Continuing Legal Education, *Just the Facts — Continuing Legal Education for Attorneys, at* http://www.sconet.state.oh.us/ CCLE/ (last visited Oct. 11, 2004). Online programs may be particularly cost-effective.

[274] *See, e.g.*, Central Philadelphia Development Corporation website (describing self-funded "business improvement district dedicated to keeping the downtown of the nation's fourth largest metropolitan area clean, safe and attractive"), *available at* http://www.centercityphila.org/home/default.aspx (last visited Oct. 11, 2004).

organizational accountability. These preliminary ideas may, however, spark greater interest in addressing this vital need.

CONCLUSION

The resurgence of interest by state AGs in exercising their oversight responsibilities in the nonprofit sector certainly should be applauded as an improvement over decades of relative inactivity. However, AG enforcement will never uniformly address the range of problems experienced by nonprofit organizations and the range of missteps by nonprofit fiduciaries. Their legislative mandates, the skills of their staffs, and the concerns of voters will lead AGs to focus their enforcement efforts on lapses of financial accountability.

This financial accountability bias afflicts even activist state AGs. Their litigation and regulatory efforts focus primarily on donor and asset protection. New Sarbanes-Oxley-type legislation, advocated by a few AGs, likewise heavily emphasizes financial issues. If enacted, these reforms might raise the level of financial transparency in nonprofit corporations, particularly those engaged in charitable solicitation and those with considerable assets. But, these reforms will have only minor impacts on organizational accountability and will do little or nothing to address the problem of mission creep. This primary, even sole, focus on financial accountability may be appropriate in the for-profit sector, where the goal of business organizations is to maximize profits for investors[275] and the well-being of so many Americans is tied up in the accurate and efficient portrayal of corporate finances. In the nonprofit sector, however, enforcement of financial accountability alone is utterly inadequate.

AGs' focus on the financial accountability of nonprofits, to the exclusion of mission and organizational accountability, leaves a gap in the assistance the nonprofit sector needs to play its necessary role in our society. The search for comprehensive nonprofit accountability, therefore, cannot end with an appeal to, or applause for, state AG activism. Rather, it is necessary to consider new mechanisms to stimulate mission and organizational accountability, including the potential mechanisms of self-regulation outlined here. To support and maintain a thriving nonprofit sector, additional enforcement methods must complement the role of AGs, to compensate for their particular focus on financial matters. Given the great importance of the nonprofit

[275] *See* Henry T.C. Hu, *New Financial Products, the Modern Process of Financial Innovation, and the Puzzle of Shareholder Welfare*, 69 TEX. L. REV. 1273, 1278-80 (1991).

sector in our economy and our society, a narrow focus on enforcing financial accountability is not nearly enough.