

TOP 10 Ways to Get Investigated by a State Regulator

In support of the [National Association of Attorneys General \(NAAG\)](#) & [National Association of State Charity Officials \(NASCO\)](#)

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When joining the board of a nonprofit organization, you take on a set of responsibilities and duties defined by law. In addition to being attentive to programs, finances, and fundraising, nonprofit board members must understand the regulatory environment in which their organizations operate. Many nonprofit activities and practices are guided by fundamental legal principles and state and federal laws and regulations. The legal risks involved in operating a nonprofit can be troubling unless its leaders are aware of the organization's and board's legal obligations, of the laws governing nonprofits, and of internal protective measures that can prevent many unnecessary headaches or irreparable damage.

In October 2016, the National Association of Attorneys General (NAAG) and the National Association of State Charity Officials (NASCO) unveiled the "Top 10 Ways to Get Investigated by a State Regulator" at their joint annual conference. State attorneys general have the power to bring a nonprofit to justice if it is not in compliance with state laws. Citizens and the media have been known to draw attention to major indiscretions in nonprofit organizations' activities that warrant investigation by state attorneys general. Additionally, the IRS monitors tax-exempt organizations and has the power to implement penalties should an organization not meet the expectations and qualifications that come with its tax-exempt privilege.

How can you avoid these top ten legal risks? BoardSource has compiled this resource to help you do just that. It includes links to additional resources available on our website — some are free community resources; others are restricted to BoardSource members or must be purchased.





BOARD GOVERNANCE — BOARD MEMBERS AND SENIOR LEADERSHIP FAILING TO BE SUFFICIENTLY ACTIVE AND INFORMED

It sounds basic, but one of the fundamental challenges that far too many board members and boards have is that they don't have a strong understanding of their roles and responsibilities. According to BoardSource's signature research, *Leading with Intent: A National Index of Nonprofit Board Practices*, more than a third of executives give their boards a grade of "C" or lower when it comes to understanding board roles and responsibilities. This lack of understanding of what is — and is not — a part of a board's essential roles can lead to a whole host of dysfunctions, such as rogue decision making, lack of engagement, and more.

Since it's impossible to do a job well if you don't know what a job is, all boards must take the time to ensure that every board leader fully understands what's expected and needed of him or her, and then hold all board members accountable when they get off track.

To avoid getting investigated by a state regulator:

- **Know your legal duties**, which include
 - Duty of Care — Every board member has a legal responsibility to participate actively in making decisions on behalf of the organization and to exercise his or her best judgment while doing so.
 - Duty of Loyalty — Every board member must put the interests of the organization before his or her personal interests when acting on behalf of the organization in a decision-making capacity. The organization's needs come first.
 - Duty of Obedience — Board members bear the legal responsibility of ensuring that the organization complies with the applicable federal, state, and local laws and adheres to its mission.
- **Spend significant time and attention on identifying, recruiting, and engaging your board members.** Organizations with committed and involved board members spend significant time and attention on each of the nine steps of [The Board Building Cycle](#) — identify, cultivate, recruit, orient, involve, educate, evaluate, and celebrate. Good boards take care, thought, planning, and evaluation.
- **Educate your board about its governance responsibilities and your nonprofit.** Good governance doesn't just happen. Adopt a [board development plan](#) that includes [board orientation](#), [board education seminars](#), and a biennial [board self-assessment](#).
- **Implement a committee structure that helps the board manage its responsibilities.** Keep in mind that, depending on which state(s) your nonprofit is incorporated or does business, you may be required to have certain committees.

Additional Resources

[Board Fundamentals: Understanding Roles in Nonprofit Governance](#)

[Legal Responsibilities of Nonprofit Boards](#)

[Ten Basic Responsibilities of Nonprofit Boards](#)

[The Committee Series](#)

[The Nonprofit Chief Executive's Ten Basic Responsibilities](#)

[Nonprofit Essentials - FAQs](#)

[Legal and Compliance Issues - FAQs](#)

[Board recruitment resources](#)

[Board Orientation Checklist](#)

[Dealing with Resistance to Board Self-Assessment](#)



FAILURE TO SAFEGUARD ASSETS

We've all heard stories about charity monies that were misused, programs that were mismanaged, and solutions that never materialized. The public wants — and deserves — to be assured that someone is watching the register, that someone is ensuring that an organization's resources are being used wisely, thus positioning it to make the biggest impact possible. That someone is the board.

