

State Bar of Arizona
Arizona Nonprofit Oversight Task Force
Final Report
April 25, 2003

STATE BAR OF ARIZONA
NONPROFIT OVERSIGHT TASK FORCE

During the summer of 2002, Earnest Calderon, President of the State Bar of Arizona (State Bar), appointed a task force to study issues relating to actual and potential governmental oversight of nonprofit organizations in Arizona. In order to gain a comprehensive and balanced insight into these issues, a broad range of interested parties were appointed to serve as Task Force members. The members represented a cross section of nonprofit interests, including hospitals, foundations, and several charitable organizations. A list of Task Force members is attached as Exhibit A.

The Task Force met three times over the course of three months. Minutes of the meetings are attached as Exhibits B, C and D. The charge of the Task Force was to objectively analyze the current regulatory framework for nonprofit organizations and present its recommendations to the State Bar Board of Governors. At the first Task Force meeting, the Oregon Attorney General's Office gave a comprehensive presentation regarding nonprofit oversight by that office. Under the Oregon system, nonprofit organizations pay annual dues to support a system within the Attorney General's Office that regulate not only solicitations, but also board governance issues and casino gaming. It was noted that the cost of such regulation was usually nominal but sometimes could be as high as over \$1,000.00 per organization.

The next Task Force meeting was a public meeting that featured several hours of wide ranging public testimony regarding nonprofit oversight. Representatives from the Arizona Secretary of State, Corporation Commission, and the Attorney General's Office presented information detailing the existing framework of nonprofit oversight that their offices provided. Several experts from the accounting and legal professions also made presentations. Numerous members of the public also presented to the Task Force. The final Task Force meeting provided an extended opportunity for only Task Force members to discuss their views.

The overwhelming majority of the Task Force members felt that additional regulatory oversight for nonprofits was unnecessary. The reasons given were as follows:

a. Existing regulation of nonprofit corporations is extensive. Those nonprofit organizations that are tax exempt are regulated by the Arizona Department of Revenue and the Internal Revenue Service. There are statutes dealing with fund-raising and securities offerings. Nonprofit corporations are still required to file a public annual report with financial statements, unlike corporations for profit, which have been relieved of the obligation to file an annual financial statement. The tax return of tax exempt nonprofit corporations, Form 990, is publicly available (and is even obtainable on the Internet at guidestar.com), but this is not true of for-profit corporations. All in all, nonprofit corporations are regulated to a fairly high degree and are exposed to public scrutiny.

b. It was further pointed out that the existing statutory scheme in Arizona was thoroughly considered by a committee of the Business Law Section of the State Bar of Arizona only a few years ago, resulting in a complete revision to the Arizona Nonprofit Corporate Code effective as of January 1, 1999. It was also felt that there was no need to re-examine the work that went into this recent amendment of the statute. The existing Corporate Code that is applicable to nonprofit corporations specifies a required standard of conduct for directors, liability for unlawful distributions, and provisions for the removal of directors under stated circumstances. The Arizona statute also contains an extensive section dealing with director conflicts of interest and liability for directors under certain circumstances engaging in conflict of interest transactions. There has been no showing of any material deficiency in the existing statutory framework.

c. A number of Task Force members also felt that there is no valid basis for a presumption that additional regulatory oversight by the Attorney General is a desirable goal. The thought was expressed that there should be comparable regulatory oversight with respect to business entities of all types: corporations, partnerships, limited liability companies, and that there was simply no reason to single out nonprofit corporations from the universe of business entities. Representatives from the Attorney General's office took the position that they have sufficient authority to deal with abuses involving nonprofit corporations and that no general supervisory authority over nonprofit corporations is desired.

Notwithstanding the majority recommendation that no further regulation was necessary or desirable, the Task Force unanimously recommended that increased educational efforts be made by governmental entities to inform board members of nonprofit corporations of their roles and responsibilities. Similarly, because of the perceived fragmented nature of the regulatory system currently in place, the Task Force also unanimously recommended that information be made more easily available to help the public navigate Arizona's regulatory system.

