

PERFORMANCE AUDIT
OF
STATE ACTIVITIES RELATED TO NONPROFIT ORGANIZATIONS

DEPARTMENT OF ATTORNEY GENERAL AND
DEPARTMENT OF CONSUMER AND INDUSTRY SERVICES

May 2002

EXECUTIVE DIGEST

STATE ACTIVITIES RELATED TO NONPROFIT ORGANIZATIONS

INTRODUCTION

This report, issued in May 2002, contains the results of our performance audit* of State Activities Related to Nonprofit* Organizations*, Department of Attorney General and Department of Consumer and Industry Services (CIS).

AUDIT PURPOSE

This performance audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Performance audits are conducted on a priority basis related to the potential for improving effectiveness* and efficiency*.

BACKGROUND

A nonprofit organization is an entity established to carry out any lawful purpose or purposes not involving pecuniary profit or gain for the directors, officers, shareholders or members.

A charitable organization* is an entity formed for benevolent, educational, philanthropic, scientific, public health, humane, religious, or other purposes or to benefit one or more other organizations that have a charitable purpose or conduct a charitable program. Charitable organizations include both charitable solicitors* and charitable trusts*.

* See glossary at end of report for definition.

Although charitable organizations are typically nonprofit organizations, not all nonprofit organizations are charitable organizations. Nonprofit organizations can be either incorporated or unincorporated.

CIS is responsible for facilitating the formation of Michigan business entities, including both profit and nonprofit corporations*. These responsibilities have been assigned to the Corporation Division, Bureau of Commercial Services. As part of its responsibilities, the Division provides services to facilitate the formation of corporations, issues certificates of authority to conduct affairs in the State, maintains a record of the filed documents for each corporation, makes this information available to the public, and responds to public inquiries regarding corporations.

The Department of Attorney General is responsible for the State's oversight of charitable organizations. These responsibilities have been assigned to the Charitable Trust Section. The Section licenses* charities soliciting or receiving contributions*, registers charitable organizations that hold assets in the State, approves dissolutions* of charitable purpose organizations incorporated in the State, and responds to public inquiries regarding charitable organizations. The Section serves as a repository of financial and other information about the State's charities. This information is available to the public to assist individuals in making wise choices about what charities to support.

As of December 2000, there were 58,029 nonprofit corporations with certificates of authority to conduct affairs in Michigan. The State also had 7,597 registered charitable organizations and 4,125 licensed charitable solicitors. During 2000, the Department of Attorney

* See glossary at end of report for definition.

General consented* to the dissolution of 120 nonprofit corporations. During this same period, the Corporation Division dissolved 50 nonprofit corporations that had submitted certificates of dissolution, 24 nonprofit corporations because their period of duration had expired, and 2,638 nonprofit corporations for failure to file their annual reports within the two-year grace period.

As of June 30, 2001, the Corporation Division included 54 employees and the Charitable Trust Section included 7 employees.

AUDIT OBJECTIVES,
CONCLUSIONS, AND
NOTEWORTHY
ACCOMPLISHMENTS

Audit Objective: To assess the effectiveness and efficiency of the Department of Attorney General's registration* and licensing of nonprofit organizations and the effectiveness of CIS's activities to facilitate the formation, existence, and dissolution of nonprofit corporations.

Conclusion: We concluded that the Department of Attorney General was generally effective and efficient in registering and licensing nonprofit organizations and that CIS was generally effective in facilitating the formation, existence, and dissolution of nonprofit corporations.

Noteworthy Accomplishments: The CIS Corporation Division has developed a half-day training seminar offered throughout the year for newly formed nonprofit corporations and persons interested in establishing nonprofit corporations. The seminar covers background information, filing requirements and forms to file, Internal Revenue Service (IRS) issues and tax-exempt designation, directors' and officers' duties and responsibilities, and a directors' guidebook. Department of

* See glossary at end of report for definition.

Attorney General staff also participate in the seminar, which addresses the requirements for charitable nonprofit corporations. Each participant receives a comprehensive desk reference manual.

Since 1995, the Department of Attorney General has eliminated a five-year backlog of initial filings, which included a review of the filing documentation to determine each charitable organization's need for licensure and/or registration. The Department has also largely eliminated a seven-year backlog of new filings by charitable trusts; processed registration statements, inventories, and financial accountings; and included this seven-year backlog of information in its database.

Audit Objective: To assess the effectiveness of the Department of Attorney General's oversight of charitable nonprofit organizations.

Conclusion: We concluded that the Department of Attorney General was generally effective in overseeing charitable nonprofit organizations. However, we noted reportable conditions* related to oversight enhancements and web site enhancements (Findings 1 and 2).

Noteworthy Accomplishments: The Department of Attorney General's Charitable Trust Section has increased its outreach to and education of the nonprofit community by participating in and presenting information at seminars and conferences, including Statewide nonprofit conferences as well as making presentations to groups and associations. It has also been both a participant and a presenter at the annual meetings of the National Association of State Charity Officials, which is affiliated with the National Association of Attorneys General. The

* See glossary at end of report for definition.

