The California Nonprofit Integrity Act
S.B. 1262
Fact Sheet

Please note that the following information is provided for general guidance only and should not be considered as legal advice. For legal advice, we urge you to seek a qualified professional familiar with California nonprofit laws and policies.

The Association of Fundraising Professionals would like to thank the California Association of Nonprofits and Silk, Adler & Colvin for the background materials that much of this document was based upon.

I. OVERVIEW

Gov. Arnold Schwarzenegger approved the California Nonprofit Integrity Act (S.B. 1262) on Sept. 29, 2004, and the Secretary of State chartered it into law the following day.

The law takes effect on January 1, 2005.

Charities Subject to the California Nonprofit Integrity Act

• charitable corporations, unincorporated associations, and charitable trusts required to file reports with the Attorney General.
• charitable corporations include foreign corporations doing business or holding property in California for charitable purposes.

Exempted Organizations

Educational institutions, hospitals, cemeteries, and religious organizations are exempt from the obligation to file reports with the Attorney General and, therefore, are not subject to this mandatory audit requirement or to the requirements for audit committees and for public disclosure of audited statements.

II. AUDITS

$2 Million Threshold

Only a charitable organization that receives or accrues in any fiscal year gross revenue of $2 million or more is required to meet the audit requirement. (*NOTE: grant or contract income from the government is not included in the charitable organization’s gross revenue so long as the governmental entity requires an accounting of those funds).

Auditing Requirements
• The financial audit must be performed by an independent certified public accountant in accordance with generally accepted accounting principles (GAAP). If the audit firm also performs non-audit functions, the firm and its auditors must conform to the standards for auditor independence set forth in the Government Auditing Standards, issued by the Comptroller General of the U.S.

• Audited statements must be made available for inspection by the Attorney General and by the general public no later than nine months after the close of the fiscal year to which the statements relate.

• Inspection of audited statements by the general public shall be accomplished by following the disclosure rules applicable to Form 990. Audited statements must be made available to the public for a period of three years at the charitable organization’s (1) principal, regional, and district offices during regular business hours and (2) by mailing a copy to any person who so requests in person or in writing, or, alternatively, by posting the audited statements to the charitable organization’s website.

• With regard to those charities required by the Act to prepare annual audited financial statements, the Act provides that charities in corporate form – including charitable corporations incorporated in states other than California and required to register with California’s Attorney General – must appoint an audit committee.
  
  o The committee must be appointed by the board of directors.
  o The audit committee may include non-board members. And it may include members of the finance committee, but the chair of the audit committee may not be a member of the finance committee, and the members of the finance committee must constitute less than half of the audit committee.
  o The audit committee may not include any member of the staff, including top management, or any person who has a material financial interest in any entity doing business with the charitable organization.
  o If audit committee members are paid they may not receive compensation in excess of the amounts received, if any, by members of the board of directors for service on the board.
  o Audit committees:
    1. shall recommend to the board of directors the retention and termination of the independent auditor,
    2. may negotiate the compensation of the auditor on behalf of the board,
    3. shall confer with the auditor to satisfy the committee members that the financial affairs of the charitable organization is in order,
    4. shall review and determine whether to accept the audit, and
    5. shall approve performance of any nonaudit services by the auditing firm.
Compensation Review Required

For any entity meeting the $2 million threshold, the Act also requires that compensation, including benefits, of two officers (the chief executive officer and the chief financial officer) shall be reviewed and approved by the board of directors or an authorized committee of a charitable corporation or an unincorporated association or the trustee or trustees of a charitable trust.

The standard for review is to determine whether the compensation is “just and reasonable.”

The review must occur when the officer is hired, when the term of employment of the officer is renewed or extended, and when the compensation is modified, unless the modification applies to substantially all employees.

III. FUNDRAISING

Definitions

"Fundraising counsel for charitable purposes" is defined as any person, individual, corporation, unincorporated association, or other legal entity who is described by all of the following:

(1) For compensation plans, manages, advises, counsels, consults, or prepares material for, or with respect to, the solicitation in this state of funds, assets or property for charitable purposes.

