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State Administration of Charities

Richard E. Friedman*

MY REMARKS will be limited to state administration of the charitable trusts and charitable organizations.

Charities are quasi-public in nature. They perform many valuable services to the community which may otherwise be performed by governmental agencies. Because of these high public purposes charitable organizations are granted special treatment in terms of tax exemptions, and tax deductions for contributions.

The definition of charity gleaned from case law is very broad, and in recent years the definition has tended to become even broader. Virtually any undertaking which may benefit the public can fall under the very broad umbrella of charities.

There is a distinction between Charitable Trust and Charitable Solicitations Acts at the state level. A shorthand definition is that Charitable Solicitations Acts relate to solicitation and collection of funds from the general public, as opposed to private individuals. The definition of a Charitable Trust Act for this discussion would be one regulating the creation of a res for charitable purposes, but which would receive funds from private, rather than public sources. There is considerable amount of overlapping jurisdiction between these two types of acts. Those states which have some form of administration in this area recognize this, and accept federal report forms, and reports which are made under court jurisdiction. They give some latitude in reporting by those organizations which are required to comply with both the Charitable Trust and the Charitable Solicitations Acts.

In the United States it is estimated that approximately \$14,000,000,000 is collected annually by charitable solicitations. This makes the business of charitable giving the fourth largest industry in the United States. In Illinois, it is estimated the amount of charitable giving annually to be approximately \$140,000,000. The figures that have been gathered in relation to charitable trust are equally large. An estimate for the amount of funds held in charitable trusts nationally is approximately \$100,000,000,000. In Illinois that breaks down to about \$8,000,000,000. This will give some idea of the need for regulation.

In 1965 the National Association of Attorneys General established its first Committee on Charitable Organizations. That committee has been instrumental in assisting a number of states in developing these

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[Editor's Note: Mr. Friedman refers throughout this paper to the Illinois Charitable Trust Act, 14 Ill. Stat. Ann. § 51 et seq. and the Illinois Charitable Solicitations Act, 23 Ill. Stat. Ann. § 5101 et seq. This paper is part of the Symposium.]

laws. The NAAG acts as a clearing house for information. It is probably the only central source that has an overview of current developments and legislative trends in this field.

There are twelve states which have strong Charitable Solicitations laws. There are a number of other states which have laws which the author would consider weak laws; they number about 18, totalling approximately 30 states which have some form of legislation in the area of Charitable Solicitation, leaving 20 states without any legislation in this area, whatsoever. The states possessing regulatory legislation have in common a registration requirement, and in some instances they require a financial report on an annual basis. The basic distinction that could be made between weak and strong state laws is whether the Act has injunctive relief for powers granted to them, provides for subpoena powers, and whether the Attorney General is granted broad investigatory powers to review the books and records of the charities. Many states have perfunctory laws which require only registration, and if there is any suspicion that there is any wrongdoing only the usual criminal law enforcement procedures are available.

There are 10 states that have some form of a Charitable Trust Act. Even though efforts have been made to advance a Uniform Charitable Trust Law there is no uniformity. It would be hoped that this will be reviewed by the NAAG and perhaps they will disseminate more information on Uniform Charitable Trust Acts. Further consideration should be given to a Uniform Act.

One of the typical problems, and perhaps the most vexing one for an administrator in this area, relates to the phenomenal growth of mass mailers. A number of charitable organizations rely wholly on mass mailing. Mass mailing is based on a low percentage return of 2 or 3 per cent. This blanket approach is very costly for the charitable organization, but statistically it gets results. It usually gets more money than it spends. The question is how much goes to the charity.

The problem of enforcement relates to interstate mailing. In Illinois we are virtually powerless to do anything about a mass mailer which has its base of operation in Michigan and no contact with the State of Illinois other than through mailing. Typically, the mailing contains a self-addressed envelope, usually postage prepaid. The person who makes a contribution puts his check or cash in the envelope and mails it back to Michigan or to the place from where it came. Consequently, the Illinois Attorney General's office or any state administrator in a similar position, finds it difficult to block these kinds of operations, even if there is a strong suspicion of fraud.

