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January 27, 2017

John P. Kacavas, Esquire
Chief Legal Officer & General Counsel
Dartmouth-Hitchcock Health
1 Medical Center Drive
Lebanon, NH 03756

Re: Norris Cotton Cancer Center – Release of Temporarily Restricted Funds

Dear Mr. Kacavas:

The Director of Charitable Trusts exercises the Attorney General's common law and statutory rights, duties and powers with respect to charitable organizations and charitable fundraising. RSA 7:20.

In October, 2016, you advised the Charitable Trusts Unit (CTU) of a complaint filed in Grafton Superior Court captioned Mark A. Israel, M.D. v. Dartmouth-Hitchcock Medical Center, et al. Paragraphs 22, 25, 26, 32 and 33 of the complaint allege misapplication of charitable donations held in several "philanthropic accounts" to benefit the Norris Cotton Cancer Center (NCCC). NCCC provides advanced cancer research and treatment leveraging the resources of Dartmouth-Hitchcock Medical Center, Mary Hitchcock Memorial Hospital, Hitchcock Clinic and the Geisel School of Medicine at Dartmouth College (collectively referred to as D-H). A portion of the philanthropic accounts held proceeds of an annual fundraising series of events known as "The Prouty". Since the proper use of charitable donations comes within the CTU's oversight responsibility, we opened an inquiry. The complaint further alleges wrongful discharge and retaliation for whistleblower actions, matters that are outside of our purview.

In response to our request, Tina E. Naimie, D-H Vice President of Corporate Finance, provided us with information about NCCC finances and changes made to policies concerning net asset classification and expenditures. Geoffrey J. Vitt, Dr. Israel's attorney, provided us with documentation concerning The Prouty and use of fundraising assets. Independently, we examined materials available to donors to The Prouty. This letter summarizes the information we reviewed, the applicable legal and accounting standards, and the conclusions reached from this analysis.

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NCCC, the Friends and The Prouty

NCCC is one of 45 comprehensive cancer centers in the United States. Its professionals lead multiple research projects, clinical trials, and the care of patients participating in treatment. NCCC relies upon multiple revenue sources for its work, including government research grants, health insurance payments and charitable contributions. The charitable contributions come from a range of sources, including events, direct marketing, trusts and estates.

The Prouty is one of NCCC's fundraising events. In recent years it has become extremely successful. The Prouty consists of a series of athletic competitions in which the participants sign up sponsors to donate money. It features bicycling, walking, running and rowing events that take place over a two day period in July of each year. The Prouty promotional material and public reports consistently represent that the funds are used "to support cancer research and patient support services at NCCC". According to publicly available reports, The Prouty raised $3 million in 2014, $3.3 million in 2015 and $3.2 million in 2016.

NCCC relies upon D-H development staff to coordinate its fundraising efforts. That staff works with a group of volunteers, known as the Friends of NCCC, to organize events, including The Prouty. From 1982 until 2004, the Friends operated as a stand-alone charitable organization. In 2004, the Friends dissolved its corporate status and filed a court action to distribute to NCCC its accumulated funds, totaling $758,000 (Grafton Probate Court No. 2004-0050). The court on June 8, 2004 granted the petition and authorized "the distribution of Friends' assets to Mary Hitchcock for the benefit of the Cancer Center." Since then, the Friends has operated directly as a fundraising arm of NCCC.

Much of the recent success of fundraising for NCCC can be attributed to Dr. Israel. He served as the director of NCCC from 2001 through 2016. He took an active leadership role with The Prouty and saw its financial success grow over the years.

Nature of the Restrictions on Funds Raised by NCCC

As is the case with many charitable organizations, D-H holds a number of funds encumbered by various donor restrictions as to their use. The restrictions that relate to this review are those that limit spending to NCCC.

The funds can be classified into several categories. Some gifts have been made to NCCC's permanent endowment. For instance, the Mary Russell Fund arose from a $125,000 bequest to NCCC made, "IN TRUST, the income only to be used for research and patient care." The Steven B. Currier Fund for Clinical Oncology Scholars was created "as a true endowment fund… and the principal will be held in perpetuity."

Other gifts to NCCC came with no restrictions other than that the funds be used for its benefit. The language of the court decree in the Friends case is such an example: "for the benefit of the Cancer Center."