Section shares information regarding charitable activities and solicitations with other states, the Federal Trade Commission, and the IRS. The Section also works with other organizations to ensure that nonprofit organizations receive complete, timely, and accurate information.

**AUDIT SCOPE AND
METHODOLOGY**

Our audit scope was to examine the State's registration, licensing, and oversight of nonprofit organizations. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Our audit procedures included an examination of records and activities primarily for the period January 1, 1998 through June 30, 2001.

Our methodology included interviewing CIS and Department of Attorney General staff and management. Also, we reviewed applicable State statutes, administrative rules, policies, Internal Revenue Code, and other states' practices to gain an understanding of the State's role regarding nonprofit organizations.

To accomplish our first audit objective, we reviewed the registration and licensing processes developed by the Department of Attorney General to register charitable organizations and to license charitable solicitors. We also reviewed activities developed by CIS to facilitate the formation, existence, and dissolution of nonprofit corporations.

To accomplish our second audit objective, we tested the Department of Attorney General's charitable trust database for accuracy and completeness. We also tested charitable organizations' compliance with statutory requirements. We

reviewed statutory requirements to determine if changes were needed to improve the State's oversight role.

AGENCY RESPONSES

Our audit report includes 2 findings and 4 corresponding recommendations. The Department of Attorney General's preliminary response indicated that it generally concurs with the findings and has initiated action to comply with most of the recommendations.

May 7, 2002

The Honorable Jennifer M. Granholm
Attorney General
G. Mennen Williams Building
Lansing, Michigan
and
Ms. Kathleen M. Wilbur, Director
Department of Consumer and Industry Services
G. Mennen Williams Building
Lansing, Michigan

Dear Ms. Granholm and Ms. Wilbur:

This is our report on the performance audit of State Activities Related to Nonprofit Organizations, Department of Attorney General and Department of Consumer and Industry Services.

This report contains our executive digest; description of practices; audit objectives, scope, and methodology and agency responses; comments, findings, recommendations, and agency preliminary responses; a comparison of states with similar charitable oversight operations, presented as supplemental information; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the Department of Attorney General's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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Description of Practices

Entity Types

Nonprofit Organizations

A nonprofit organization is an entity established to carry out any lawful purpose or purposes not involving pecuniary profit or gain for the directors, officers, shareholders or members. A nonprofit organization may be either incorporated or unincorporated.

Corporations

A corporation is an association of persons created by law and existing as an entity with powers and liabilities independent of those of its shareholders or members. A corporation is one of several types of business entities available to individuals establishing an entity. Incorporating may protect the owners or directors from personal liability for debts and other liabilities that may occur in operating the corporation. The management of a corporation consists of directors and officers, usually elected by the members or shareholders. The governance of the corporation is prescribed by law, the bylaws of the corporation, and the resolutions and decisions of the members or shareholders. A corporation's existence begins when articles of incorporation have been prepared and have been submitted to and filed by the Corporation Division, Bureau of Commercial Services, Department of Consumer and Industry Services (CIS).

Corporations must designate a registered office and resident agent* in the articles of incorporation.

A nonprofit corporation may be a membership, a directorship, or a stock corporation. The owners of a profit corporation are shareholders.

The laws relating to the organization and regulation of corporations include the Nonprofit Corporation Act (Act 162, P.A. 1982, as amended, i.e., Sections 450.2101 - 450.3192 of the *Michigan Compiled Laws*), the Business Corporation Act (Act 284, P.A. 1972, as amended, i.e., Sections 450.1101 - 450.2099 of the *Michigan Compiled Laws*), and the Michigan General Corporation Act (Act 327, P.A. 1931, as amended, i.e., Sections 450.1 - 450.192 of the *Michigan Compiled Laws*).

* See glossary at end of report for definition.

Nonprofit Corporations

Nonprofit corporations are corporations established to carry out any lawful purpose or purposes not involving pecuniary profit or gain for the directors, officers, shareholders, or members. Unlike profit corporations, the members of a nonprofit corporation do not receive any profits of the corporation. Nonprofit corporations that have an Internal Revenue Code Section 501(c)(3) designation can obtain a State sales tax exemption.

The organization and regulation of nonprofit corporations are addressed in the Nonprofit Corporation Act (Act 162, P.A. 1982).

Charitable Organizations

A charitable organization (either incorporated or unincorporated) is an entity formed for benevolent, educational, philanthropic, scientific, public health, humane, religious, or other purposes or to benefit one or more other organizations that have a charitable purpose or conduct a charitable program. Charitable organizations include only those entities organized to advance a public purpose. Charitable organizations include both charitable solicitors and charitable trusts. Charitable organizations are established to benefit the public, which in turn give time, energy, and money to sustain the charity's intended purpose.

Although charitable organizations are typically nonprofit organizations, not all nonprofit organizations are charitable organizations. To be considered a charitable organization, the assets of the organization must be dedicated to carrying out the charitable mission of the organization. To obtain charitable tax-exempt status under Section 501(c)(3) of the Internal Revenue Code, organizations must apply to the Internal Revenue Service (IRS).