Section 5B of the Illinois Charitable Solicitation Act, and most of the other state acts in this field, provide for substituted personal service on the Secretary of State, if there is no registered agent, or the corporation does not do any business within the state. This is not very effective, and

I don't think the Uniform Enforcement of Judgments Act would be adequate for us to send an Illinois judgment to Michigan to try to enjoin a fraudulent charitable organization operating out of Michigan without any other contact within the State of Illinois.

The real anomaly that arises in this situation is that a fraudulent charitable organization can operate in the State of Illinois with impunity if it does not solicit in the State of Illinois. It can use Illinois as a base of operations for its mass mailing to all of the other 49 states, and the other 49 states are virtually powerless to obtain injunctions which may have any real effect. In this situation the State of Illinois cannot take action unless they solicit in Illinois. This problem could be covered by federal legislation. The only recourse at the present time would be to advert to the federal criminal procedures, particularly those involving postal and mail fraud, but they are rather unwieldy processes and are difficult to sustain.

The only real enforcement power in Illinois and in other states is that we can obtain a limited injunction against such an interstate mass mailer. Because most charitable organizations are sensitive to adverse publicity, the mere fact of our filing a complaint for an injunction and obtaining an injunction, because of the attendant publicity, has the effect of, at least temporarily, drying up the source of funds in that state or community in which the injunction is granted.

Let us review the structure of the Illinois Charitable Trust Act and compare it to similar state laws, and do the same with the Illinois Charitable Solicitation Act. These Acts contain the essential elements found in the 30 to 38 states with similar legislation. The real problem for a practitioner representing a charitable organization or a charitable foundation which has its base in one state and is active in another state, is that he may be required to comply with, perhaps, 20 to 30 different sets of registration statements and varying accounting requirements which can be costly and burdensome. I don't know the answer to that problem other than a uniform reciprocal act, or the possibility that the federal government may pre-empt the states in this area. It is a very difficult problem, and most state administrators are aware of it.

The Illinois Charitable Trust Act was drafted in 1961. It provides for a number of citation exemptions, including a broad religious exemption, and a specific exemption to corporate fiduciaries. Consequently there is no control over the activities of a corporate fiduciary which holds funds belonging to private foundations. The registration statement is required for all charitable organizations, including the names of Directors, Executors, Administrators and the like, charitable purposes, place of business, and other identifying information. The registration statement is not particularly burdensome; it usually relates to available information that one has in the initial structuring of the organization.

An income report is due within 6 months after the end of the fiscal or the calendar year. The state provides accounting forms for the information, however, there are a number of exceptions to filing the state form. If an organization is under court supervision, or if there is a court administered document relating to income disbursements, the Attorney General will accept the court required report instead. Another example would be where the organization is already registered under the Solicitations Act. A further exception would be if the organization in the usual course of business prepares a certified statement that would be accepted in lieu of the annual financial accounting required by the Attorney General. The Attorney General is granted broad rule making power, and has broad investigatory powers. There is a provision for hearing and notice, and he also has a subpoena power with enforcement by application to the circuit court for a contempt citation. This has been used effectively in a number of cases. There is no licensing provision in either of the Illinois acts, but there is a registration which may be cancelled for cause by the Attorney General.

The Illinois Charitable Solicitation Act was drafted in 1963. Prior to drafting the Act the Attorney General took a great deal of time to discuss the matter with practitioners who specialized in problems of charitable organizations as well as the administrators of charitable organizations. We engaged in 6 months of informational discussions to try to resolve problem areas. When the bill was introduced in 1963 in the Illinois General Assembly, we had as proponents of the bill a broad cross section of many of the administrators of large charitable organizations and foundations in the state. We have had an excellent working relationship with charitable organizations. Charitable organizations are in favor of some sort of state administration, provided that the state administration is on a reasonable basis. Most of the organizations are competing for a slice of the charitable pie, and the marginal operators who have high mass mailing fund raising costs have the effect of diminishing the amount of money available to the established organizations. It is in the best interest of reputable charitable organizations to have state regulation, even though it does cause some internal problems.

The Illinois Act requires a registration statement prior to any solicitation. Most other states, except those states that have prior licensing provision, allow a charity to solicit money from the public and then file a statement. It is then too late to protect the public. Registration and financial reports are public records. The Attorney General has broad rule making power and the one great defect in the Illinois Act is the number of exemptions. There is a broad religious exemption, as mentioned. The Community Chest is exempted, volunteer firemen are exempted, as well as other specific charities. In the opinion of the author no exemptions should be permitted.