The nonprofit board has fiduciary responsibility for the organization — for safeguarding the organization's assets, or holding them “in trust” on behalf of the public. In fact, providing oversight of finances and programs, as well as the organization's legal and ethical conduct, is the most important reason for having a board.

Fiscal oversight addresses the board's responsibility to review and approve how the organization budgets, spends, and earns money. The board may work in concert with the chief executive and/or delegate some details to finance, audit, and/or investment committees, but it always retains the final responsibility for fiscal oversight, for safeguarding assets. It must ensure the organization operates in compliance with the law and its own policies. Individual board members, as well as key employees of a nonprofit, can be held personally liable for their own acts and deeds should they breach the standard of fiduciary responsibility.

To avoid getting investigated by a state regulator:

- **Establish and follow [financial policies](#) and [internal controls](#)** that segregate financial duties, protect cash receipts, require second signatures on large checks, keep track of inventory, require an efficient bidding process, produce timely reports, and maintain accurate recordkeeping. Appropriate internal controls create a firm base for an effective outside financial audit.
- **Conduct an independent audit** to verify that the organization's financial systems and practices meet accepted standards. It is the board's responsibility to ensure that any issues identified in the management letter are addressed. A clean, unqualified audit does not guarantee that there has been no financial impropriety, however, since the auditor can only judge by the documents provided. It is best practice for the board to meet with the auditors without staff present after the audit has been conducted. The board should also evaluate the performance of the organization's audit firm regularly
- **Review and approve an annual organization budget** that balances short- and long-term needs. The budget creates the framework for program management and overall administrative decisions. Ensure that the organization has adequate [operational reserves](#) for unexpected opportunities. If a diversion of funds is suspected (theft, embezzlement), call for an immediate investigation.
- **Provide competency education for board members to ensure that they [understand nonprofit financial statements](#) and examine financial statements regularly.** By comparing actual figures to projected ones, the board is able to verify that the organization is staying on track or question any major variances.
- **Establish [dashboard reporting](#)** tools that provide important indicators and flag risks. To be useful, dashboards need to contain reliable data, be produced on a timely basis, and be interpreted to inform meaningful decision making.
- **Review the Form 990.** The full board should review the Form 990 each year before it is filed. This ensures that board members are familiar with the information reported and that it accurately reflects the organization's financial and operating environment.

Additional Resources

[The Nonprofit Policy Sampler](#)

[The Nonprofit Dashboard: Using Metrics to Drive Mission Success](#)

[Understanding Nonprofit Financial Statements](#)

[Welcome to Your Key Financial Statements: A Primer for Nonprofit Board Members](#)

[Avoiding Financial Risks](#)

[Common Benefits of Dashboard Reporting Creating Nonprofit Policies](#)

[Financial and Fundraising - FAQs](#)

[Seven Questions to Ask When Reviewing the Annual Budget](#)

[Who Handles the Finances?](#)

[Are Your Financial Statements Trying to Tell You Something?](#)



CONFLICT OF INTEREST

Conflicts of interest can be surprisingly difficult for some board members to identify. The legal definition of a conflict of interest, usually included in state laws governing nonprofit corporations, is very specific and covers relatively few situations. In reality, most conflicts fall into a gray area where ethics and public perception are more relevant than legal statutes or precedents. For this reason, conflicts of interest are often misunderstood, misrepresented, ignored, or mishandled.

The fact is, conflicts of interest are an unavoidable part of the life of a busy board member. They can be financial, professional, or personal in nature and can even hide behind good intentions. They can be perceived, actual, or potential. Not matter what, they require attention, if not action. Even if there is no actual conflict, you should be mindful that just the question of conflict can erode public trust.

Dealing with conflicts of interest starts with understanding types of conflict so they can be avoided.

