

LAW OFFICES  
**WEBSTER, CHAMBERLAIN & BEAN**  
1747 PENNSYLVANIA AVENUE, N.W.  
WASHINGTON, D.C. 20006  
(202) 785-9500  
FAX: (202) 835-0243

ARTHUR L. HEROLD  
ALAN P. DYE  
EDWARD D. COLEMAN  
JAY H. ROTZ  
FRANK M. NORTHAM  
JOHN W. HAZARD, JR.  
HUGH K. WEBSTER  
DAVID P. GOCH  
CHARLES M. WATKINS  
HEIDI K. ABEGG  
DAVID M. ABRAHAMS\*  
JOHN R. STROUT\*

GEORGE D. WEBSTER (1921-1996)  
CHARLES E. CHAMBERLAIN (1917-2002)  
OF COUNSEL  
J. COLEMAN BEAN  
KENT MASTERSON BROWN\*  
  
\*NOT ADMITTED TO DC BAR

**MEMORANDUM**

TO: Charities Soliciting in or Registered with California  
Professional Fundraising Consultants  
Professional Solicitors

FROM: Charles M. Watkins

DATE: January 26, 2005

RE: **California Legislation – Senate Bill 1262**  
**“The Non-Profit Integrity Act of 2004”**

The California legislature has passed, and Governor Schwarzenegger has signed, legislation that makes substantial changes to the rules governing charities required to be registered with the Attorney General’s Registry of Charitable Trusts (“the Registry”), and professional fundraising consultants and solicitors who contract with and perform services for such charities. The new rules are effective January 1, 2005, so charities and others subject to the new rules must act quickly to ensure that they are in compliance with the law.

This legislation was the subject of intense scrutiny and lobbying by the charitable community. The California Association of Nonprofit Organizations consistently opposed the legislation because of the unnecessary additional burdens it imposes on charities directly and (through additional costs on consultants and solicitors) indirectly. As a result of the Association’s leadership, and the contributions of dozens of its members and others, the bill that was signed into law by Governor Schwarzenegger is substantially improved over that which was introduced earlier in the year. Special thanks are due to Ken Larson for his tireless work on this legislation.

**This memorandum describes the principal provisions of the new legislation, but does not describe all of its provisions, and reading this memo is not a substitute for reading and understanding the import of the statutory language.** A copy of the legislation (as signed by the Governor) is available on the World Wide Web at:

[http://www.leginfo.ca.gov/pub/bill/sen/sb\\_1251-1300/sb\\_1262\\_bill\\_20040930\\_chaptered.pdf](http://www.leginfo.ca.gov/pub/bill/sen/sb_1251-1300/sb_1262_bill_20040930_chaptered.pdf).

Memo re Cal. SB 1262

January 26, 2005

Page 2

The California Attorney General has published a *Guide to the Nonprofit Integrity Act of 2004* and *Frequently Asked Questions* about the Act, both of which can be accessed from: <http://caag.state.ca.us/charities/>.

## CALIFORNIA REGISTRATION REQUIREMENTS

At the outset, it is important to understand that California's registration law is not a *charitable solicitation* registration law. Instead, it is a version of the Uniform Supervision of Trustees for Charitable Purposes Act. This act requires registration of organizations doing business or holding property in California for charitable purposes—it does not require registration merely because a charity is soliciting in California. The provisions of the Act (including the amendments made by S.B. 1262) are available on the World Wide Web at <http://www.leginfo.ca.gov/cgi-bin/displaycode?section=gov&group=12001-13000&file=12580-12599.5>.

Most charities that are conducting *intrastate* business in California – *i.e.*, they have offices or real or tangible personal property (not financial or investment accounts) located in California, or they have employees or agents who are located in or who regularly visit California—are required to register with and annually report to the Attorney General's Registry of Charitable Trusts. Forms CT-1 (Registration) and RRF-1 (Annual Report) are used for this purpose. The registration and reporting requirements enable the Attorney General to fulfill his duty to supervise charities to ensure that their assets are being properly used to fulfill the charity's purposes. These rules were not changed by S.B. 1262.

The registration requirement does not apply to religious organizations, to hospitals and educational institutions, or to charities that conduct only *interstate* business with persons in California. Thus, a charity whose only contacts with California are to solicit by mail, telephone, or other electronic means is not required to register. Similarly, infrequent visits to California by employees or agents of a charity that otherwise does not do intrastate business in California should not trigger the registration requirements.

