



NONPROFIT BASICS AND LEGAL ISSUES

Legal & Practical

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LAW &

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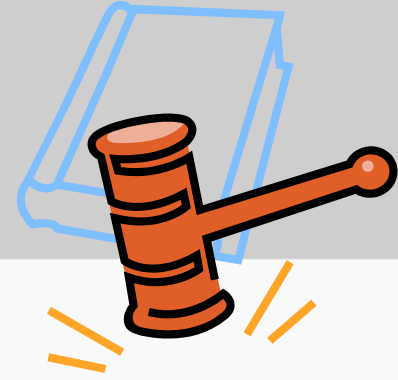


Calendar for Today



- We will cover
 - Nonprofit basics and legal issues facing start ups
 - The nonprofit legal check up
 - Duties and responsibilities of serving on a board
 - Liability of directors after Sarbanes-Oxley
 - What nonprofits need to know about government regulations

Calendar for January 12th



- We will cover
 - Regulations, the impact of the 990s
 - Nonprofits and Unrelated business income tax
 - Evaluating non-core revenue streams
 - Use of donor-advised funds
 - Mergers, acquisitions and collaboration, recapitalization, sale of assets
 - Set-up for nonprofits entities for a nonprofit



What Are Nonprofits Really

- Nonprofits or Nontax entities
 - Nonprofits suggests to those new to this group that the organization isn't suppose to make money. **WRONG** it is a **BUSINESS**
 - NonTax is the appropriate description the federal government has established 501(c)3,4,5,6,7s as well as sub-corporations status of 509 a,b,c as entities without federal or state tax exempt status.
 - Letter of Determination - IRS

A photograph of an open handwritten ledger or account book. The pages are filled with columns of numbers and text, organized into a grid-like structure. The handwriting is in blue ink on aged paper.

Non-profit vs. For-profit Corporate



- Non-Profit

- Stakeholders
- Must have charitable purpose Education, Scientific, Religious, Charitable
- Can retain surplus income non taxed
- Unrelated income will be taxed
- Must limit amount of unrelated income in order to protect tax exemption
- Eligible for many grants from gov't and foundations

- For-profit

- Shareholders
- All income taxed
- Dividends paid to parent not taxed
- May be more attractive to commercial partners, eligible for some government financing (New Market Tax Credit, SBA loans)



What Are The Types of NPOs

- 501(c)(1) — Corporations Organized Under Act of Congress (including Federal Credit Unions)
- 501(c)(2) — Title Holding Corporation for Exempt Organization
- 501(c)(3) — Religious, Educational, Charitable, Scientific, Literary, Testing for Public Safety, to Foster National or International Amateur Sports Competition, or Prevention of Cruelty to Children or Animals Organizations
- 501(c)(4) — Civic Leagues, Social Welfare Organizations, and Local Associations of Employees
- 501(c)(5) — Labor, Agricultural, and Horticultural Organizations
- 501(c)(6) — Business Leagues, Chambers of Commerce, Real Estate Boards, etc.
- 501(c)(7) — Social and Recreational Clubs
- 501(c)(8) — Fraternal Beneficiary Societies and Associations
- 501(c)(9) — Voluntary Employees Beneficiary Associations



Non-Profit 501(c)(3)

- Must be a public benefit organization
- No shareholders
- Assets belong to the public
- No tax on “related” income
- Liability generally limited to assets of corp; directors have only very limited liability for wrongful conduct
- Ban on political activity
- Limitations on lobbying
- Must have a board of directors



Board Responsibilities

- The board has three major functions (small and large).
 - Fundraising (ensuring constant flow of funds)
 - Stewardship and planning (strategic planning, foreseeing potential challenges, setting policies, improving governance)
 - Fiduciary responsibility (managing, budgeting & reporting)