CONCLUSION

The Task Force recommends that no action be taken at this time by the State Bar concerning the regulation of nonprofits other than to recommend to governmental entities currently responsible for such regulation that their educational efforts toward nonprofit board members and the public be increased.

EXHIBIT

A

STATE BAR OF ARIZONA
Arizona Nonprofit Oversight Task Force
Roster 2002-2003

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EXHIBIT

B

MINUTES OF THE MEETING
OF THE
NONPROFIT OVERSIGHT TASK FORCE

FENNEMORE CRAIG
PHOENIX, ARIZONA

SEPTEMBER 24, 2002

MEMBERS PRESENT: Barry Wong, Mike Rooney, Sue Navran, Beth Schermer, Kate Forbes, Dick Whitney, Mark Sendrow, Diane McCarthy, Denise Blommell, Hon. Rebecca Albrecht, Robert Zumoff, Pamela Kingsley, Terry Thompson, Frank Brady, Rita Carrillo, Neal Kurn

OTHERS PRESENT: Ross Laybourn, Ernie Calderón and Ron Johnson

CALL TO ORDER: Co-Chairs Mike Rooney and Barry Wong called the meeting to order at 12:05 p.m.

MESSAGE FROM THE PRESIDENT: Ernie Calderón, President of the State Bar of Arizona, thanked the task force members for their participation. Mr. Calderón then described his vision to have the State Bar utilize its resources in efforts to benefit the entire community. In furthering this vision, Mr. Calderón emphasized that the purpose of the task force was to begin the dialogue on nonprofit oversight and not to act as an advocacy group.

REMARKS FROM THE CO-CHAIRS: Co-Chair Mike Rooney stated that the first meeting was informational in nature. He then thanked Neal Kurn for the background materials provided for the first meeting and the guest speaker, Ross Laybourn, for being present at this meeting.

Mr. Rooney then stated that the second task force meeting will be a public meeting designed to gather input from the entire nonprofit community and any other interested parties. The essential issues to be addressed at this meeting are whether a problem exists with nonprofit oversight in Arizona and, if so, any recommendations for improvement.

The third and final meeting will be an opportunity to review any public policy recommendations. A final report will then be presented to Mr. Calderón by December.

Co-Chair Barry Wong echoed Mr. Rooney's remarks and thanked the members for volunteering their time on this important issue. The task force members were then asked to introduce themselves.

BACKGROUND INFORMATION: Neal Kurn discussed the background materials and memorandum he prepared for the initial meeting. He then noted that the nonprofit world has become increasingly large and complex. Mr. Kurn further remarked that there is a significant public interest in this topic not only because of the work performed by the various organizations, but also because of tax benefits and other considerations. He concluded by stating that Arizona is one of only four states where the Attorney General does not have the common law authority to regulate nonprofit organizations.

Ross Laybourn of the Oregon Attorney General's Office then discussed the work performed by his office. Nonprofit oversight in Oregon entails the following: 1) oversight of charitable assets; 2) misrepresentation in solicitations; and 3) charitable gaming. Excluding the charitable gaming division, Mr. Laybourn's office has 9 FTE's and an annual budget of \$800,000. Funding is provided exclusively by fees charge to nonprofit organizations on a sliding fee basis. The highest fee charge to any nonprofit organization in Oregon is \$1,200.

CONCLUDING REMARKS: After a period of questions and answers with Mr. Laybourn, Mr. Rooney stated that an e-mail would be sent within the next two weeks notifying members of the next meeting date.

ADJOURNMENT: The meeting was then adjourned at 1:30 p.m.

EXHIBIT

C

MINUTES OF THE MEETING
OF THE
ARIZONA NONPROFIT OVERSIGHT TASK FORCE

STATE BAR OF ARIZONA
PHOENIX, ARIZONA

OCTOBER 24, 2002

MEMBERS PRESENT: Barry Wong, Mike Rooney, Sue Navran, Dick Whitney, Mark Sendrow, Pamela Kingsley, Terry Thompson, Neal Kurn, Jacque Steiner and Rita Carrillo

OTHERS PRESENT: Cindy Zwick, Matt Silverman, Ron Johnson and Kathleen Lundgren

CALL TO ORDER: The meeting was called to order at 2:30 p.m. Co-Chair Barry Wong provided an overview of the task force origins and a brief discussion of the first meeting.