Notwithstanding the clear language in the statute—that the term “Charitable corporation” means any nonprofit corporation organized under the laws of this State for charitable or eleemosynary purposes and any similar foreign corporation doing business or holding property *in this State* for such purposes”—the Attorney General has announced its position that—

The Act applies to all foreign charitable corporations (corporations formed under the laws of other states) doing business or holding property in California for charitable purposes. *Doing business in California includes soliciting donations in*

Memo re Cal. SB 1262

January 26, 2005

Page 3

*California by mail, by advertisements in publications or by any other means from outside of California.* Other examples of doing business in California include engaging in any of the following activities in California: holding meetings of the board of directors or corporate members here, maintaining an office here, having officers or employees who perform work here, conducting charitable programs here, and/or maintaining financial accounts or investments at an office of a financial institution located here. However, a charity is not doing business in California if its sole contact with this state is making purely discretionary grants to persons or entities located here.

<http://www.ag.ca.gov/charities/faq.htm#no1> (Jan. 17, 2005).

It is worth noting that the Attorney General has re-affirmed that it follows the “Charleston principles,” <http://www.nasconet.org/public.php?pubsec=4&curdoc=10>, for determining when a charity whose *sole* solicitation to California residents is via its website must register. (These guidelines generally eliminate registration for local or regional charities that maintain a website, but do not solicit in a state by mail, telephone, e-mail, advertising, etc.)

The Attorney General’s position—that even charities whose only contact with California is via interstate communications, or incidental activities such as holding an occasional board meeting in California or maintaining financial accounts at the California office of a financial institution—is a very broad interpretation of the phrase “doing business . . . in” California, particularly when compared with the exclusions for interstate activity in Cal Corp. Code §191(c), which are used to determine when a foreign nonprofit corporation must obtain a certificate of authority to transact intrastate business in California. It is also unlikely to withstand constitutional scrutiny.

**In contemplation of this legislation, religious organizations, and charities that do not conduct *intrastate* business in California, that have previously voluntarily registered with the Attorney General, should consider asking for confirmation that they are *not* required to register or file annual reports in the future.**

#### **NEW LAW APPLICABLE TO ALL CHARITIES SOLICITING IN CALIFORNIA**

Sections 17510 through 17510.95 of the Business and Professions Code impose certain requirements on *any* charity soliciting or conducting a charitable sales campaign in California, regardless of whether it is required to register with the Registry of Charitable Trusts. These statutes are available on the World Wide Web at <http://www.leginfo.ca.gov/cgi-bin/displaycode?section=bpc&group=17001-18000&file=17510-17510.95>.

Memo re Cal. SB 1262

January 26, 2005

Page 4

The only exceptions are for solicitations to members and solicitations conducted on the charity's "regular[ly] occupied premises." §17510.6. This exempts most solicitations by churches.

Sections 17510.3 and 17510.4 impose various disclosure requirements on charities soliciting in California. Section 17510.5 has been amended to require soliciting organizations to maintain their financial records on the basis of generally accepted accounting principles as defined by the AICPA, the Financial Accounting Standards Board, or the Governmental Accounting Standards Board.

### **NEW LAWS APPLICABLE ONLY TO CHARITIES, COMMERCIAL FUNDRAISERS, AND FUNDRAISING COUNSEL REQUIRED TO BE REGISTERED WITH THE REGISTRY OF CHARITABLE TRUSTS**

The following new or amended statutes apply only to those charities, commercial fundraisers, and fundraising counsel required to be registered with the Registry of Charitable Trusts. All section numbers refer to the Government Code. The provisions discussed below amend the Uniform Supervision of Trustees for Charitable Purposes Act, described above.

1. **Unincorporated associations.** Section 12581 and other sections are amended to clarify that the provisions of §§12580-§12599.8 (new) apply to unincorporated associations and other legal entities subject to the enforcement or supervisory powers of the Attorney General. Conforming changes are made to other provisions throughout the affected sections.

2. **Accelerated registration requirement.** Section 12585 is amended to require registration with the Registry of Charitable Trusts within 30 days (instead of 6 months) after receiving property or after a future interest, *e.g.*, a remainder interest, becomes a present interest.

3. **Audited Financial Statements.** Section 12586 is amended to impose certain audit-related requirements on any charity whose gross revenue in any fiscal year is at least \$2,000,000.

a. Charities whose gross revenue in any fiscal year is at least \$2,000,000 will be required to prepare financial statements using generally accepted accounting principles. The financial statements must be audited by an *independent* auditor in accordance with generally accepted auditing standards.

b. To be "*independent*," the auditor's relationship with the charity must satisfy the Government Auditing Standards issued by the Comptroller General of the United States. The Government Auditing Standards can be found at [www.gao.gov](http://www.gao.gov), and the sections addressing

Memo re Cal. SB 1262

January 26, 2005

Page 5

independence are found on pages 28-50 of the "Yellow Book." The general rule in the Yellow Book is:

**3.04** Auditors and audit organizations have a responsibility to maintain independence so that opinions, conclusions, judgments, and recommendations will be impartial and will be viewed as impartial by knowledgeable third parties. Auditors should avoid situations that could lead reasonable third parties with knowledge of the relevant facts and circumstances to conclude that the auditors are not able to maintain independence and, thus, are not capable of exercising objective and impartial judgment on all issues associated with conducting and reporting on the work.