The laws relating to the organization, regulation, and supervision of charitable organizations and persons soliciting or collecting contributions for charitable purposes include the Charitable Organizations and Solicitations Act (Act 169, P.A. 1975, as amended, i.e., Sections 400.271 - 400.294 of the *Michigan Compiled Laws*), the Supervision of Trustees for Charitable Purposes Act (Act 101, P.A. 1961, as amended, i.e., Sections 14.251 - 14.266 of the *Michigan Compiled Laws*), and the Dissolution of Charitable Purpose Corporations Act (Act 169, P.A. 1965, as amended, i.e., Sections 450.251 - 450.253 of the *Michigan Compiled Laws*). The Public Safety Solicitation Act (Act 298, P.A. 1992, i.e., Sections 14.301 - 14.327 of the *Michigan Compiled Laws*) regulates the solicitation activities of police and public safety organizations.

State Oversight

The State's oversight of nonprofit organizations is administered by several agencies. The CIS Corporation Division administers the Nonprofit Corporation Act and is responsible for maintaining the public records of nonprofit corporations. The Charitable Trust Section, Department of Attorney General, is responsible for the registration and oversight of charitable nonprofit organizations. The Bureau of Elections, Department of State, oversees campaign funds, which are typically considered unincorporated nonprofit entities.

Department of Consumer and Industry Services

The Corporation Division, Bureau of Commercial Services, is responsible for facilitating the formation of Michigan business entities. As such, the Division provides services to facilitate the formation of corporations and issues certificates of authority to foreign nonprofit corporations to conduct affairs in the State. Corporations must appoint a resident agent and maintain a registered office in the State. If the corporation wishes to change the resident agent or the registered office address, it must file the change with the Corporation Division. Corporations are also required to annually report the names of officers and directors to the Division. The Division maintains a record of the filed documents for each corporation, makes this information available to the public, and responds to public inquiries regarding corporations.

As of December 2000, there were 57,013 domestic nonprofit corporations and 1,016 foreign nonprofit corporations with certificates of authority to conduct affairs in Michigan. During 2000, the Corporation Division dissolved 50 nonprofit corporations that had submitted certificates of dissolution and 24 nonprofit corporations because their period of duration had expired. The Division also dissolved 2,638 domestic nonprofit corporations for failure to file their annual reports within the two-year grace period and revoked 93 foreign nonprofit corporations' certificates of authority to conduct affairs in the State for failure to file their most recent annual reports. As of June 30, 2001, the Corporation Division included 54 employees.

Department of Attorney General

The State has established a higher level of oversight for charitable organizations as opposed to other nonprofit organizations because charitable organizations are established to benefit the public instead of a select group of members. The State has entrusted the Attorney General with protecting the interests of the public by overseeing the State's charitable organizations. This oversight role is critical to the public because

individuals rely on information collected by the Department of Attorney General to help them make wise decisions as to which charities to donate.

The Charitable Trust Section, Department of Attorney General, is charged with the administration and enforcement of four Michigan statutes. These statutes regulate charitable organizations, professional fund-raisers that solicit donations in Michigan, charitable organizations that hold charitable assets in Michigan, and police and fire organizations.

The Charitable Trust Section licenses charities soliciting or receiving contributions, registers charitable organizations that hold assets in the State, and responds to public inquiries regarding charitable organizations. The Section serves as a repository of financial and other information about the State's charities. This information is available to the public to assist individuals in making wise choices about what charities to support.

The Dissolution of Charitable Purpose Corporations Act provides that incorporated charitable organizations established to hold property for charitable purposes, except for religious organizations, shall not dissolve without first giving notice to and obtaining the consent of the Attorney General. The Attorney General has the authority to ensure that terminating charitable trusts distribute their assets to other charitable entities or for charitable purposes similar to those for which the assets were acquired.

The Charitable Trust Section reviews charitable organizations' requests for dissolution and requires proof that charitable assets have been properly distributed. The Section consents to the final dissolution of incorporated charitable organizations.

Most of the police and fire organizations do not fall within the requirements of the Charitable Organizations and Solicitations Act because they are not charitable organizations. However, they are nonprofit organizations. Public safety organizations, as defined by the Public Safety Solicitation Act, must register with the Attorney General prior to soliciting donations.

As of December 2000, the State had 7,597 registered charitable organizations, 4,125 licensed charitable solicitors, 270 licensed professional fund-raisers, 77 registered public safety organizations, and 16 fund-raisers registered to act on behalf of those public safety organizations.

During 2000, the Department of Attorney General sent letters to 120 nonprofit corporations either approving the filing of a certificate of dissolution with the Corporation Division or expressing no interest because the corporation did not have charitable purposes. As of June 30, 2001, the Charitable Trust Section included 7 employees.