- [Ethical](#) lapses may not be spelled out in a strict form in any law book but, rest assured, a victim in a case dealing with confidentiality, loyalty, or conflict of interest may seek legal remedy.
- If an individual who has significant influence over the organization enters into an arrangement with the nonprofit and receives benefits greater than she or he provides in return, you are likely dealing with [private inurement](#).
- Similarly, when a person is on both sides of a financial transaction, he or she is engaged in [self-dealing](#). In a nonprofit organization, this may happen when the organization does business with a board member. The board member is in a position of influence within the organization, and he or she may be seen as obtaining personal benefit from a financial relationship.

To avoid getting investigated by a regulator:

- **Establish and follow [conflict of interest policies](#).** They will help your board identify possible conflicts of interest, provide a framework for evaluating the possible conflict, and guide decision making. In addition to simply having a conflict-of-interest policy, board members should review the policy annually and sign to confirm their understanding.
- **Vet potential board members during the recruitment process to identify possible conflicts.** However, having conflicts does not have to preclude board service. Your conflict-of-interest policy should establish a process to work through the conflict.
- **Document all conflict conversations** in the meeting minutes.

Legal and Ethical Oversight Resources

[Managing Conflicts of Interest: The Board's Guide to Unbiased Decision Making](#)

[Coming to Terms with Conflict of Interest](#)

[Legal and Compliance Issues - FAQs](#)

[ePolicy Sampler – Ethics and Accountability](#)

[Legal & Ethical Oversight](#)

[The Board Building Cycle: Nine Steps to Finding, Recruiting, and Engaging Nonprofit Board Members](#)

4

EXCESSIVE COMPENSATION AND/OR EXECUTIVE DIRECTOR WITH TOO MUCH POWER

Excessive executive compensation receives a lot of media attention. Those who believe that the nonprofit sector has become too professionalized and “corporate” cite excessive nonprofit compensation as an example of how organizations are losing sight of their mission and their distinctiveness as nonprofits.

Because revelations of inordinately high compensation can erode donor confidence and cause increased public skepticism, board members should pay close attention to their compensation decisions. The compensation of board members, officers, and key employees of the organization is included on the IRS Form 990 — a public document that must be made available when requested by members of the public, including the press. The real challenge many boards face is not how to reign in excessive compensation, however, but rather how to find the resources to pay appropriate salaries.

No matter your situation, the IRS evaluates the following when determining if executive compensation is appropriate:

- Was the compensation decision made by an independent board?
- Was appropriate comparable compensation data obtained?
- Was the basis for determining compensation documented?

Intermediate Sanctions regulations enable the IRS to impose excise taxes and other penalties on nonprofit executives who are over-compensated.

To avoid getting investigated by a state regulator:

- **Evaluate the appropriateness of your [executive compensation](#)** by considering the size and complexity of your nonprofit; the mission area, geographic location, and financial condition of the organization; the qualifications required for the job; and compensation at comparable organizations.
- **Educate yourself about intermediate sanctions and private inurement.** Excessive compensation is the most common form of [private inurement](#), which the IRS condemns through [intermediate sanctions](#) (significant excise taxes). Insiders — referred to in IRS parlance as “disqualified persons” — can be high-level managers, board members, founders, major donors, highest paid employees, family members of any of the above, and a business where the listed persons own more than 35 percent of an interest.
- Keep in mind that **executive compensation is not limited to salary**; bonuses and all other incentives should also be considered.
- **Develop a compensation policy** that is not exclusive to the chief executive; the organization-wide policy should include overall compensation philosophy and strategy.
- **Create accountability through [chief executive performance evaluation](#).** Performance management should be a full-year process that involves goal setting, support and oversight, and an annual [assessment of the chief executive](#).

An executive director or CEO with too much power is indicative of a weak, rubber-stamping board and weak board–staff partnership. In strong boards, members comprehend their role as the fundamental unit guiding the organization. In some weak boards, individual board members are oblivious to their specific responsibilities and obligations and are content to be led by others. They neglect the duty of care, one of the legal obligations of board service, and do not ask pertinent questions, consider various solutions to dilemmas, or consult each other or outside experts before voting on issues. When the entire board does not understand its role as a strategic leader, executive directors and CEOs can use this weakness to their advantage and make the organization follow their private agendas.