**Comment: Many charities will not be familiar with the Yellow Book, because they receive no government funds. The statute also permits the Attorney General to issue regulations governing auditor independence, even if those standards differ from the GAO standards.**

c. The audited financial statements must be available to members of the public on the same basis as its Form 990 must be made available to the public. See I.R.C. §6104(d). A summary of the rules is included in the instructions to Form 990 (Item M).

The disclosure requirements also apply to charities with gross revenue of less than \$2,000,000, if they prepare financial statements that are audited by a CPA.

**Comment: Because many charities whose gross receipts are less than \$2,000,000 obtain audited financial statements, they will be subject to this disclosure rule.**

d. Audit committee. A charity that is a corporation that must have an audit committee appointed by the Board of Directors. The Committee may include non-directors, but not staff or senior management. A charity that has a finance committee must have a separate audit committee, the chairman of the audit committee may not be a member of the finance committee, and members of the finance committee (if any) must be a minority on the audit committee. In addition, the audit committee may not include any members of the staff, including the President or CEO and the Treasurer or CFO. Members of the audit committee may not receive any compensation from the corporation other than in their capacity as members to the Board of Directors, and may not have any material financial interest in any entity doing business with the corporation.

**Comment: This requirement will be difficult for small charities operated by employee-directors. It effectively requires each charitable corporation to have at least two non-employee directors, and will have the effect of eliminating finance committees. The**

Memo re Cal. SB 1262  
January 26, 2005  
Page 6

**Board of Directors should consider appointing outsiders to the audit committee, especially if they bring needed expertise to the audit committee.**

Subject to the supervision of the Board of Directors, the audit committee is responsible for retaining and terminating the auditor; setting the auditor's compensation; assuring that non-audit services performed by the auditor do not compromise the auditor's independence; conferring with the auditor to satisfy themselves that the financial affairs of the corporation are in order; and reviewing and approving the audit.

**4. CEO/CFO Compensation.** Section 12585(g) is added:

The Board of Directors of the charity must review and approve the compensation, including benefits, of the corporation's President or CEO, and its Treasurer or CFO, "to assure that it is just and reasonable." The review must occur when each individual is hired, when the term of employment (if any) is extended, and when the officer's compensation is modified (except in accordance with a modification affecting a relatively large number of employees, e.g., a 2% cost-of-living increase given to all employees).

**Comment:** The Board should not be charged with reviewing or approving the compensation of the CFO. "Best practice" leaves this to the discretion of the CEO or his delegate, because the CEO is responsible for the performance of the CFO, and this rule could be used to undermine the relationship between the CEO and the Board. In addition, CFOs are most commonly employees "at will" and do not have contracts that are renewed or extended.

However, because the Board of a charity registered in California is now charged with reviewing and approving the CFO's compensation, it should do so as "gently" as possible, deferring to the judgment of the CEO on the question unless it is unconscionable or illegal to do so. In order to avoid undermining the CEO, the Board should also not entertain direct communication from the CFO about his compensation package.

**5. Contract Provisions—Commercial Fundraisers (Professional Solicitors).**

**Comment:** According to the Attorney General, these requirements apply to all contracts with charities soliciting in California, regardless of whether the charity is required to be registered in California.

a. New Section 12599(h) requires that notice of a solicitation campaign by a "commercial fundraiser for charitable purposes" (professional solicitor) must be filed at least 10 days before the commencement of the solicitation campaign, events, or other services.

Memo re Cal. SB 1262  
January 26, 2005  
Page 7

Notice of solicitations in connection with disasters or emergencies may be filed concurrently with the commencement of solicitation.

b. New Section 12599(i) requires that each contract be signed by an official of the charity, and include all of the provisions listed below.

1. The legal name and address of the charity (unless it is exempt from registration);

2. A statement of the charitable purpose for which the solicitation campaign, events, or services are being conducted;

3. A statement of the respective obligations of the commercial fundraiser and the charity;

4. If the commercial fundraiser is to be paid a fixed fee, a statement of the fee to be paid, and "good faith estimate of what percentage the fee will constitute of the total contributions received." The contract must clearly disclose the assumptions upon which the estimate is based, and the stated assumptions must be based upon all of the relevant facts known to the commercial fundraiser regarding the solicitation to be conducted.