Board Members Behavior



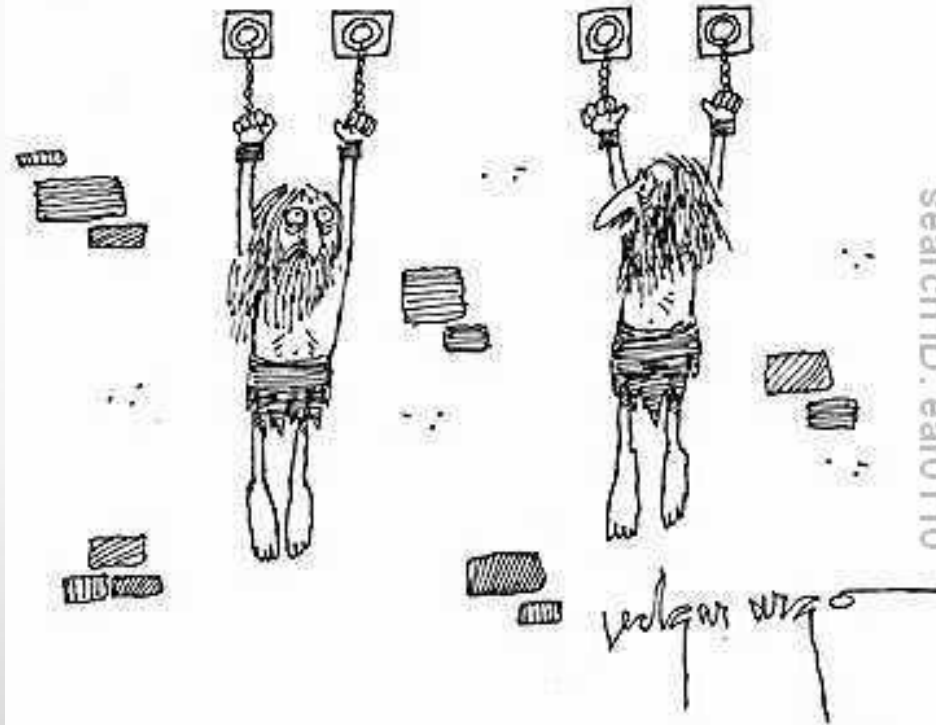


Role of the Board

- Preserving and when necessary reshaping the mission
- Selection and reviews of chief executive
- Ensuring the organization is well managed
- Representing the external world to the organization
- Protecting the organization from external threats
- Exercising financial stewardship
- Making sure the organization is in compliance with the laws and regulations

Liabilities of Directors after SOX

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" I THOUGHT 'GOOD ACCOUNTING PRACTICES'
WAS JUST A SUGGESTION!!! "





Governance Is Essential

- Financial Responsibilities
 - Having a conflict-of-interest policy
 - Whistleblower policy
 - Records retention policy
- Fiscal Oversight
 - Key tasks is to exercise fiscal stewardship
 - Executive compensation of CEO
- Developing Key Committees



Committee



- Finance – All nonprofits
 - The Finance Committee is a standing committee of the Board of Directors and is typically chaired by the Board Treasurer. The committee is responsible for reviewing and providing guidance for the organization's financial matters. Specifically, the committee assures internal controls, independent audit, and financial analysis for the organization.



Committees

- Investment Committee - \$1 million plus
 - The Finance/Investment Committee is a standing committee of the Board of Directors formed to assist the Board in fulfilling its responsibilities to provide oversight relating to fiscal management of the organization. The Committee shall be comprised of a person with appropriate skill sets and the Board Treasurer
 - There may be need for a separate Investment committee



Committees



- Audit Committee – \$3 million plus
 - Nonprofits that expend more than \$500,000 of federal funds are required to conduct an annual audit.
 - Charitable organization with \$1 million or more in total annual revenues
 - Smaller charities with revenues of at least \$250,000 should choose a review or at least have their financial statements compiled by a professional accountant.
 - In California, the Nonprofit Integrity Act of 2004 requires that any charity registered with the attorney general and receiving annual gross revenues of \$2 million or more must form an audit committee.

Other Important Responsibilities



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Examination By Attorney General

- 5250: A corporation is subject at all times to examination by the Attorney General, on behalf of the state, to ascertain the condition of its affairs and to what extent, if at all, it fails to comply with trusts which it has assumed or has departed from the purposes for which it is formed. In case of any such failure or departure the Attorney General may institute, in the name of the state, the proceeding necessary to correct the noncompliance or departure.