To avoid getting investigated by a state regulator:

- Ensure that each board member understands his individual and the full board's responsibilities and liabilities. Rely on your [governance committee](#) to [recruit](#) capable and willing members, draft [job descriptions](#), and structure board member [orientation and continuing education](#).
- Enhance [chief executive–board collaboration](#). Recognize that only through working together can the governing body and management reach mutual objectives. Schedule regular check-ins between the executive and chair, commit to “no surprises,” and assess both the board's and the executive's performance on a regular basis.
- Ensure that thoughtful deliberation incorporating a variety of perspectives precedes [decision making](#).

Additional Resources

[ePolicy Sampler – Personnel Policies](#)

[ePolicy Sampler – Chief Executive](#)

[Financial and Fundraising - FAQs](#)

[Nonprofit Executive Compensation: Planning, Performance, and Pay](#)

[Nonprofit Chief Executive Job Description](#)

[Performance Expectations for the Chief Executive](#)

[Building the Governance Partnership: The Chief Executive's Guide to Getting the Best from the Board](#)

[Assessment of the Chief Executive](#)

[Board Self-Assessment](#)

[Moving Beyond Founder's Syndrome to Nonprofit Success](#)

[Assessing and Supporting Your Chief Executive: A BoardSource Toolkit](#)

[Board-Staff Interaction: What's Acceptable, What's Not? You Ask, We Answer](#)

[Setting Goals for Your CEO](#)

[CEO Compensation Checklist](#)

[How to Conduct a Chief Executive Performance Assessment](#)



CLEAR FAILURE TO FOLLOW THE MISSION OF THE NONPROFIT

Your organization's articles of incorporation and the original determination letter define the purpose and the structure of your organization. Fulfillment of the mission is the primary justification for a nonprofit's existence. Directing the organization, whether intentionally or not, in activities that deviate from mission can put the organization in non-compliance with the articles of incorporation and at risk of losing its tax-exempt status.

To avoid getting investigated by state regulators:

- **Decide what your organization's priorities are given limited dollars and unlimited demands.** Through the [strategic plan](#), the board ensures that current and proposed programs and services align with the organization's stated mission and purposes. Once priorities are chosen, the board then needs to monitor progress (at a macro level) to ensure the programs are running smoothly and to identify opportunities where the board may be able to support the staff with additional resources or discussion. It can be tempting for boards to get interested in the details of the programs and veer into [micromanagement](#). Boards can avoid this by focusing on the strategic level and by asking themselves, "How do we know whether the organization is making a difference or advancing on the mission?"
- **Do not accept gifts that do not relate to your mission.** If a donor proposes to fund a pet project or offers seed money for an activity that does not relate to the mission and purpose of the organization, the board must carefully assess the consequences of accepting this money. Without clear guidelines — or blinded by a generous offer — the organization may veer off course and become involved in activities that will drain resources from its bona fide programs. "Follow the mission" is the strongest gift acceptance policy any board can have.
- **Do not change the mission or purpose of the organization without appropriately notifying the IRS and the office of the secretary of state.**

Additional Resources

[ePolicy Samper – Mission Related Issues](#)

[The Nonprofit Board's Role in Mission, Planning, and Evaluation](#)

[Driving Strategic Planning: A Nonprofit Executive's Guide](#)

[Stand for Your Mission](#)

[Nine Characteristics of a Mission Statement](#)

[Mind the Gap: Mission Accomplishment Measures](#)

[Mission Statement](#)



MEMBERSHIP ORGANIZATION BOARD CONFLICT

The Duty of Loyalty refers to pursuing the best interests of the organization above all else. This entails acting in good faith, avoiding conflicts of interest, and putting aside personal and professional interests. But this can be especially hard for membership organizations where many board seats are committed to and occupied by members of association chapters, affiliates, or members who also have a Duty of Loyalty to their own organization.

Remember, however, that when you have people with different values, perspectives, and communication styles — as a board should — it is almost inevitable that conflict will sometimes occur. The impact of conflict depends on what the conflict is about, how it is initiated, and how it is managed. Submerged conflict eventually surfaces. When someone raises a controversial issue, he or she at least gives others a chance to address the issue. When differences of opinion aren't expressed, people may enter into covert forms of conflict that aren't readily apparent.