PRESENTATIONS OF SPEAKERS:

Secretary of State - Connie Copeland

Ms. Copeland gave an overview of the jurisdiction the office has with respect to nonprofit solicitations. She stated that the Secretary of State's office has worked with the Legislature to streamline the process for nonprofits over the last two years. Recently, the Legislature also amended statutes so that the definition of "charitable organizations" complies with federal definitions.

Ms. Copeland stated that beyond statutory changes, the Secretary of State's jurisdiction has also been enhanced. The office can deny registration if names are misleading, etc. The Secretary of State, for the first time, can also revoke a nonprofit's registration if there are unlawful practices. Additionally, contracted fundraisers now have heightened enforcement from the Secretary of State.

Questions were taken from the floor. Ms. Copeland discussed a new statute for failure to comply with their oversight of nonprofit solicitations. To date, however, no conviction of this class 1 misdemeanor has occurred.

Attorney General Office - Karen Treon

Ms. Treon from the Consumer Fraud Office acknowledged that the Attorney General has no common law authority over nonprofits. Nonetheless, the Attorney General has a lot of authority to deal with problems as such. She stated that the Attorney General's office was not advocating any position on related legislation.

Ms. Treon then discussed the two components of regulation; 1) compliance (e.g., registration, reporting and licensing) and 2) enforcement (e.g., investigation). She mentioned that although the Attorney General does not have common law authority, it does have regulatory authority pertaining to enforcement. They can handle civil matters as well as criminal.

Ms. Treon noted that the Attorney General office is a law enforcement agency and is reactive. The office typically deals with nonprofit scams, which is only one sector of the whole nonprofit picture. She also mentioned that the Attorney General's office is not hearing of any problems pertaining to charitable fundraising that they cannot address.

Arizona Corporation Commission - Dean Miller

Mr. Miller discussed the two divisions of the office; 1) securities and 2) corporate. He noted that they have limited jurisdiction. The securities division registers and oversees compliance enforcement. In the past, there was no oversight of charitable bonds for construction, but this has been tightened. Mr. Miller noted that if there is a violation of the Securities Act, the Corporation Commission will issue an administrative order.

The corporate division handles nonprofit filings, such as organizational papers for the articles of incorporation, publication notices, annual reports, membership and certain financial information. The division has the authority to dissolve a corporation for noncompliance with these reporting requirements. Mr. Miller cautioned that the Commission does not have the authority to mediate disputes between members of nonprofits, and has no real power over nonprofits.

During the question period, Mr. Miller mentioned that the Commission has attempted to strengthen the securities statement during the last two years. Income statements vary and can include any numbers. There are occasions when the Commission refers matters to the Department of Revenue if something seems wrong. It was noted that dissolution of nonprofits are mainly for non-reporting reasons. It was verified that there are 28,271 nonprofit entities in Arizona with the majority having 501 (c)(3) status.

Nonprofit Financial Advisor - Rob Leslie, CPA

Mr. Leslie noted that a common misperception in the nonprofit community was that the IRS tax exemption means "no problems." With a manpower shortage of the IRS, however, there is not enough staff to respond to problems and there is very little IRS oversight. He noted that the Form 990, which all 501 (c) (3) organizations must annually supply to the IRS, is good but they frequently contain inaccurate information.

Nonprofit Legal Advisor - Jon Cohen

The task force was cautioned by Mr. Cohen to go slow because there is not a strong need for regulatory oversight in the Attorney General's office. He advised that, in his view, not everything is a problem, and not to jump to a swift fix. He suggested that there is a lot of authority presently. If something needs to be fixed with the fraud or solicitation statutes he suggested we fix it, if necessary. According to him, the Department of Revenue already has the responsibility and the Securities Division has a lot of authority as well. Nonprofit corporations already file more information than for profits with the state, according to Mr. Cohen.