**Comment: Practically speaking, this is impossible, and the costs of preparing the required information will ultimately be paid by the charity.**

5. If a percentage fee is to be paid to the commercial fundraiser, a statement of the percentage of the total contributions received that will be paid to or retained by the charity, or if the solicitation involves the sale of goods services or admissions to an event, the percentage of the price that will be paid to the charity. The percentage must be calculated by taking into account not only the fundraiser's fee, but also other expenses that are incurred by the charity in connection with the solicitation.

**Comment: This, too, will be a difficult standard to satisfy. The commercial fundraiser may have no information regarding the expenses that may be incurred by the charity.**

6. The effective and termination dates of the contract and the date solicitation activity is to commence in California.

7. A requirement that each contribution in the control or custody of the commercial fundraiser must, within 5 days of its receipt, (a) be deposited in a bank or other financial account solely in the name of the charity and over which the charity has sole control of withdrawals, or (b) be delivered to the charity in person or via overnight delivery.

Memo re Cal. SB 1262

January 26, 2005

Page 8

8. A statement that the charity exercises control and approval over the content and frequency of any solicitation.

9. If payments for any person's attendance at, or sponsorship, approval, or endorsement of, a charity fundraising event are to be made, the maximum dollar amount must be stated in the contract.

10. The charity must have the right to cancel the contract without cost, penalty, or liability for a period of 10 days following execution, by serving written notice of the cancellation on the fundraiser. The cancellation is effective 5 days after the date of mailing; any funds collected after the effective date of cancellation are held in trust for the benefit of the charity without offset; and the charity is entitled to recover all funds collected after the date of cancellation. A duplicate copy of the notice of cancellation must be mailed to the Registry of Charitable Trusts. Waivers are not permitted.

**Comment: This is similar to New York's termination requirements.**

11. After the initial 10-day cancellation period, the charity must be permitted to terminate the contract on 30 days' notice by certified mail, subject to payment for services provided before the effective date of termination.

12. Following the initial 10-day cancellation period, the charity must be permitted to terminate the contract at any time without payment or compensation of any kind if the commercial fundraiser (1) makes any material misrepresentations in the course of solicitations or with respect to the charity; (2) has been convicted of a felony or misdemeanor arising from the conduct of the solicitation for a charity; or (3) otherwise conducts fundraising activities in a manner that causes or could cause public disparagement of the charity's good name or good will.

**Comment: This will lead to disputes regarding what is "material." In addition, the AG's publication of its annual report on telemarketing for charities suggests that any telemarketing contract "could cause public disparagement of the charity's good name or good will."**

**Comment: Statutory rights parallel to the requirements in items 10-12 above are added in new Section 12599.3(b) – (g).**

13. Any other information required by the Attorney General.

Memo re Cal. SB 1262

January 26, 2005

Page 9

- c. New §12599(j) requires certain disclosures by commercial fundraisers:

If requested by a person solicited, a commercial fundraiser must disclose “the percentage of total fundraising expenses” of the fundraiser. This percentage is the ratio of the total expenses of the fundraiser to the total revenue received by the fundraiser on behalf of the charity, reported on the charity’s most recent report to the Attorney General. The stated percentage must be calculated taking into account both the fees and expenses of the solicitation. Fee disclosures must be made within 5 working days after the receipt of written request. Oral disclosure of this information must be made immediately when a request is made in person or by telephone call, and must be followed up within 5 working days with the written information.

d. New §12599(l) prohibits anyone from acting as a commercial fundraiser for charitable purposes if that person, or any person with a controlling interest in the commercial fundraiser, or any person employed or contracted by the commercial fundraiser to solicit for compensation, has been convicted of a felony or misdemeanor involving dishonesty or arising from the conduct of a solicitation for a charity.

e. New §12599(m) prohibits a commercial fundraiser from soliciting in California on behalf of a charity that is neither registered nor exempt from registration with the Attorney General.

6. **Contract Provisions – Fundraising Counsel.**

**Comment: According to the Attorney General, these requirements apply to all contracts with charities soliciting in California, regardless of whether the charity is required to be registered in California.**

a. New §12599.1(e) requires that fundraising counsel notify the Attorney General not less than ten (10) working days before beginning to perform services for any charitable organization registered or required to be registered with the registry. As in the case of commercial fundraisers, the notice can be filed concurrent with the commencement of solicitations in the case of a disaster or other emergency.

b. New §12599.1(f) requires that each contract be signed by an authorized official of the charity, and include all of the provisions listed below.