To avoid getting investigated by a state regulator:

- **Put aside the best interest of the home organization** if you serve on as a national board member. You must act in the best interest of the association as a whole.
- **Create a [collaborative team culture](#) in your boardroom.** One reason boards can experience conflict is because they lack a shared goal, a common purpose. To address this, develop a board mission statement, determine a goal, maintain a sense of urgency and focus, and assess the board's performance on a regular basis.
- **Control conflict.** Use these tactics to keep conflict healthy and productive:
 - Disagree with the idea: don't criticize an individual.
 - Respond to disagreement with a spirit of inquiry. Ask for clarification or examples.
 - Focus on commonalities. Point out the similarities between individual perspectives. Build on those.
 - Ask two people who most oppose each other to sit down together and work out a common approach.
 - If the board is deeply divided, postpone decision making. Appoint a task force to work on a proposal to the board. Include all factions on this task force.
- **Discuss [confidential](#) topics in [executive session](#),** rather than during [open meetings](#).

Additional Resources

[Membership Organizations](#)

[Role of the National Board](#)

[Executive Sessions: How to Use Them Regularly and Wisely](#)

[ePolicy Sampler – Ethics and Accountability](#)

[Govern as a Team](#)

[Handling Conflict During Board Meetings](#)



MISUSING YOUR ENDOWMENT OR RESTRICTED ASSETS

Many nonprofits — including schools and universities and foundations — have endowments and/or restricted assets.

Endowments can serve numerous purposes, providing financial stability, regular income, emergency funds, funding for new opportunities, generational equity, and confidence. Some nonprofits conduct capital campaigns to create or grow their endowment.

Restricted assets are money or other items of value that have been given to a nonprofit with the stipulation that the gift be used for a specific purpose — its use is restricted.

During the transfer of assets, the donor delegates the overall management and supervision of the funds to the organization's board and stipulates the primary objectives of their use. Complications arise when an organization does not honor donor intent or experiences major change that impacts the original intent of a gift.

The Cy Pres Doctrine requires that when a gift is made by will or trust (usually for charitable or educational purposes), and the named recipient of the gift — the foundation or nonprofit — does not exist, has dissolved, or no longer conducts the activity for which the gift is made, then the estate or trustee must make the gift to an organization that comes closest to fulfilling the purpose of the gift. Sometimes this results in heated court disputes in which a judge determines the appropriate substitute to receive the gift.

To avoid getting investigated by a state regulator:

- **Respect the original intent of the donor.** Donors often stipulate the types of activities that their gift should support. It is worth repeating, nonetheless, that the donor gives up the “ownership” of the funds — he or she alone can no longer make financial decisions regarding the use of the funds. Without this premise, the original gift is not [tax deductible](#).
- When creating an endowment, **create an endowment resolution.** This resolution should address the following questions:
 - What is the purpose of this endowment and how will it tie in with the mission of the organization?
 - Who will manage the endowment? Will we have an independent investment committee or will we hire an outside manager?
 - What is going to be our investment strategy? How can we ensure that the separate and detailed investment policies remain in accordance with this strategy?
 - What will our disbursement policy be? Will the board have the authority to transfer funds under special circumstances?
- **Invest your funds prudently and supervise all investments and investors/advisors.** Remember, the board has fiduciary responsibility for the organization and must ensure that the organization is appropriately stewarding the resources entrusted to it and following all legal and ethical standards.

Additional Resources

[Financial and Fundraising Issues – FAQs](#)

[Foundation Board Basics](#)

[Fundraising Responsibilities of Nonprofit Boards](#)

[ePolicy Sampler – Finance and Investments](#)

[Who's Minding the Money: An Investment Guide for Nonprofit Board Members](#)

[Donor Bill of Rights](#)



FUNDRAISING ISSUES

The board is responsible for ensuring the organization has the financial resources with which to operate and for overseeing the faithful use of all funds received in accordance with donor restrictions, accounting standards, and legal and ethical requirements. This includes adopting appropriate fundraising policies and supporting the organization's fundraising activities.