Campaign Funds and Religious and Educational Exempt Organizations

Our audit did not address campaign funds or religious and educational organizations. Campaign funds are considered nonprofit organizations but are not charitable organizations and are regulated by the Bureau of Elections, Department of State. Religious organizations or their affiliated groups that have received Internal Revenue Code Section 501(c)(3) tax-exempt status as well as charitable corporations that are organized and operated primarily as educational institutions are specifically exempted from the State's statutory oversight of charitable organizations.

Audit Objectives, Scope, and Methodology and Agency Responses

Audit Objectives

Our performance audit of State Activities Related to Nonprofit Organizations, Department of Attorney General and Department of Consumer and Industry Services (CIS), had the following objectives:

1. To assess the effectiveness and efficiency of the Department of Attorney General's registration and licensing of nonprofit organizations and the effectiveness of CIS's activities to facilitate the formation, existence, and dissolution of nonprofit corporations.
2. To assess the effectiveness of the Department of Attorney General's oversight of charitable nonprofit organizations.

Audit Scope

Our audit scope was to examine the State's registration, licensing, and oversight of nonprofit organizations. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Audit Methodology

Our audit procedures included an examination of records and activities primarily for the period January 1, 1998 through June 30, 2001. Our work was performed between December 2000 and June 2001.

We examined records of selected nonprofit corporations and charitable organizations to evaluate the State's registration and licensure processes; activities to facilitate the formation, existence, and dissolution of nonprofit corporations; and oversight functions. Although our audit covered both the Department of Attorney General and CIS functions, our primary focus was on charities and the Department of Attorney General's oversight because charities are more highly regulated and more sensitive to public opinion.

Our methodology included interviewing staff and management from the Department of Attorney General, CIS, the Department of State, and the Department of Treasury. We

reviewed applicable State statutes, administrative rules, policies and procedures, reference materials, Internal Revenue Code, and other states' requirements and practices to gain an understanding of the State's role regarding nonprofit organizations. We assessed the management control* pertaining to the filings of nonprofit corporations, the registration of charitable organizations, and the licensure of charitable solicitors to formulate a basis for defining the audit scope.

For our first objective, we reviewed the registration and licensing processes developed by the Department of Attorney General to register charitable organizations and to license charitable solicitors. We reviewed the processes by examining test groups of charitable organizations and charitable solicitors to determine whether the required documentation was on file prior to registering and/or licensing the corporations and organizations. We also reviewed the activities of CIS to facilitate the formation, existence, and dissolution of nonprofit corporations. We examined a test group of nonprofit corporations to determine whether the required documentation was on file prior to CIS's recognition of the nonprofit corporations' existence.

For our second objective, we tested the Department of Attorney General's charitable trust database for accuracy and completeness. We also tested charitable organizations' compliance with statutory requirements. We verified the existence of a test group of charitable organizations whose licenses and/or annual filings* were past due. We evaluated the effectiveness of the Department of Attorney General's oversight role in the dissolution of charitable nonprofit corporations, reviewed the distribution of assets, and obtained confirmation of the distribution from the recipients. We reviewed statutory requirements to determine if changes were needed to improve the State's oversight role. We further assessed the sufficiency of the information on the Department of Attorney General's web site.

Agency Responses

Our audit report includes 2 findings and 4 corresponding recommendations. The Department of Attorney General's preliminary response indicated that it generally concurs with the findings and has initiated action to comply with most of the recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the Department of Attorney General's written comments and oral discussion

* See glossary at end of report for definition.

subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require the Department of Attorney General to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

REGISTRATION, LICENSING, AND OTHER ACTIVITIES RELATED TO NONPROFIT ORGANIZATIONS

COMMENT

Background: The Corporation Division, Department of Consumer and Industry Services (CIS), provides services to facilitate the formation, existence, and dissolution of nonprofit corporations. In order to form a nonprofit corporation, articles of incorporation must be prepared and be submitted to and filed by the Division. The articles of incorporation must include the name of the corporation; the resident agent and the registered office of the corporation; the specific purpose of the corporation; the term of existence for the corporation; the number and class of shares to be offered, if any; the name and address of the incorporators; and any additional provisions required or permitted under the governing act. This may include distributions of assets and dissolutions. The Division maintains a record of the filed documents for each corporation, makes this information available to the public, and responds to public inquiries regarding corporations.

The Charitable Trust Section, Department of Attorney General, is responsible for the licensure of charitable solicitors and for the registration of charitable organizations. The Section makes the determination of whether an organization must be licensed, registered, or both after reviewing the organization's completed questionnaire and requested documentation. Incorporated charitable organizations must submit a copy of their articles of incorporation. Unincorporated charitable organizations must submit a copy of their organizing document, such as a constitution and bylaws or trust agreement. Organizations that have received tax-exempt status from the Internal Revenue Service (IRS) must provide a copy of their IRS determination letter.

To become licensed, the charitable solicitor must file an application and supporting documentation with the Section. Supporting documentation includes a copy of the organization's IRS return and also may include, depending upon the organization's level of support, financial statements that have been audited or reviewed by an independent certified public accountant. If the organization intends to continue to solicit or receive

contributions in Michigan, this license must be renewed annually by filing a renewal application and supporting documentation.

