



REGULATORY AND LEGAL ISSUES PART II

Legal & Practical

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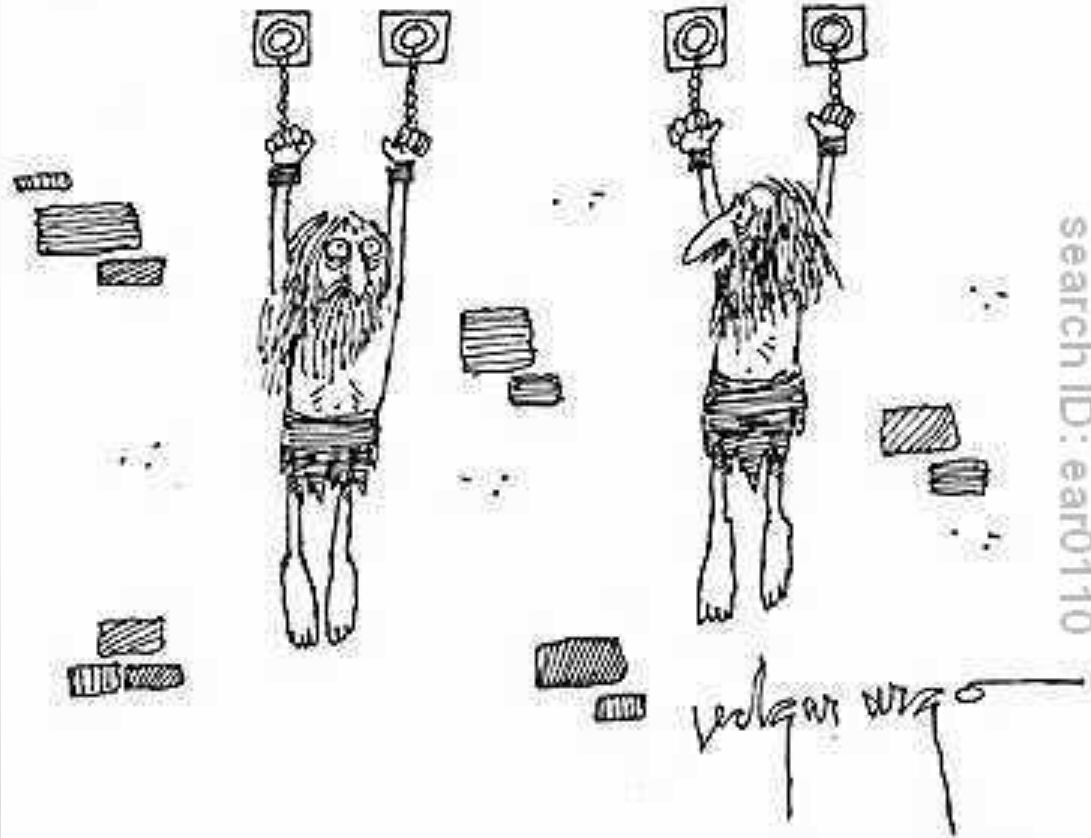
Calendar for January 12th



- We will cover
 - Regulations, the impact of the 990s
 - Governance and Committee importance
 - Operational impact on charities
 - Mergers, acquisitions and collaboration, recapitalization, sale of assets

Liabilities of Directors after SOX

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





Philosophy of Form 990

- Compliance, transparency, accountability
 - Focus on areas with substantial compliance interests and trends; build the form to design compliance projects
 - Build the form to appropriately take advantage of its public nature and accountability aspects
 - Structure: core form for all, complete schedules depending upon activities
 - Provide opportunities to explain and supplement their responses, tell their story
- California Integrity Act
 - In the wake of federal Sarbanes-Oxley legislation, California has enacted a new law to bring increased accountability to nonprofits and commercial fundraisers doing business in California.



