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## Upfront

**One for Deregulation: Why states' nonprofit regulation rules may not be just unnecessary, but also unwise. By Maia Szalavitz**

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## One for Deregulation

*Why states' nonprofit regulation rules may not be just unnecessary, but also unwise*

After a hacker severely damaged the popular Nonprofit FAQ Web site in the late 1990s, its editor, Putnam Barber, a nonprofit consultant based in Washington state, used what remained of the site to solicit donations for its repair. But he soon received a letter from the attorney general of Minnesota saying that the group was not registered to raise funds in her state. She asked him either to register his nonprofit or to desist from his fundraising.

To comply with state fundraising rules – even for a short-term, specific campaign to fix a Web site important to nonprofits – Barber's organization would have had to file varying forms due at different times in the 39 states that require it. It would also have had to pay filing fees – in some states as high as \$400 – as well as invest time and effort to complete the forms. Barber decided the red tape just wasn't worth it, and ended his perfectly

legitimate Web campaign.

The complex network of state regulations that Barber encountered is meant to reduce charitable fraud and abuse and, in turn, build public trust in nonprofits and encourage giving. Yet recent research by Renee Irvin of the University of Oregon, published in the June 2005 issue of *Nonprofit and Voluntary Sector Quarterly*, suggests that these regulations may not only be ineffective, but also wasteful.

Irvin first calculated how much it costs (including fees, time, and labor) for a nonprofit to register in its home state and in multiple states. For home state registration, the average cost for a nonprofit was \$366 per year. But for multiple-state registration, which many say is required if an organization

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puts a “donate now” button on its Web site, she estimated the cost to be over \$8,000 annually.

Irvin then surveyed deputy and assistant attorneys general in six states that do not have nonprofit registration requirements. They did not report unusual levels of fraud and abuse – some states prosecute one or two cases a year, and others prosecute none. Moreover, charitable contributions made by these states’ residents were in line with the national average.

“I have not found any evidence that reporting done on an annual basis actually deters fraud,” Irvin concludes. Instead, she suggests that the unwieldy cost of processing registration and reporting may actually divert resources from the investigation of wrongdoing. She cites research showing that state charity enforcement agencies (usually attorneys general) spend two-thirds of their time – and 50 percent of their budgets for charity enforcement – tracking registration and reporting. But many, if not most, fraud investigations are actually generated by consumer complaints, not problems discovered in nonprofits’ paperwork.

“The present regulatory regime is misshapen,” agrees Barber, who is now senior consultant to the Executive Alliance, a membership organization that advances the work of nonprofits through a variety of programs. “Change is definitely needed and [Irvin] did a great service by doing detailed work that shows it.”

Irvin proposes partial deregulation. Only professional fundraisers and the nonprofits that retain them would have to register, pay fees, and file financial reports with state agencies. She points out that most of the data collected by states are already reported on nonprofits’ Form 990s. But she suggests that states continue to regulate professional

fundraisers, because up to 70 percent of the charitable donations that they secure never reach the charity. Protecting donors from deception – i.e., from not knowing that only 30 percent of their donation is channeled to the cause when professional fundraisers are involved – may require greater oversight, she argues.

In contrast, Marion Fremont-Smith of the Hauser Center for Nonprofit Organizations at Harvard University’s Kennedy School of Government thinks that both nonprofit and fundraiser registration are valuable. “It makes nonprofits aware of their responsibilities and it is manageable,” she says.

Fremont-Smith agrees that the current system is not ideal, however, and is

co-convenor of the Expert Advisory Group for the Panel on the Nonprofit Sector, the panel that the Senate Finance Committee encouraged nonprofits to create. She says that electronic filing and more uniform requirements across states will eventually make even multistate filing relatively painless.

Irvin notes that her findings may be limited, because unregulated states tend to have small populations, and small states may not attract as much fraud as larger states do. Nevertheless, she still contends that state agencies would be wiser to spend their resources on investigating public complaints, rather than on enforcing registration rules. –Maia Szalavitz



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