To register, the charitable organization must submit a registration statement and an inventory of its assets. A registered charitable organization must annually submit its most current financial accounting to the Section within six months following the end of its fiscal year. If the organization is also applying for a solicitation license or renewal of its license, the financial supporting documentation submitted with the application will meet this requirement. If it is not required to be licensed, the registered organization must provide a copy of its IRS return, financial statements, or other financial accounting. Organizations that are not licensed and have gross receipts of less than \$25,000 during the fiscal year and hold assets valued at less than \$100,000 may qualify to have their financial accounting requirement waived. This requirement will be waived only after the organization has submitted at least one financial accounting to the Section.

Audit Objective: To assess the effectiveness and efficiency of the Department of Attorney General's registration and licensing of nonprofit organizations and the effectiveness of CIS's activities to facilitate the formation, existence, and dissolution of nonprofit corporations.

Conclusion: We concluded that the Department of Attorney General was generally effective and efficient in registering and licensing nonprofit organizations and that CIS was generally effective in facilitating the formation, existence, and dissolution of nonprofit corporations.

Noteworthy Accomplishments: The CIS Corporation Division has developed a half-day training seminar offered throughout the year for newly formed nonprofit corporations and persons interested in establishing nonprofit corporations. The seminar covers background information, filing requirements and forms to file, IRS issues and tax-exempt designation, directors' and officers' duties and responsibilities, and a directors' guidebook. Department of Attorney General staff also participate in the seminar, which addresses the requirements for charitable nonprofit corporations. Each participant receives a comprehensive desk reference manual.

Since 1995, the Department of Attorney General has eliminated a five-year backlog of initial filings, which included a review of the filing documentation to determine each charitable organization's need for licensure and/or registration. The Department has also largely eliminated a seven-year backlog of new filings by charitable trusts;

processed registration statements, inventories, and financial accountings; and included this seven-year backlog of information in its database.

OVERSIGHT OF CHARITABLE NONPROFIT ORGANIZATIONS

COMMENT

Background: The Department of Attorney General has been entrusted with the oversight responsibilities of charitable organizations and professional fund-raisers as part of its statutory responsibility to protect the interests of the people of the State and ensure that the purposes of the trusts have been carried out. To accomplish this, the Department requires charitable solicitors to annually renew their licenses; requires charitable trusts to submit annual filings of financial and other information; and requires professional fund-raisers to be bonded, to annually renew their licenses, and to submit annual financial reports. This information is included in a database and is available to the public to assist individuals in their assessment of the worthiness of a charitable organization. The Department continues its oversight role during the dissolution, merger, conversion, and withdrawal of charitable organizations.

Most charitable corporations that hold property for charitable purposes cannot be dissolved without first giving notice to and obtaining the consent of the Department. Prior to approving the requests for dissolution, the Charitable Trust Section is required to ensure that the charitable organizations have complied with their dissolution plans and have properly disposed of any remaining assets.

The Section is also responsible for reviewing mergers and conversions that involve the demise of an organization holding charitable assets or the transfer of charitable assets. The Section reviews the following documents for mergers, conversions and withdrawals: an explanation of the transaction, copies of the merger plan and merger agreement, the articles of incorporation, IRS status, IRS returns, financial statements and recent audits, information on the survivor, and an inventory of assets held in Michigan and their disposition.

Audit Objective: To assess the effectiveness of the Department of Attorney General's oversight of charitable nonprofit organizations.

Conclusion: We concluded that the Department of Attorney General was generally effective in overseeing charitable nonprofit organizations. However, we noted reportable conditions related to oversight enhancements and web site enhancements.

Noteworthy Accomplishments: The Department of Attorney General's Charitable Trust Section has increased its outreach to and education of the nonprofit community by participating in and presenting information at seminars and conferences, including Statewide nonprofit conferences as well as making presentations to groups and associations. It has also been both a participant and a presenter at the annual meetings of the National Association of State Charity Officials, which is affiliated with the National Association of Attorneys General. The Section shares information regarding charitable activities and solicitations with other states, the Federal Trade Commission, and the IRS. The Section also works with other organizations to ensure that nonprofit organizations receive complete, timely, and accurate information.

FINDING

1. Oversight Enhancements

The Department of Attorney General could enhance the effectiveness of its oversight of charitable organizations.

The Department is responsible for ensuring that the State's charitable organizations comply with statutory requirements and for establishing rules, regulations, policies, and procedures to carry out the day-to-day activities related to the oversight responsibilities. The Department also has a primary role in identifying needed statutory changes that would enhance the effectiveness of its oversight responsibilities.

Our review of the oversight of charitable organizations identified areas in which the Department could enhance its effectiveness by:

a. Pursuing statutory authority to:

- (1) Charge charitable solicitors and charitable organizations for licensure, registration, or annual renewal fees. At the time of our audit, four employees within the Charitable Trust Section were responsible for annually licensing and registering the State's charitable organizations and

for updating the Section's database with financial and other information submitted by the State's charitable organizations. Charging annual fees for licensure and registration would help to ensure that the costs of the program are assessed to the program's participants. Typically, when the costs of the program are passed along to the program participants, both the participants and the State evolve to a higher level of expectations and outcomes.