1. The legal name and address of the charity (unless it is exempt from registration);

Memo re Cal. SB 1262

January 26, 2005

Page 10

2. A statement of the charitable purpose for which the solicitation campaign, events, or services are being conducted;

3. A statement of the respective obligations of the commercial fundraiser and the charity;

4. A clear statement of the fees and any other form of compensation, including commissions and property, that will be paid to the fundraising counsel;

5. The effective and termination dates of the contract, and the date services will commence with respect to solicitation in California;

6. A statement that the fundraising counsel will not at any time solicit funds, assets, or property for charitable purposes, receive or control funds, assets, or property solicited for charitable purposes, or employ, procure, or engage any compensated person to solicit, receive, or control funds, assets, or property for charitable purposes.

7. A statement that the charity exercises control and approval over the content and frequency of any solicitation.

8. The charity must have the right to cancel the contract without cost, penalty, or liability for a period of 10 days following execution, by serving written notice of the cancellation on the fundraiser. The cancellation is effective 5 days after the date of mailing; any funds collected after the effective date of cancellation are held in trust for the benefit of the charity without offset; and the charity is entitled to recover all funds collected after the date of cancellation. A duplicate copy of the notice of cancellation must be mailed to the Registry of Charitable Trusts. Waivers are not permitted.

**Comment: This is similar to New York's termination requirements.**

9. After the initial 10-day cancellation period, the charity must be permitted to terminate the contract on 30 days' notice by certified mail, subject to payment for services provided before the effective date of termination.

**Comment: Statutory rights parallel to the requirements in items 8-9 above are added in new §12599.3(b) – (f).**

10. Any other information required by the Attorney General.

Memo re Cal. SB 1262

January 26, 2005

Page 11

c. New §12599.1(g) prohibits fundraising counsel from performing services with respect to the solicitation of funds in California without being registered and having timely filed its annual renewal registrations.

**7. Other Specific Requirements.**

a. New §12599.3(a) prohibits a commercial fundraiser or fundraising counsel from contracting with a charity unless the fundraiser or counsel is registered before any solicitation begins. A contract with an fundraiser or counsel who does not register before solicitation begins is voidable.

b. New §12599.6(a) prohibits a charity from misrepresenting its purpose, or the nature, purpose, or beneficiary of a solicitation. Misrepresentation may occur by words, conduct, or failure to disclose a material fact.

c. A charity is expressly required to “establish and exercise control over its fundraising activities conducted for its benefit, including approval of all contracts and agreements, and shall assure that fundraising activities are conducted without coercion.” New §12599.6(b).

d. Charities are prohibited from contracting with any commercial fundraiser or fundraising counsel, or to raise funds for any other charity required to be registered, unless the other party is registered with the Registry of Charitable Trusts. New §12599.6(c), (d).

e. Charities and others are generally prohibited from violating the law, or making any misrepresentations or misleading statements about several aspects of, or in the context of, any solicitation or charitable sales promotion campaign. New §12599.6(f).

**8. Recordkeeping**

Commercial fundraisers must maintain records regarding each solicitation campaign for at least 10 years following the completion of the campaign, and the records must be available for inspection upon demand by the Attorney General. New §12599.7.

The records must include:

- a. The date and the amount of each contribution received, and for non-cash contributions, the name and address of the contributor;
- b. The name and residences address of each employee, etc. involved in the solicitation campaign;

Memo re Cal. SB 1262

January 26, 2005

Page 12

- c. Records of all revenue received and expenses incurred in the course of the campaign; and
- d. For each account into which the commercial fundraiser deposited contributions, the account number, and name and location of the bank or other financial institution in which the account was maintained.

Similar requirements apply to commercial fundraisers who sell tickets to an event and represent that the tickets will be donated for the use of another.

**9. Effective date**

The bill includes no provisions addressing its effective date. Thus, under California law, the new rules become effective on January 1, 2005. Govt. Code, §9600. Consequently, charities, fundraising counsel, and commercial fundraisers must act quickly to ascertain their status under the law and bring their contract forms into compliance with the new requirements of California law.

If you have any questions regarding this legislation, please feel free to contact me at your convenience.

Charles M. Watkins, Esq.  
Webster, Chamberlain & Bean  
1747 Pennsylvania Avenue, N.W., #1000  
Washington, D.C. 20006-4693  
(202) 785-9500, ext. 34 (phone)  
(202) 835-0243 (fax)  
cwatkins@wc-b.com

CMW/ctb