Aggrieved Party - Dee Ann Griebel, CPA

Ms. Griebel, representing victims of the Baptist Foundation, stated there is a wealth of information on nonprofits already, if one understands how to get it and where to go for it. She reiterated that the Corporation Commission's budget is very underfunded. She advised to go slow with any changes. Her suggestion was to fund an entity for user guidance with an additional small fee increase.

PUBLIC DISCUSSION:

James Feltham, Family Housing Authority from Southern Arizona, asked the task force to proceed cautiously. He requested the focus be on abuses.

Keely Moran, outlined her nonprofit experiences and that due to a lack of supervision, financial problems, lack of internal controls among other things, she resigned from a nonprofit board. She suggested better public education, board member education, and a single resource for advice.

Deborah Whitehurst, Arizona Community Foundation, after outlining the history and service of the organization, expressed her concern that Arizona's reputation for harboring abuses was hurting legitimate nonprofits. Ms. Whitehurst stated that government oversight was necessary to prevent transgressions and to help keep the public trust. Her recommendation was that an entity be governed at the state level with local oversight and to look to other states for examples of success.

Andy Conovaloff, local pastor, advocated for a consumer fraud hotline and that an additional small charge be added to the filing fees to help relieve problems.

Pamela Smith, Education Technology Services, who works with charter schools felt that there was no place to report fiduciary fraud. She recommended a formal ombudsman office to hear these types of complaints from nonprofits. Ms. Treon interjected that the Attorney General's office has a school fraud division.

Dave Bixby, Banner Health Systems, relayed that the task force is a "solution looking for a problem." He noted that there are no resources to enforce existing problems and that to invite the Attorney General into governance issues was a mistake. He felt there was no problem with nonprofit abuse. If there is an issue of unreasonable compensation, he noted that the IRS could levy a prohibitive fine/tax.

Susan Edwards, Friends of Public Radio, Arizona, wanted prevention with education. She recommended Board of Directors' education about fiduciary responsibility as a solution.

Roberto Armijo, Community Information and Referral and Organization of Nonprofit Executives, then asked that no more regulations be placed on nonprofits. According to him, there are more reporting requirements, which are becoming more time consuming, than those placed on for profits. He recommended that existing regulations be strengthened.

Teresa Brewer, Better Business Bureau, also requested that Board members should be educated. She noted that it is difficult to find solutions for information that nonprofits need.

SUMMATION: Neal Kurn noted that there is a concern for protecting the nonprofit community and enhancing a system for accountability. He gave an overview of the situation and noted that the Attorney General has no authority before a criminal act is committed. He mentioned that Arizona has a reputation of being out of control and that a system that would allow for a centralized resolution to the public is worthwhile.

CONCLUDING REMARKS: Co-Chair, Barry Wong expressed the Task Force members thanks to all participants and speakers for their time and interest. He suggested that the task force would meet to discuss the recommendations presented as soon as possible.

ADJOURNMENT: The meeting was then adjourned at 5:05 p.m.

EXHIBIT

D

MINUTES OF THE MEETING
OF THE
ARIZONA NONPROFIT OVERSIGHT TASK FORCE

STATE BAR OF ARIZONA
PHOENIX, ARIZONA

NOVEMBER 26, 2002

MEMBERS PRESENT: Barry Wong, Mike Rooney, Sue Navran, Pamela Kingsley, Jacque Steiner, Rita Carrillo, Diane McCarthy, Robert Zumoff, Kate Forbes and Beth Schermer

OTHERS PRESENT: Jon Cohen, Pamela Kingsley, David Bixby, James Feltham, Helene Fenlon, Mike Levy, Pamela Smith, Ron Johnson and Kathleen Lundgren

CALL TO ORDER: Co-Chair Mike Rooney called the meeting to order at 2:40 p.m. He provided an overview of the prior task force meetings discussions and suggested the need for an additional meeting. He requested that each task force member present their views in order to reach a conclusion about possible recommendations. It was also noted that Neal Kurn, due to a conflict, had resigned his position on the task force.