- (2) Charge charitable organizations late fees when they do not meet the deadlines for renewing their licenses or for filing their required financial information.

As of April 4, 2001, 1,464 (28%) of the 5,210 charitable solicitors' licenses had been expired 1 to 115 months and approximately 1,559 (21%) of the 7,290 registered charitable trusts were past due by 1 to 195 months in submitting their most recent annual filings to the Section. The Section did not follow up charitable organizations that did not meet the deadlines for renewing their licenses or for filing their required financial information.

Also, the Section's internal procedures did not facilitate the annual renewal and filing processes. The Section sends out license renewal notices; however, these notices are included with the mailing of the current year's license and, thus, are received approximately one year prior to the license expiration date. In addition, the Section does not send out requests to registered charitable trusts for current financial information. Instead, the Section informs the charitable trusts of their annual filing requirements only when it mails out the initial registration material.

Late filing fees implemented in other states have resulted in fewer delinquent filings.

- (3) Increase the charitable organizations' reporting threshold. The charitable organizations' reporting threshold of \$8,000 has not been revised since it was established by legislation in 1975.

Charitable organizations that solicit or receive contributions of more than \$8,000 or charitable organizations that compensate anyone, including

employees, for fund-raising services must obtain a charitable solicitation license and must annually provide the Department with the organizations' IRS tax forms and audited or prepared financial statements, as applicable.

The IRS has established a \$25,000 threshold as its reporting requirement for these same charitable organizations. At least 14 other states have thresholds of \$25,000 or higher. Approximately 700 of the State's 7,290 charitable organizations would benefit from raising the reporting threshold to \$25,000 by no longer having to incur additional expenses related to preparing the IRS 990-EZ form.

The Department has drafted a comprehensive set of statutory amendments that address these issues. These amendments were supported by the philanthropic and nonprofit communities. The House of Representatives unanimously adopted this amendatory legislation during both the 1997-98 and 1999-2000 legislative sessions. During the same period, the Senate did not schedule a vote on the amendatory legislation.

- b. Improving its oversight of existing statutory requirements. For example:
 - (1) The Section did not independently verify the distribution of assets of charitable organizations that were in the process of dissolution. The Department is required to approve the dissolution of incorporated charitable trusts. It is also responsible for ensuring that charitable organizations do not dispose of their assets in a manner inconsistent with their articles of incorporation, bylaws, or statutory requirements.

As part of our testing, we mailed out confirmation requests to 28 charitable organizations in the process of dissolving and received 25 responses. We received positive confirmation that each of the 25 respondents had received the assets as reported by the dissolving charitable organization to the Section. The assets from the 25 positive confirmations totaled approximately \$863,000. An independent verification would provide the Department with more assurance that the dissolving charitable organization has complied with statutory requirements in disposing of the organization's assets.

- (2) The Section did not determine whether charitable trusts that were overdue in submitting their annual filings were still in existence or in the process of dissolving. Failure to submit the most recent annual filings may be the first indication that the charitable organization is in the process of disposing of assets and dissolving. As of April 4, 2001, there were 2,002 charitable corporations with overdue registrations included in the Section's database. Some of these charitable corporations may have begun the process of dissolving and may not have been aware of the statutory requirement to obtain the Department's approval.

Also, the Section did not follow up with incorporated charitable organizations that either had started the dissolution process by requesting a dissolution questionnaire but had not returned it to the Section or had not responded to the Section's request for additional information following the Section's receipt of the dissolution questionnaire. To carry out its oversight responsibilities of dissolving charitable organizations, the Section needs to enhance its efforts to stay in contact with those charitable organizations that have indicated to the Section their intentions to dissolve.

- c. Developing written policies and procedures to ensure the consistency of day-to-day operations.

The Department could improve the consistency of its day-to-day operations by developing written policies and procedures. Staff relied on information provided in memorandums, various forms, and internal checklists. Although this information is useful, it does not compensate for written policies and procedures. Written policies and procedures would provide instruction for day-to-day procedures that have not been addressed in statutory regulations and corresponding administrative rules.

The lack of written policies and procedures impacts the effectiveness of Section operations and hinders the consistency of practices. Written procedures are also valuable in training new employees and serve as guides for more effective and uniform Section operations.

RECOMMENDATIONS

We recommend that the Department of Attorney General enhance the effectiveness of its oversight of charitable organizations by:

- a. Continuing to seek amendatory legislation to help enhance the effectiveness of existing statutory requirements.
- b. Improving its oversight of existing statutory requirements.
- c. Developing written policies and procedures to ensure the consistency of day-to-day operations.