(2) Does not solicit funds, assets, or property for charitable purposes.

(3) Does not receive or control funds, assets, or property solicited for charitable purposes in this state.

(4) Does not employ, procure, or engage any compensated person to solicit, receive, or control funds, assets, or property for charitable purposes.

"Commercial fundraiser for charitable purposes" is defined as any individual, corporation, unincorporated association, or other legal entity who for compensation does any of the following:

(1) Solicits funds, assets, or property in this state for charitable purposes.

(2) As a result of a solicitation of funds, assets, or property in this state for charitable purposes, receives or controls the funds, assets, or property solicited for charitable purposes.

(3) Employs, procures, or engages any compensated person to solicit, receive, or control funds, assets, or property for charitable purposes.
A commercial fundraiser for charitable purposes shall include any person, association of persons, corporation, or other entity that obtains a majority of its inventory for sale by the purchase, receipt, or control for resale to the general public, of salvageable personal property solicited by an organization qualified to solicit donations.

**Charities Must Establish and Exercise Control Over Fundraising Activities**

The Act states that charitable organizations must “establish and exercise control” not only over their fundraising activities but over fundraising activities conducted by others for their benefit. That control must include approval of all written contracts, and the charitable organization must assure that fundraising activities are conducted without coercion.

A charitable organization may not contract with any commercial fundraiser not registered as required with the Attorney General’s Registry of Charitable or raise funds for any other charitable organization if it is not registered as required.

**Misrepresentations**

Charitable organizations (and commercial fundraisers) may not misrepresent the purpose of the charitable organization or the nature or purpose or beneficiary of a solicitation. Misrepresentation may be established by word or conduct or failure to disclose a material fact.

**Prohibited Acts**

The Act sets forth twelve prohibited acts and practices in the planning, conduct, or execution of any charitable solicitation or sales promotion. The prohibitions apply, according to the Act, “regardless of injury”:

1. Operating in violation of this Act or order of the Attorney General or after registration is no long valid.
2. Engaging in fraud or using any unfair or deceptive act or practice that creates a likelihood of confusion or misunderstanding.
3. Using any name or any other representation that misleads a reasonable person as to the identity of the charitable beneficiary.
4. Misrepresenting or misleading anyone to believe that the beneficiary of a solicitation or sales promotion is a charitable organization when it is not.
5. Misrepresenting or misleading anyone to believe that another person sponsors, endorses, or approves a charitable solicitation or sales promotion when that person has not given consent in writing to the use of the person’s name.
6. Misrepresenting or misleading anyone to believe that goods or services have endorsement, sponsorship, approval, characteristics, ingredients, uses, qualities, or benefits that they do not have or that a person has
endorsement, sponsorship, approval, status, or affiliation that the person does not have.

7. Exploiting registration to imply endorsement or approval by the Attorney General.

8. Representing that a charitable organization will receive more than the amount reasonably estimated.

9. As to solicitations by commercial fundraisers for police, fire, and other public safety personnel, involving the distribution of membership cards, stickers, emblems, plates, or other items that suggest affiliation with or approval by any public safety personnel or group.

10. Soliciting for advertising in a for-profit publication that relates to a charitable purpose without making at the time of solicitation these disclosures:
   a. the publication is for-profit,
   b. the name of the solicitor and the fact that the solicitor is a professional solicitor, and
   c. the publication is not affiliated with any charitable organization.

11. Representing that any part of contributions solicited by one charitable organization will be given to another charity unless the charity has agreed in writing prior to the solicitation to the use of its name.

12. Representing that tickets to events will be donated for use by another unless certain requirements are met to prevent abuse.