Today, there is a lot of attention paid to how nonprofits raise and use the dollars that they need to support their missions. You don't have to look far to find news stories and other advisories about organizations that are being accused of spending too much on fundraising. While it is possible to spend too much on fundraising, which can erode the public's trust in an organization, fundraising is absolutely mission critical for most nonprofits.

To avoid getting investigated by a state regulator:

- **Adopt the [Donor Bill of Rights](#)**, which helps leaders understand donor expectations while bolstering donor confidence. It also outlines the donor's right to receive proper recognition, gain access to the organization's financial statements, obtain information on how funds are being distributed, and stay anonymous if desired. A Donor Bill of Rights is a set of standards created by a group of professional fundraising societies for nonprofits to generate confidence between donors and donees. Board members of nonprofits should embrace these fundraising standards and make certain that the development staff of their organization is familiar with the Donor Bill of Rights.
- **Create a [strategic plan](#)** for the organization's future to ensure it has goals to fundraise against. The board and staff should create a fiscal strategic plan to finance the future described in the strategic plan.
- **Ensure the organization has fundraising plans and [policies](#) in place to match the strategic and fiscal plans.**
- **Review the [fundraising budget](#).**
- **Evaluate the effectiveness of your fundraising strategy.** A new framework, [Measuring Fundraising Effectiveness](#), presents three primary measures of fundraising effectiveness for both internal and external use that together provide a complete picture of an organization's fundraising health.
- **Ensure that your organization complies with each state's charitable solicitation registration laws**, which differ from state to state. By ensuring that your organization's fundraising is entirely legal in every state in which you raise funds, you reduce your board members' personal liability for your organization.

Additional Resources

[Financial and Fundraising Issues – FAQs](#)
[Donor vs. Investor: An important Distinction](#) (blog)
[The F Word and how to Use It](#) (blog)
[Association of Fundraising Professionals website](#)
[Fundraising Responsibilities of Nonprofit Boards](#)
[ePolicy Sampler – Fundraising Development Committee](#)
[Measuring Fundraising Effectiveness](#)
[Affinity Fundraising Registration](#)
[Presenting: Fundraising](#)
[Fundraising Communications Toolkit](#)



PUBLIC ACCOUNTABILITY & TRANSPARENCY

Functioning in a transparent manner is the key to earning the public's trust. Without trust there are no supporters. Without supporters, it is impossible to survive and advance the mission of the organization. Equally, transparency is a tool for accountability.

In an environment where donors, the public, and charity regulators are asking more and more questions about the effectiveness of nonprofit organizations, it is increasingly important for nonprofits to lead the charge in creating transparency around their organizational practices, including the work of the board. It should disclose appropriate information, comply with federal and state reporting requirements, and share both good and bad news.

To avoid getting investigated by a state regulator:

- **Share with the public those documents that all nonprofits are legally obligated to share.**
 - [Form 990](#). With some exceptions, every tax-exempt nonprofit must share this form from the last three years with anyone requesting it. One easy way to meet this IRS requirement is to post the form on the nonprofit's own website or with [GuideStar](#). Form 990 informs the public about how the nonprofit created revenue, how it spent the money, whether board members were compensated, how much key employees earned, and various other financial, programmatic, and governance details.
 - Form 990-T. This form indicates in what types of unrelated business activities the organization was involved.
 - Forms 1023 and 1024. These are the tax-exemption application forms that must be readily available. These forms explain the original purpose of the organization and allow those interested to verify that the primary mandate is still being respected.
 - Specific financial documents as state laws specify. Know your state requirements if you have a formal membership organization.
 - Board meetings, meeting notices, and minutes must be open or available to the public if the organization is covered by the [state sunshine laws](#).
- **Share information about essential board leadership practices**, including board orientation and education, executive oversight, ethics and transparency, board composition and diversity, and board performance and assessment in the [Guidestar](#) Nonprofit Profiles' People and Governance section.
- **Have at least one and preferably more than the one [annual meeting](#) required by law.** Most state laws require at least one annual meeting, but BoardSource believes that one meeting is insufficient for boards to provide proper oversight.
- **Formalize a process for setting appropriate [compensation for the executive](#)** and approve the compensation package.
- **Ensure that there are policies** related to disclosing and managing conflicts of interest, whistleblower processes, and document retention and destruction.
- **Ensure that an annual audit is conducted** and that the board engages directly with the audit firm to discuss the results.
- **Ensure that the organization is keeping adequate and timely records.**