AGENCY PRELIMINARY RESPONSE

The Department of Attorney General generally concurs with the finding. Specifically:

- a. As the report acknowledges, the Department drafted and sought to advance comprehensive statutory amendments that address every area of potential enhancement identified by the Auditor General. In the two years prior to the current legislative session, these amendments passed the House unanimously and were supported last year by the philanthropic and nonprofit communities. Without broad bipartisan support, there is little likelihood that the Legislature will take action to pass the amendments in both houses.
- b. The Department agrees that sending solicitation license renewal notices and overdue registration accounting notices would be beneficial. A superior mechanism to achieve a higher level of timely compliance would be the imposition of late fees for delinquent filings. The authority to assess late fees is among the array of statutory changes the Department has been seeking. While the Department believes that it is meeting all statutory obligations and is using its limited resources efficiently, it will also attempt to provide greater follow-up as its technological and other resources improve.

The Charitable Trust Section now requires that dissolving entities provide verification, usually in the form of signed receipts, that assets have been distributed to other charitable entities. The Auditor General proposes that, to ensure that those receipts are accurate and not falsified in some way, an

independent verification that the recipient charities have received the distribution is warranted. However, the Auditor General's tests in this regard did not find any instances in which independent verification would have indicated results different from the Section's confirmation of asset distributions. Further, secondary independent verification does occur in many instances and the Section's procedures for verifying asset distributions are consistent with procedures used in Michigan courts (which generally do not require independent verification). Finally, the Department believes that the Section's verification procedures already go well beyond those of almost all other states. While the Auditor General's recommendation that the Section implement a second post-dissolution verification may add minimally to the Section's effectiveness in dissolution oversight, in the Department's view, this would be an inefficient use of Section resources. A superior mechanism to further diminish the potential of improper distribution of charitable assets, as well as to address the issue of nonresponse of dissolving entities, would be amendment of the Dissolution of Charitable Purpose Corporations Act to provide for the imposition of civil penalties for the failure to make timely and appropriate distributions.

- c. The Department has developed draft procedures for the issuance of charitable solicitation licenses, the most complex procedure performed by the Section. Staff will also be working on draft procedures and procedures manuals for the other eight procedures conducted by the Section, although the audit focused on only two of those procedures, issuing charitable solicitation licenses and registering charitable trusts.

FINDING

2. Web Site Enhancements

The Department of Attorney General could enhance the public's accessibility to charitable organization-related information by placing it on the Department's web site.

The Department has developed a web site that is organized by topical areas. The web site includes a link to its "charitable giving" site, which provides information related to the Charitable Trust Section. The charitable giving site includes procedures and requirements for registering a charitable organization, statutes

applicable to charitable organizations, consumer alerts, frequently asked questions, and licensing and registration forms that can be downloaded by charitable organizations.

The Department has not provided a listing of the State's registered charitable organizations and licensed professional solicitors* or the financial information and statistical data of the State's registered charitable organizations and licensed charitable solicitors on the Department's web site. Instead, when an individual wants to verify that a charitable organization is registered or that a professional solicitor is licensed to solicit or receive charitable contributions within the State, the individual must contact the Section and have staff look up the information on the Section's database. Similarly, when an individual wants to review a charitable organization's financial information, the individual must contact the Section and request the information. We compared the contents of the other 49 states' and the District of Columbia's web sites and determined that: 22 states and the District of Columbia do provide listings of their registered charitable organizations and/or professional solicitors; 16 states provide financial information regarding their charitable organizations and/or professional solicitors; and 12 states provide statistical data related to their charitable organizations and/or professional solicitors.

Although the Section encourages individuals to make wise and informed decisions regarding their charitable donations and provides information and answers questions asked by consumers who call the Section, the information could also be made available by other means. The Department could provide this information to the public by including a listing of the State's registered charitable organizations and licensed charitable solicitors and their essential financial information and statistical data on its web site.

During our audit, we determined that the Section had examined the charitable organization-related information that other states included on their web sites for the purpose of improving the content of the Department's web site. However, we were informed by the Section that because of a lack of resources, it has not been able to pursue upgrading the information available on the existing web site.

* See glossary at end of report for definition.

The Department's web site does provide charitable organizations with useful information, including statutory requirements and various required forms and questionnaires that can be downloaded over the Internet. This web site receives approximately 900 inquiries per month.

RECOMMENDATION

We recommend that the Department of Attorney General enhance the public's accessibility to charitable organization-related information by placing it on the Department's web site.

AGENCY PRELIMINARY RESPONSE

The Department of Attorney General concurs with the finding. The Charitable Trust Section has already upgraded the Department's web site to include a list of licensed charitable organizations that is updated each week. It is the intention of the agency to continue to upgrade the web site to include financial information regarding licensed charities. The amendments to the Charitable Organizations and Solicitations Act include a public education requirement and dedicate funds to carry out this mission. Therefore, once the amendments are enacted and funds become available, the agency can more completely fulfill the recommendation. Fulfilling the recommendation, however, is also dependent on technical support that must be made available through the newly created Department of Information Technology.