Gifts made in response to direct mail solicitation and from events require a focus on the language of the fundraising appeal. With regard to The Prouty, publicly available materials consistently stated that the funds raised would be used for cancer research and patient support services. Each year's appeal went on to describe a variety of novel research and cancer treatments supported by those fundraising dollars. The literature also discussed various support services provided for cancer patients and their families. None of these documents represented that a specific amount of future Prouty funds would be directed to a specific research, treatment or support service program. The most specific public information presented was a pie chart and reference sheet created in 2016 to illustrate past areas of spending from the 2015 Prouty, but with no dollar amounts attributed. Our review did not find any publicly available information indicating that any of The Prouty funds would be allocated to endowment, i.e. to a permanently restricted or time restricted fund.

Accumulation and Expenditure of Restricted Funds at NCCC

In his role as the director of NCCC, Dr. Israel determined that some monies raised on behalf of NCCC would not be spent currently, but rather would be retained from year to year. It appears that the accounting and management staff at D-H either approved of or acquiesced in Dr. Israel's decision. As a result, over the years, not all of The Prouty fundraising proceeds were expended in a given year. Instead, some portion accumulated in temporarily restricted fund accounts at D-H, specifically as part of accounts No. 22882 (NCCC quasi-endowment) and No. 22892 (NCCC permanent fund). The same approach was applied to the $758,000 distributed from the Friends dissolution. Those funds were deposited in account No. 22892. There are two other accounts at issue here: No. 24900 (NCCC development fund) which received funds from direct marketing and No. 24953 (NCCC Quasi Endowment Appropriated Fund) which held investment earnings from other funds. According to D-H, those four funds totaled $5,873,431 in 2015.

Ms. Naimie states that in 2013 she began a review of all funds held at D-H, including funds held to benefit NCCC, Children's Hospital at Dartmouth and other departments. A formal Funds Policy Project was launched on August 29, 2014. She and her team retained fund accountants from PriceWaterhouseCoopers, LLC (PwC) to provide assistance. From that review, D-H determined in 2015 that it should release $6.1 million in temporarily restricted funds for current expenditure in that year by NCCC, including the entire amount held in accounts No. 22892, 22882, 24900 and 24953, plus income appropriated from other permanently restricted funds that benefit NCCC.

In August of 2015, D-H released the restrictions on $6.1 million of temporarily restricted funds effective for the fiscal year ended on June 30, 2015. It applied those funds to what it determined were qualifying expenditures at NCCC for that year. Of that amount, D-H reports that about $770,000 was attributable to accumulated funds from The Prouty. Dr. Israel believes the amount attributable to The Prouty amounts to about $1.6 million. The released amount also includes the $758,000 received from the dissolution of the Friends entity in 2004.

The Dispute

Sometime during 2015, the Finance group at D-H informed directors of departments at D-H about the ongoing review of the status of restricted funds benefiting their units. Dr. Israel adamantly objected to the release of NCCC funds from the temporarily restricted accounts over which he held some control. He told D-H staff that using those temporarily restricted funds for "operations" was not consistent with donor intent. D-H subsequently went ahead with its release of the $6.1 million, and obtained supporting opinions of its decision from PwC and from its outside legal counsel. In September, 2015, Dr. Israel was relieved of his role as the director of NCCC. He still holds an appointment as a professor at Dartmouth's Geisel School of Medicine.

On October 27, 2016, Dr. Israel filed suit against D-H for wrongful termination of employment as well as retaliatory discharge for whistleblowing. His complaint alleges that D-H misapplied those restricted funds because they should have been retained indefinitely and their use for "operations" is inconsistent with donor intent.

Accounting Standard

Fund accounting for net assets of a charitable organization is complicated. The CTU has found that even experienced auditors and financial managers may make mistakes. Larger charitable organizations in New Hampshire must file audited financial statements annually with the CTU that comply with generally accepted accounting principles (GAAP). RSA 7:28, III-a and III-b. In its review of audits, the CTU from time to time requires auditors to correct fund accounting mistakes with respect to asset classification. Because the subject is complicated, some discussion of fund accounting is needed.

Since June of 1993, auditors must report net assets of a charitable organization in one of three categories: permanently restricted, temporarily restricted and unrestricted. These rules arise from Financial Accounting Standards (FAS) 116 and 117, which were the product of the Financial Accounting Standards Board's Task Force of Accounting Issues for Not-for-Profit Organizations. Those standards seek to bring uniformity to accounting for contributions.

Permanently restricted funds are those that, by virtue of a condition placed on a donor's gift, must be held by the organization in perpetuity, with only income available for expenditure. At D-H, the Mary Russell Fund and the Stephen B. Currier Fund are examples of permanently restricted funds. There is no allegation that any of The Prouty funds are permanently restricted

funds, and we have seen no public appeal indicating that the funds are to be held in a permanent endowment.