The financial reporting provision situation is a good balance between information needed by the state agency and information readily available to the charity. A financial report within 6 months of the end of the fiscal or calendar year is required. If the organization raises over \$10,000 in funds, a long form report is required and this report must be certified. If the solicitation is under \$10,000 a short form is required which requires no certification and may be signed by responsible fiscal officers. We have a special provision relating to professional fund raisers, and if a professional fund raiser is utilized in any respect by an organization, the long form certified report must be made. The Attorney General may cancel a registration for failure to file, within the time permitted.

Illinois and most other states provide for substituted service on organizations or persons having no office within the state. These are brave words, but they have only a limited impact when you get into the realities of enforcing a judgment against a foreign corporation.

Illinois has a provision relating to professional fund raisers. A registration is required of a professional fund raiser prior to any undertaking on behalf of a charitable organization. The professional fund raiser must file a \$5,000 performance bond with the security running for the use of the people of the State of Illinois. He must file an annual report of his activities; any contract or agreement between the professional fund raiser and the charitable organization must be in writing, and a copy of that contract must be filed with the Attorney General. There is also a section dealing with a professional solicitor who typically is employed by a professional fund raiser. He must also register. Illinois has provided as a sanction for the professional fund raiser-solicitor a misdemeanor penalty providing up to one year in jail or a \$1,000 fine for violation and conviction of any of the provisions dealing with professional fund raising. In the experience of the Better Government Association the temptation of the charitable organization to turn to prohibited activities is increased greatly when it obtains the service of a professional fund raiser. The great majority of professional fund raisers do a good job, and have very high professional standards. But some of the individuals are nothing but con-artists who have styled themselves as professional fund raisers. They recognize the impact in obtaining a charitable dollar by virtually renting crippled children, and sending out a colored brochure in large quantities with assurance that they're going to make some money.

One other provision in the Act relating to professional fund raisers is that it is a violation for any professional fund raiser or professional solicitor to have had a prior record of conviction for either a misdemeanor or felony involving the misapplication or misuse of money. This reflects our concern for the unscrupulous professional fund raiser. The Attorney General may enjoin a charitable organization for any scheme,

artifice, false representation or other device, and the definition is most broad. The Attorney General also has a subpoena enforcement power by application to the circuit court.

The Attorney General has broad investigatory power. There is a provision for hearing and notice to require the production of books and records, hearings, conferences and the like.

There are a number of other ancillary provisions, one of which will be outlined. There is a provision which makes it a violation of the Act to use another's name on a charitable solicitation drive, without first having received written prior permission of that individual. Typically, there may be a new charitable organization which has a very prestigious listing of people as their founders and supporters. Upon closer review it will be discovered that some know nothing about the organization.

Michigan has a licensing provision upon application. The license may be revoked by hearing. In Illinois there is no licensing procedure. A registration statement is accepted without the further steps of issuing a license. From an administrative standpoint it makes more sense to have a license which may be the subject of license revocation procedure.

Even though there are states without laws relating to charitable organizations, the Attorney General has inherent common law powers to prosecute on behalf of the public or unnamed beneficiaries when there is fraudulent use of public funds. This can be extended to the collection and disbursement of funds. Under the Illinois Constitution the Attorney General is a Constitutional officer whose powers were co-extensive with that of the English Attorney General at common law. That gives the Illinois Attorney General broad power, and this is true in more than 40 of the states. There is a substantial number of cases, beginning in 1920, prior to the institution of these laws, which provides ample precedent for enforcement by the Attorney General under his common law powers.

The following is an amalgam of the kinds of problems that have been encountered in Illinois. A very typical example would relate to an organization located outside Illinois which had in its purpose the care of crippled children. It developed a mass mailing technique whereby it mailed expensive brochures containing a plea for these children into 25 of the most populous states. It was quite effective. The problem, however, was that in one year they raised 1.3 million dollars and they spent 1.2 million dollars on fund raising and administrative costs. Only \$100,000 was devoted to their program to aid crippled children. The sponsors of the charity were anxious to expand their operation, and they thought the fastest and easiest route to develop a charitable organization was through a mass mailing technique. Difficulty was had in obtaining its books and records. This was a typical interstate mailing problem. It was an out of state corporation which mailed into Illinois. The only point of contact was by letter, with a return envelope soliciting a con-

tribution. After a series of conferences the sponsors signed a Consent Decree and agreed not to solicit in the State of Illinois.