Membership

- **CA Code 5210**
 - Each corporation shall have a board of directors. Subject to the provisions of this part and any limitations in the articles or bylaws relating to action required to be approved by the members (Section 5034), or by a majority of all members (Section 5033), the activities and affairs of a corporation shall be conducted and all corporate powers shall be exercised by or under the direction of the board.
- **CA Code 5310**
 - A corporation may admit persons to membership, as provided in its articles or bylaws, or may provide in its articles or bylaws that it shall have no members



Articles of Incorporation

- 5130: The articles of incorporation of a corporation formed under this part shall set forth:
 - (a) The name of the corporation.
 - (b) The following statement:
- "This corporation is a nonprofit public benefit corporation and is not organized for the private gain of any person. It is organized under the Nonprofit Public Benefit Corporation Law for (public or charitable [insert one or both]) purposes."



Standards Of Conduct

- 5231. (a) A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner that director believes to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.



Standards of Conduct

- 5233. (a) Except as provided in subdivision (b), for the purpose of this section, a self-dealing transaction means a transaction to which the corporation is a party and in which one or more of its directors has a material financial interest and which does not meet the requirements of paragraph (1), (2), or (3) of subdivision (d). Such a director is an "interested director" for the purpose of this section.



Standards of Conduct

- 5236. (a) A corporation shall not make any loan of money or property to or guarantee the obligation of any director or officer, unless approved by the Attorney General; provided, however, that a corporation may advance money to a director or officer of the corporation or of its parent or any subsidiary for expenses reasonably anticipated to be incurred in the performance of the duties of such officer or director, provided that in the absence of such advance, such director or officer would be entitled to be reimbursed for such expenses by such corporation, its parent, or any subsidiary.



The Sale or Exchange of Assets

- 5913: A corporation shall give written notice to the Attorney General 20 days before it sells, leases, conveys, exchanges, transfers or otherwise disposes of all or substantially all of its assets unless the transaction is in the usual and regular course of its activities or unless the Attorney General has given the corporation a written waiver of this section as to the proposed transaction.

Where Does Best Practices Fit



“Financial planning requires long-term thinking. Especially if you get caught.”



Best Practices



- Tuning up the mission
 - The Board is ultimately responsible for reviewing the Corporation's effectiveness in satisfying its charitable mission. This typically will include:
 - Evaluating and modifying (where necessary, and subject to receipt of any required regulatory and judicial approvals) the charitable mission of the Corporation;
 - A periodic assessment of the Corporation's performance and effectiveness in achieving mission-related goals; and
 - Requesting from management, on a periodic basis, reports identifying specific means to address perceived deficiencies in mission effectiveness.



Best Practices

- Relationship of board and senior management team
 - Establish an appropriate balance between the CEO and Board Chairman roles, either through separation of offices or establishment of “Lead Independent Director” position
 - CEO manages the day-to-day operations the board is to support and provide council



Best Practices

- Oversight and stewardship
 - Board of Directors is responsible for setting the mission and strategic direction and oversight of the finances, operations, and policies.
 - The Board and individual directors and officers shall act in accordance with the Board Governance policy, the Conflict of Interest policy and any other policies adopted by the Board related to the appropriate conduct of directors and officers.



Best Practices

- Ensuring that policies are in effect:
 - A written conflict of interest policy should be adopted that complies with existing state law requirements and Internal Revenue Service non-binding guidance and that recognizes the potential for conflict arising from material financial and non-financial relationships
 - Knowledgeable of and complies with all applicable laws, regulations and professional standards
 - The Board should be certain there are policies employing controls to avoid potential for fraud





What Protects the Board

- Reduce Risk first
- Volunteer Protection Act (VPA) provides that, if a volunteer meets certain criteria, he or she shall not be liable for simple negligence while acting on behalf of a nonprofit or governmental organization.
- State of California S.543 a bill to provide certain protections to volunteers
- Transfer Risk – Using D&O insurance to protect Directors, I recommend \$3 million

Questions and Comments



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Thank You



- References:

- Independent Sector (www.independentsector.org) and Panel on the Nonprofit Sector (www.nonprofitpanel.org)
- Association of Governing Boards of Universities and Colleges (www.agb.org)
- American Society of Association Executives (www.asaenet.org/)
- National Council of Nonprofit Associations (www.ncna.org)
- Center for Philanthropy (www.philanthropy.iupui.edu)
- BoardSource (www.boardsource.org)