Unrestricted funds are just that: funds that have accumulated from operations or that have been properly transferred from a restricted fund and may be currently spent by the organization. Unrestricted funds include those voluntarily set aside by the board of directors, sometimes called a board designated fund or a quasi-endowment. Also included in this category are funds transferred from permanently or temporarily restricted funds because a condition has been fulfilled or an appropriation from a fund has been made pursuant to a spending policy. This category tangentially apples to The Prouty funds, as discussed below.

Temporarily restricted funds are comprised of several types of accounts. They include funds with donor restrictions, either as to time or purpose. The organization must hold these funds until the donor imposed restriction is met. Examples include a scholarship endowment gift with a ten year payout or a capital campaign gift for a new building. The Prouty funds come within the temporarily restricted classification because the gifts were solicited for certain purposes: cancer research and patient support services. When D-H then decides to appropriate for expenditure a restricted fund, including any Prouty funds, those funds are reclassified as unrestricted funds. Of course the expenditure must follow any donor imposed purpose restriction applicable to the released fund. Finally, temporarily restricted funds include the appreciation and income from permanently restricted funds. See, FAS Release 117-1.

FAS 116, ¶17 describes the sequence in which different classes of funds are appropriated for a specific expenditure. If an organization decides to make a qualifying purchase of goods or services that matches the purpose of a temporarily restricted fund (including the allowable amount of appreciation or income from a permanently restricted fund), then the allowable amount is reclassified as unrestricted. This reclassification occurs whether or not the organization actually uses those restricted funds to make the purchase. From an accounting standpoint, the released money has been spent even if the organization used another funding source. This is called the "First Dollar Rule", meaning that an organization is deemed to release the donor imposed restriction as soon as a qualifying expense is incurred. Note that qualifying purchases do not include purchases made using funds from other restricted funds, such as a government research grant.

Legal Standard

New Hampshire common law requires that donees, including charitable organizations, honor donor intent. To borrow from the New Hampshire Trust Code, a donor's intent as expressed in a document is "paramount". RSA 564-B:1-112. That language codifies a long series of New Hampshire court decisions. *See, e.g., Shelton v. Tamposi*, 164 N.H. 490, 495-96 (2013) (donor intent "paramount" in interpretation of a trust). "The donor's intention is given effect to

the maximum extent allowed by law." Restatement (Third) of Property, §10.1. *See*, DeGrandpre, 7 New Hampshire Practice: Wills, Trusts and Gifts (4th ed. 2003) §34.04.

A donor's intent tends to be expressed explicitly in a will or trust instrument. *See*, *Shelton*, 164 N.H. at 496-98 (court interpretation of detailed trust language). Gifts made without a writing require additional review. *See*, *Humiston v. Bushnell*, 118 N.H. 759, 761 (1978) (donative intent inferred from abandonment of property). Gifts made to fundraising appeals do come with a writing, but it is the writing of the donee soliciting the gift. Accordingly, the donor exercises less control over the use of the gift. By default a donor's intent is expressed in the language appearing in the material promoting the campaign. That language is often very general, thereby permitting the organization flexibility in its use of the money. If a donor writes a check or swipes a credit card to support such a fundraising promotion, that act signifies endorsement, or at least acquiescence, in the organization's use of the donor's gift for that purpose. Allowing individual donors to direct the use of a small gift would prove unwieldy to charitable organizations soliciting a larger number of gifts. Still, the organization must use gifts received in accordance with its written promotional materials.

The law also requires that charitable organizations not engage in any unfair or deceptive acts or practices. RSA 7:28-f, I(b). This includes a prohibition on unfair or deceptive acts or practices in the conduct of fundraising activities. While there is no private right of action under RSA 7:28-f, individual donors do have a right to pursue common law remedies for fraudulent misrepresentations. The donor must prove that in making a gift, he or she reasonably relied upon a false representation that the organization negligently or intentionally made.

Charitable organizations must also comply with the provisions of the Uniform Prudent Management of Institutional Funds Act (UPMIFA), RSA 292-B, which creates rules for the management, investment, accumulation and expenditure of "institutional funds". All institutional funds must be invested and managed prudently. RSA 292-B:3. There are additional limitations placed upon the accumulation and appropriation for expenditure of "endowment funds", i.e. a fund that "under the terms of the gift instrument, is not totally expendable by the institution on a current basis". RSA 292-B:2, II and 4. Because the fundraising materials relating to The Prouty do not limit the current use of gifts, it is an institutional fund but not an endowment fund subject to the restrictions on expenditure contained in RSA 292-B:4.