There is a need for regulation in this area. The problem is to balance that need with an attempt to limit the burdens and expense for the charitable organization which complies with the Act.

Another word about the mass mailers. The mass mailer is a rather new phenomenon. It have proven mailing lists. An organization may pay as much as \$500,000 to rent the list for one year. The economic reason is that a proven mailing list makes money on a margin as small as a 3 per cent return. If one here wanted to form a home for crippled children, one could enter into a contract with a mass mailer, who in many cases will advance the funds necessary for this mass mailing. The significance is that a high percentage of the public's available charitable dollar is going for fund raising costs and not to charity.

We have new legislation in the State of Illinois dealing with fund raising costs which may set a pattern for a number of other states. The problem is, what constitutes an efficient fund raising program; what are the percentages? The shocking fact is that of those charitable organizations registered in the State of Illinois, the average amount devoted to fund raising and administrative costs is 45 per cent. Those organizations which are established and have a good reputation in the community average somewhat less than 20 per cent for fund raising costs. The range between 15 and 20 per cent would be acceptable. If it is over 20 per cent for fund raising costs, I am concerned. Anything over 30 per cent for fund raising costs should be prohibited.

The author recognizes some variable problems that are encountered by charitable organizations. Obviously, a long established charitable organization with a "saleable" disease, such as heart, cancer, and the like, has a better chance of obtaining a charitable dollar than a new organization with a more obscure disease. The Attorney General has an overview of the problem and is in an excellent position to make some allowance for these problems. If an established organization attempts to change its format and it makes a mistake in one year, and its fund raising costs go up, those factors should be considered. The counter argument is, of course, that some absolute objective determination should be sought.

Illinois has a new piece of legislation which doesn't meet either of those problems and may cause a lot of additional problems for practitioners in the future. Illinois has a 75 per cent rule, which is illusory. By definition, it relates everything to administrative costs, so what we have now is a law that says that you cannot devote more than 25 per cent of total collections for administrative costs. It very nicely avoids the real problem, which is fund raising.

Many of the mechanical problems that occurred in the early days of the Act have been solved by the adoption of the Uniform Standards of Accounting. Major arguments centered on what portion of the funds would be devoted to a program, what would be attributed to fund raising costs, and what would be administrative costs. An example of that kind of problem is this. A solicitation letter bears the legend on the envelope, "help fight disease." Many organizations consider that to be educational in nature, and they attempt to deduct the whole amount of the mailing and preparation of the brochure, or at least a substantial proportion from their fund raising costs, considering it to be part of their educational program. That is an extreme example. Adoption of the Uniform Standards of Accounting which was prepared by a broad spectrum of the national health and welfare organizations has solved many of these problems.

The review procedure within the Attorney General's office proceeds along the following lines. There is a desk audit of the registration statement and of the annual financial report at which time approximately 20 per cent of the audits or financial statements are marked for further review. The following things are some of the things noted. Self dealing; excessive retention of net income; controlling interest in a business; political activity concerned with voter registration drives; grants made to specifically named individuals; thrift stores or the sale of merchandise; and, anything that is sent through the mail in the form of merchandise. There is concern with the ratio of gross receipts to net charitable distribution, and the possibility of excessive salaries taken by administrators. When this review is completed, perhaps over 80 per cent of the returns have been cleared. The balance of 20 per cent of returns gets a more detailed review, and perhaps 5 per cent of the returns receive a detailed audit of their books and records. This procedure relates to both charitable organizations and charitable trusts.

The numbers may be of interest. In Illinois, there are currently registered 4,000 charitable organizations and about 100 professional fund raisers. There are approximately 4200 charitable trusts and private foundations registered.

Two equitable maxims should be added to the literature of charitable organizations: in terms of Charitable Trusts, the imperative "all men walketh in a vain show, they heapeth up riches and know not who gathereth them"; and for Charitable Solicitation, "bread cast on the water comes back soggy."