SUPPLEMENTAL INFORMATION

STATE ACTIVITIES RELATED TO NONPROFIT ORGANIZATIONS
Comparison of States With Similar Charitable Oversight Operations (1)

| State | State Population (in millions) | Employees | Attorneys | Staff | Registered Charities | Number of Registered Charities per | | |
|---------------------|--------------------------------------|--|--|--|-------------------------|------------------------------------|--------------|--------------|
| | | Involved in Charitable Oversight | Involved in Charitable Oversight | Assigned to Registration Functions | | Employee | Attorney | Staff |
| California | 33.9 | 40 | 10 | 24 | 82,000 | 2,050 | 8,200 | 3,417 |
| New York | 19.0 | 58 | 18 | 8 | 40,000 | 690 | 2,222 | 5,000 |
| Ohio | 11.4 | 32 | 8 | 4 | 3,000 | 94 | 375 | 750 |
| Michigan (2) | 9.9 | 9 | 1 | 4 | 4,125 | 458 | 4,125 | 1,031 |
| Massachusetts | 6.3 | 20 | 7 | 5 | 41,000 | 2,050 | 5,857 | 8,200 |
| Minnesota | 4.9 | 12 | 3 | 5 | 5,501 | 458 | 1,834 | 1,100 |
| New Hampshire (3) | 1.2 | 4 | 1 | 1 | 6,000 | 1,500 | 6,000 | 6,000 |

- (1) Six other states have charitable oversight operations that are similar to Michigan's Charitable Trust Section. Each of these states registers charities, professional fund-raisers, solicitors, and charitable trusts that hold assets within the state; maintains a database of information regarding the state's charitable organizations; approves the dissolution of charitable corporations; and oversees estates that include charitable bequests. This table provides selected information regarding the six states.
- (2) Michigan is the only state listed that licenses charities and professional fund-raisers.
- (3) New Hampshire does not have an annual registration renewal. Its registration is a one-time-only process.

Source: Charitable Trust Section, Michigan Department of Attorney General

Glossary of Acronyms and Terms

| | |
|--------------------------------|--|
| annual filings | Documentation required to be submitted yearly by charitable trusts including: a completed IRS 990 (or comparable) form; a completed IRS 1041-A form; a certified public accountant audit, court accounting, or bank trust accounting; and a completed charitable solicitation license (renewal) application. |
| CIS | Department of Consumer and Industry Services. |
| charitable organization | An entity formed for benevolent, educational, philanthropic, scientific, public health, humane, religious, or other purposes or to benefit one or more other organizations that have a charitable purpose or conduct a charitable program. Charitable organizations include only those entities organized to advance a public purpose. Charitable organizations include both charitable solicitors and charitable trusts. All assets of a charitable organization must be used for the established purpose of the charity. |
| charitable solicitor | An entity that solicits contributions for a charitable purpose. A charitable organization that requests or receives funds for charitable purposes must have a charitable solicitation license. |
| charitable trust | A charitable organization with assets, including cash, real or personal property, investments, or anything of value, that are held for a charitable purpose or for the use or benefit of a charitable organization. |
| consent | The Attorney General's approval of a charitable nonprofit corporation's request to dissolve. |
| contributions | The promise, grant, or payment of money or property of any kind or value, including promises to pay. |

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| corporation | An association of persons created by law and existing as an entity, with powers and liabilities independent of those of its shareholders or members. |
| dissolution | The process used by a corporate entity to cease its existence. The process involves resolving liabilities, disposing of assets, and filing required final documents with all State and federal taxing and regulatory authorities. A dissolved corporation continues its existence but shall only conduct affairs incident to the liquidation of its affairs. |
| effectiveness | Program success in achieving mission and goals. |
| efficiency | Achieving the most outputs and outcomes practical for the amount of resources applied or minimizing the amount of resources required to attain a certain level of outputs or outcomes. |
| IRS | Internal Revenue Service. |
| license | The authorization granted to a charitable organization by the Charitable Trust Section to request and receive funds or assets in Michigan for a charitable organization or a charitable purpose. Such authorization is granted only after receipt of all information required by the application for license to solicit donations. |
| management control | The management control environment, management information system, and control policies and procedures established by management to provide reasonable assurance that goals are met, that resources are used in compliance with laws and regulations, and that valid and reliable performance related information is obtained and reported. |
| nonprofit | Not seeking a profit or a financial gain. |

| | |
|------------------------|--|
| nonprofit organization | An entity established to carry out any lawful purpose or purposes not involving pecuniary profit or gain for the directors, officers, shareholders, or members. |
| performance audit | An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action. |
| professional solicitor | A person who obtains donations on behalf of a charitable organization. |
| register | The process described in the Supervision of Trustees for Charitable Purposes Act, whereby forms and other required attachments are submitted to the Charitable Trust Section to create a file for a charitable organization. |
| reportable condition | A matter coming to the auditor's attention that, in the auditor's judgment, should be communicated because it represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner. |
| resident agent | Any individual resident of the State, authorized to conduct affairs, who has been appointed by the corporation as its agent upon whom documents, notices, or demands may be served. |