Finally, as discussed previously, larger New Hampshire charitable organizations must report their financial activities, including gifts from fundraising, in accordance with GAAP. RSA 7:28, III-a and III-b. Still, if there is a conflict between GAAP and the requirements of UPMIFA or the common law of gifts, the latter requirements will prevail.

Analysis and Conclusions

This review focuses on whether D-H properly reclassified $6.1 million from NCCC temporarily restricted funds in 2015, including funds accumulated from The Prouty. Of those accumulated funds, we only have documentation for the purposes of The Prouty and the Friends dissolution funds.

While there are several documents describing the origin and purpose of the Friends dissolution fund, the ultimate authority is the probate court's decree which directs that the account be used "for the benefit of the Cancer Center." To the extent there is $758,000 of NCCC spending in 2015, under the First Dollar Rule that fund must be applied to it.

As discussed above, the Prouty funds were solicited for cancer research and patient support services. To the extent there is $770,000 (according to D-H) or $1.6 million (according to Dr. Israel) of NCCC spending for cancer research and patient support services in 2015, under the First Dollar Rule those funds must be applied to it.

D-H does not currently keep its expenditure accounts in a functional format that easily dovetails with the categories of restricted funds. PwC in its November 5, 2015 memorandum reported that it had tested $5.3 million of the expenditures for which D-H had released net asset restrictions and "noted no exceptions", meaning that it had no issues with D-H's allocation of released funds to specific expenses. D-H represents that NCCC expended $87.7 million in 2015 and of that $2.3 million can be attributed to salary and benefits of professionals performing research and patient support services not paid from government or other grant funding sources.

These documents indicate that NCCC incurred expenses for its activities well in excess of the $6.1 million released from restriction in 2015. The $2.3 million in salaries and benefits for staff performing cancer research and providing patient support services also exceeds the amount of Prouty temporarily restricted funds.

Based upon the materials we reviewed, and the applicable accounting and legal standards, D-H had no choice but to reclassify as unrestricted the $6.1 million of accumulated temporarily restricted funds, including The Prouty funds. As a result, D-H properly used that $6.1 million for 2015 expenditures consistent with any purpose restrictions applicable to their use

The focus of Dr. Israel's criticism is the "loss" of those funds as a quasi-endowment and as a source for the purchase of equipment and services above and beyond budgeted items. He maintains that the $6.1 million was diverted to "operations" contrary to donor intent. But as was discussed above, donor intent depends on documentation, and the documentation available here points to broad categories of support for NCCC. For instance, cancer research and patient support services are expansive terms and fairly include the salary, equipment and occupancy costs associated with those activities. The sort of restriction advocated by Dr. Israel would require language in the donor material with explicit terms like: "x% of the gift will be allocated to NCCC's permanent endowment" or "the gift will be used only for activities outside of

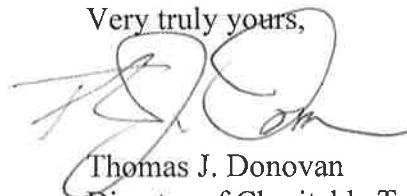
NCCC's normal operations as determined by NCCC's director". Our review has found no documentation of that type.

Accordingly, the Charitable Trusts Unit will take no further action with respect to the reclassification of temporarily restricted funds at D-H in 2015, including the reclassification of accumulated funds from The Prouty.

This determination does not mean that D-H handled its temporarily restricted funds accounts perfectly. For example, accounts No. 22892, 22882, 24900 and 24953 never should have been allowed to accumulate year after year. From our examination of the records, D-H does not appear to have a process that readily tracks its expense accounts functionally to mesh seamlessly with the purposes of its restricted funds. Moreover the temporarily restricted fund account names are confusing and include pools of funds with somewhat different purpose restrictions. Still, the 2015 reclassification has remedied some of these deficiencies as part of a larger effort to address D-H's net asset accounting. We therefore believe that D-H is making good progress to track its classification and use of restricted funds.

Finally, our determination is not meant to conclude that no individual donor could have been misled in contributing to NCCC, including to The Prouty. Our review looked at publicly available written material. If D-H provided a potential donor with specific written information to the effect that some or all of the funds would be set aside for a period of time, or for a more specific purpose, then that donor has a right to request that the purpose of the gift be carried out.

Very truly yours,



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TJD/d
cc: Geoffrey J. Vitt, Esquire, Vitt & Associates, PLC