**FUNDRAISING COUNSEL**

**Fundraising Counsel Must Register and File Notice with the Registry**

Current law requires that fundraising counsel must register with the Registry. The Act adds a requirement that before performing any services for a charitable organization, fundraising counsel must also file a notice with the Registry not less than 10 working days prior to the start of the performance of any services for a charitable organization setting forth information including the name and address of fundraising counsel, of the charitable organization for which counsel is working, and the date when the performance of services begins and ends.

**Fundraising Counsel Must Enter a Written Contract with Charitable Organizations**

The Act also makes clear that there must be a written contract between the fundraising counsel and each charitable organization for each service to be performed. The contract must be signed by the authorized contracting officer for fundraising counsel and by an official who is authorized to sign by the governing body of the charitable organization. Current law sets forth extensive provisions that must be included in the contract. The contract must also contain two distinct provisions relating to cancellation of the contract:
1. The contract must allow the charitable organization to cancel a contract with a fundraising counsel without cost, penalty, or liability for a period of 10 days after signing, by giving written notice in a specified manner, and
2. The contract must permit a charitable organization to terminate the contract on 30 days’ written notice to fundraising counsel. The termination is effective five days from the date of mailing, and the charitable organization is liable for the services of fundraising counsel up to the effective date of termination.

COMMERCIAL FUNDRAISERS

Commercial Fundraisers Are Constructive Trustees

Under the Act, a commercial fundraiser for charitable purposes is also considered a constructive trustee regarding all funds collected in response to a solicitation for charitable purposes. That fundraiser must account to the Attorney General for all funds. Moreover, the fundraiser is subject to the Attorney General’s supervision and enforcement over charitable funds to the same extent as a trustee for charitable purposes.

Commercial Fundraisers Must Register and File Notice with the Registry

Current law requires that a commercial fundraiser for charitable purposes must register with the Registry. The Act adds the requirement that before beginning any charitable solicitation, a commercial fundraiser must also file a notice with the Registry setting forth information identifying the fundraiser and the charitable organization, the fundraising methods to be used, the dates when fundraising will begin and end under the contract, and identifying information about the person responsible for directing and supervising the work of the fundraiser.

The notice must be filed not less than 10 days before the beginning of each solicitation campaign, event or service (for solicitations to aid victims of emergency hardship or disasters the notice must be filed not later than when the solicitation begins).

Commercial Fundraisers May Not Make Misrepresentations

Commercial fundraisers (and charitable organizations) may not misrepresent the purpose of the charitable organization or the nature or purpose or beneficiary of a solicitation. Misrepresentation may be established by word or conduct or failure to disclose a material fact.

Commercial Fundraisers Must Deposit Contributions in a Bank Within 5 Working Days

As to each contribution, in the control or custody of a commercial fundraiser, and made to benefit a charitable organization, the fundraiser is required, within five working days of receipt (1) to deposit the contribution, in an account, solely in the name of the
charitable organization, in a bank or other federally insured financial institution, over which the beneficiary charitable organization has the sole right of withdrawal, or (2) to deliver the contribution to the charitable organization in person, by Express Mail, or by another method providing for overnight delivery.

**Commercial Fundraisers Must Enter Written Contracts with Charitable Organizations**

The Act requires that a commercial fundraiser and a charitable organization must enter into a written contract for each solicitation campaign, event, or service. The contract must be signed by an authorized contracting officer for the commercial fundraiser and by an official authorized to sign by the charitable organization’s governing body. The mandatory provisions of the contract, which may be inspected by the Attorney General, include:

1. A statement of the charitable purpose of the fundraiser.
2. A statement of the “respective obligations” of the commercial fundraiser and the charitable organization.
3. If the fundraiser is to be paid a fixed fee, the contract must state the fee and provide a good faith estimate of what percentage the fee will be of total contributions (the contract must also disclose the assumptions on which the estimate is based, and they, in turn, shall be based on all relevant facts known to the fundraiser).
4. If the fundraiser is to be paid a percentage fee, a statement of the percentage of total contributions that will be remitted to or retained by the charitable organization or if the sale of goods is involved, the percentage of the sales price remitted to or retained by the charitable organization (in determining that stated percentage, the fundraiser’s fee, as well as any other amounts the charitable organization is required to pay as fundraising costs, must be subtracted from the contributions and sales receipts received).
5. The effective and termination dates of the contract and the date solicitation activity is to begin within California.
6. The contract must require the fundraiser to handle contributions in accordance with the Act’s requirements (as noted previously) on the deposit or delivery of funds to the charity.
7. A statement that the charitable organization exercises control and approval over the content and frequency of any solicitation.
8. If the fundraiser proposes to pay any person or legal entity, in cash or in kind, to attend, sponsor, approve, or endorse a charity event, the contract shall contain that maximum dollar amount of those payments.

The contract must also contain three distinct provisions relating to cancellation of the contract:

1. The contract must allow the charitable organization to cancel a contract with a commercial fundraiser without cost, penalty, or liability for a period of 10 days after signing, by giving written notice in a specified manner.
Any funds collected by the commercial fundraiser after notice of
cancellation shall be held in trust for the benefit of the charitable
organization without deduction for costs of expenses.

2. The contract must permit a charitable organization to terminate the
contract on 30 days’ written notice to the commercial fundraiser, which is
effective on the expiration of five days from the date of mailing. Under
this 30-day provision, the charitable organization is liable for the services
of commercial fundraiser up to 30 days after the service of the notice.

3. The contract must provide that after the initial 10-day cancellation period,
the charitable organization may terminate the contract at any time on
written notice, without payment of any kind to the commercial fundraiser,
if the commercial fundraiser or agent
   a. makes material misrepresentations in the course of the solicitation
      or with regard to the charitable organization,
   b. are found by the charitable organization to have been convicted of
      a crime, punishable as a misdemeanor or felony, arising from
      charitable solicitation, or
   c. otherwise conduct fundraising activities that causes or could cause
      “public disparagement of the charitable organization’s good name
      or good will.”

Commercial Fundraisers: Prohibitions

A commercial fundraiser for charitable purposes may not solicit in California on behalf
of a charitable organization unless it has registered with the Registry or is exempt from
such registration.

No person may act as a commercial fundraiser if that person (or any officer or director of
that person’s business or any person with a controlling interest in the business or any
person employed or paid to solicit funds by the commercial fundraiser) has been
convicted in state or federal court of a crime, punishable as a misdemeanor or felony,
arising from the conduct of charitable solicitation.

Commercial Fundraisers Must Maintain Two Types of Records

Commercial fundraisers must maintain for not less than 10 years two categories of
records: (1) solicitation campaign records, including donor information, revenue and
expense data, the names and addresses of employees, and the name and number of each
bank or other account in which funds were deposited by the commercial fundraiser, and
(2) ticket sale records for charitable events, including the number of tickets purchased
and donated by each contributor and the identification of all organizations receiving
donated tickets for use by others.

Charitable Organizations: Right to Cancel or Void Contracts with Commercial
Fundraisers or Fundraising Counsel
Contract cancellation rights of charitable organizations are addressed twice in the Act.

1. They appear as mandatory provisions of contracts between charitable organizations and commercial fundraisers and fundraising counsel.

2. They appear as separate rights, entirely apart from the contracts. Thus even if contracts fail to spell out the required rights, the Act provides that charitable organizations nevertheless have those rights of cancellation.

In addition, whenever a charitable organization cancels a contract, it must mail a duplicate copy of the notice of cancellation to the Registry. Similarly, enforcement of registration with the Registry is addressed from three distinct perspectives:

1. as a requirement of commercial fundraisers and fundraising counsel,

2. as a prohibition to charitable organizations, barring them from contracting with a commercial fundraiser or fundraising counsel if not registered as required,

3. and as a remedy for charitable organizations, allowing them to void contracts with commercial fundraisers and fundraising counsel if not registered as required.