Co-Chair Wong asked each task force member to introduce him or herself. Co-Chairs Rooney and Wong thanked the task force members for their diligence and their attendance at the meetings.

PRESENTATION:

Nonprofit Legal Advisor - Jon Cohen

The task force was cautioned to proceed slowly as Mr. Cohen felt there was not a strong need for regulatory oversight. According to Mr. Cohen, several state agencies already have authority to regulate nonprofit organizations, including the Department of Revenue, the Secretary of State and the Corporation Commission. Mr. Cohen noted that nonprofit corporations already file more information than for profit corporations. Because of the breadth of the existing nonprofit oversight, Mr. Cohen was opposed to even further oversight of nonprofits by placing common law authority in the Attorney General's Office.

Mr. Cohen noted a common misperception that there is a lack of state authority over nonprofits. Perhaps the most meaningful solution, however, to improving nonprofit oversight would be to increase the education of potential board members about their responsibilities, standards and ethics.

In conclusion, it was felt that concerns about governance issues for board members can be addressed through existing legal channels by the Attorney General's Office, etc. Mr. Cohen stressed that there is a need for education for both board members and the public.

GENERAL DISCUSSION:

Various task force members expressed their views about the need for a centralized repository for educational information and the need to make it readily available to the public. Given the current economic climate, however, a concern was expressed that money to provide education would be difficult to obtain. Oregon's system for publishing simple, understandable pamphlets was lauded as an example for disseminating information to the public and nonprofit organizations in Arizona. It was suggested that as a public service matter, an agency or foundation working with the press could take on the job of creating an educational brochure and disseminating it effectively to help address Board governance concerns.

Many task force members insisted that the task force not create another level of bureaucracy. It was stated that such a solution may not be the best solution and that the cost to implement a new regulatory system might be prohibitive for most nonprofit organizations.

It was recommended that a comprehensive strategy to disseminate educational information should be done carefully and effectively so that concerns/issues addressed are done without the need to transfer callers to other locations for answers. This one-stop location would be helpful for both the 'start-up' nonprofit organizations and the consumers.

It was noted that besides the state agencies already mentioned, other governmental agencies, such as the IRS, are moving to have closer scrutiny of nonprofits. Similarly, certain websites provide interested parties with reviews of financial and other operational documents so that the public can investigate nonprofit organizations.

PUBLIC COMMENT:

Dave Bixby, Banner Health Systems, felt that there were adequate remedies now to deal with internal governance problems and that it was "opening a can of worms" to seek a "solution looking for a problem." He noted that inviting the Legislature or the Attorney General Office into mandating governance issues was a big mistake. He felt that the Charitable Funding Act protected consumers and that legitimate nonprofit organizations were sensitive to their fiduciary and governance duties and responsibilities.

ADDITIONAL DISCUSSION:

Robert Zumoff questioned the need for additional legislation to regulate nonprofits and the problem of funding a solution. Mr. Zumoff noted that there are strong measures that are already in place, through the Attorney General's Office, especially with the Consumer Fraud Act, to protect the public. Regulating how nonprofits spend money would be problematic to him.

Co-Chair Wong proceeded to read the remarks of task force member Frank Brady, whereby he stated that there was a need for some regulatory body, but through his experience on the Arizona Board of Accountancy, he did not feel there was a significant enough problem to establish a full-fledged agency to regulate the nonprofit community. Mr. Brady felt there was a need for a governmental unit that consumers could contact to discuss their concerns. He suggested that the Attorney General's Office was the most likely body. If the volume of complaints or identifiable problems indicated a need for increased regulation, a separate body could eventually be established. Mr. Wong requested Mr. Brady's note be entered into the record.

It was noted through virtually unanimous comments by the task force members that there did not appear to be wide spread abuse and that it was imperative that Board members and consumers invest more time in due diligence and education.

CONCLUDING REMARKS: Co-Chair Wong requested that an additional meeting would be scheduled. A draft outline of recommendations and options would be circulated to the task force members with the objective of a conclusion that could be presented to the Board of Governors.

ADJOURNMENT: The meeting was then adjourned at 4:05 p.m.