Additional Resources

[The Nonprofit Policy Sampler](#)

[Open Meeting Laws and Nonprofit Organizations](#)

[Sunshine Laws](#)

[The Accountable Board](#)

[Stakeholder Complaints](#)

[Building Trust Through Transparency](#) (blog)

[Transparency](#)

[Nonprofit Public Disclosure Requirements and the Form 990](#)

[Every Board's Must-Have Documents](#)



IGNORING THE ATTORNEY GENERAL'S OFFICE

Few people understand how nonprofits are monitored and regulated. For much of its history, the nonprofit sector has operated outside the realm of harsh public scrutiny. No government agency exists exclusively to monitor the activities of nonprofits; most nonprofits aren't required to hold public meetings; and few journalists report on nonprofits with the same depth and focus devoted to business and government. But that doesn't mean we can afford to be less than scrupulous about how we operate.

Disenchanted stakeholders can — and do — report irregularities to watchdog organizations, state and federal regulators, and the media. Problems, when they do arise, are particularly damaging because of the nature of nonprofits themselves — organizations created to provide some public benefit.

The [attorney general's office](#) is your state charity regulator. They, or some other part of the state government, maintain a list of registered nonprofits and investigate complaints of fraud and abuse. If your attorney general's office makes recommendations to your organization, it is in your own best interest to take those recommendations very seriously. Often the state attorney general serves as the primary investigator in cases of nonprofit fraud or abuse, and ignoring their recommendations can lead to serious consequences.

Additionally, a small division of the IRS (the [exempt organizations division](#)) is charged with ensuring that nonprofits are complying with the requirements for eligibility for tax-exempt status. Their recommendations should also never be ignored. IRS auditors investigate the financial affairs of thousands of nonprofits each year. As a result, a few have their tax-exempt status revoked; others pay fines and taxes.

The following stakeholders may seek recourse through the state attorney if they detect discrepancies in the practices of a nonprofit organization.

- **Customers and constituents** — A beneficiary of nonprofit services has the right to be treated with quality, respect, and discretion. When these rights are neglected, a legal suit may be an option.
- **Donors and members** — One of the most powerful safeguards of nonprofit integrity are individual donors and members. By giving or withholding their financial support, donors can cause nonprofits to reappraise their operations. Donors also have the right to see that their money is spent as specified. Donors or their family may file a suit when this trust has been breached.
- **Staff** — Employment issues are the most common reasons for a nonprofit to get sued. It is not always easy to find the fine line between fairness and bias in situations dealing with alleged discrimination, nepotism, harassment, or firing an employee.
- **Fellow board members** — Individual board members may, for instance, sue their peers in a derivative action if they are able to show that the organization suffered injury because of the fellow members' breach of their legal duties.
- Other stakeholder groups to take very seriously include, but are not limited to, the following:
 - **Private watchdog groups** — Several private watchdog groups (who are themselves nonprofits) monitor the behavior and performance of other nonprofits. Some see their mission as serving as advisors to donors who want to ensure that their gifts are being used effectively; others are industry or "trade" groups that provide information to the public and encourage compliance with generally accepted standards and practices.
 - **Media** — Most of the major scandals involving nonprofit organizations come to light as a result of media investigations and resulting news stories. While many nonprofit leaders feel misunderstood or even maligned by negative media coverage, this media watchdog role has resulted in increased awareness and accountability throughout the sector.

How to avoid getting investigated by state regulators:

Don't ignore any of the above!

Additional Resources

[Stakeholder Complaints](#)

[Regulating and Monitoring Nonprofits](#)

[Risk Management Resources](#)

[National Association of Attorneys General](#)

[Charity Watchdogs and What Your Organization Can Do to Put Its Best Foot Forward](#)