Form 990: an IRS Perspective

- What IRS did
 - Released the form Dec. 2007, no instructions
 - Effective for 2008 tax years (2009 filings)
 - One year relief for hospitals
- Why IRS did it
 - Current form is out of date and inadequate to serve transparency and tax compliance needs
 - Does not portray what organization does



Key Aspects of the 990

- Redesigned 990 to be phased in over three years for “smaller” entities, who may use Form 990-EZ IF
 - 2008 Form (years begun in 2008): Gross receipts less than \$1.0m and total assets less than \$2.5m
 - 2009 Form (years begun in 2009): Gross receipts less than \$500K and total assets less than \$1.25m
 - 2010 Form (years begun in 2010) ... and beyond: Gross receipts less than \$200K and total assets less than \$500K



What It Takes (6 Days EZ)

Form	Record Keeping	Learning the form	Preparing the form
990	117 hr. 54 min	16 hr. 4 min	23 hr 28 min
990 EZ	29 hr. 10 min	11 hr. 33 min	14 hr. 24 min
Schedule B	5 hr. 58 min	1 hr. 35 min	1 hr. 45 min
Schedule C	22 hr	42 min	1 hr. 5 min
Schedule E	5 hr. 30 min	53 min	1 hr. 1 min
Schedule G	24 hr. 9 min	24 min	45 min
Schedule L	5 hr. 30 min	1 hr. 5 min	1 hr. 5 min
Schedule N	7 hr. 53 min	42 min	51 min
Schedule O	43 min	-	-
Total	101 hr. 44 min	17 hr. 10 Min	20 hr. 56



Penalties Can Be Severe



Under \$1 million

- \$20 a day not to exceed \$10,000 or 5% of the gross receipts of the organization
- Against responsible person(s) \$10 a day shall not exceed \$5,000
- Potential loss of exemption



Over \$1 Million

- \$100 a day not to exceed \$50,000
- Or files incomplete or failing to supply appropriate schedules
- Against responsible person(s) \$10 a day shall not exceed \$5,000
- Potential loss of exemption



Key Aspects of the 990

- Increased focus on activities, not just numbers
- Summary page - snapshot
- Checklist of schedules - burden, snapshot
- Governance section - board, policies, disclosure
- Compensation and insider transactions
- Foreign activities
- Related organizations, joint ventures, UBI
- Non-cash contributions and fundraising
- Targeted information: hospitals, bonds other tax filings, endowments, major transactions, FIN 48



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
 - Board has liability and responsibility
 - Executive compensation of CEO



Governance

- Did compensation process for CEO include review and approval by independent persons, comparability data, and substantiation?
- Describe the compensation review and approval process for other officers and key employees.
- Written policies regarding participation in joint ventures, including safeguards for exempt status.
- Number of narrative explanations - does ability to explain make it less likely that these policies will become de facto legal standards?



Governance (continued)

- Policies governing consistency of affiliate activities?
- Was 990 provided to board before it was filed?
- Was governing documents, conflicts policy, 990/990-T, and financial statements made available to public.
- Developing Key Committees

Importance of Committees

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"This committee will have two functions - to execute my plans and to accept responsibility if they fail."





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 –
 - 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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Preparing for Operational Impact

- Review governance policies and procedures
 - Assure “yes” to policies on conflicts of interest, whistleblower, document retention/destruction, consistency of affiliate activities, and safeguarding exempt status while participating in joint ventures
 - Apply new independence standard in assessing number of independent directors
 - Contemporaneous minutes for all committee meetings
 - Determine any failure to monitor and enforce compliance with conflicts policy



Preparing for Operational Impact

- Continue to collect data on business and family relationships among current officers, directors, trustees, and key employees
- Expand collection of data on business relationships between entity and current/former officers, directors, trustees, and key employees
 - Relationships only as they existed at any time during year for which 990 is filed?
 - How far back on former(s)?
 - Any de minimis amounts, such as \$5,000?

New Entities



Did I say "merger?"
I meant "acquisition."



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less.



Mergers and Acquisitions

- A transaction where two organizations agree to integrate their operation because they have mission, resources and capabilities that together may create stronger competitive advantage.
 - This may be through absorption or consolidation that may result in a totally new organization



Types of Acquisition or Mergers

- The stronger organization absorbs the weaker organization assets and liabilities
- The acquiring organization absorbs only the assets of the acquired organization
- Assets are transferred from a dissolving organization



Mergers and Acquisition

- Reasons are many:
 - Wounded charity
 - Extending mission
 - Expanding footprint
 - Founder retiring
 - Unable to get to the next level
 - Funders recommendations
 - Dissolution
 - New social enterprise organization





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.



Supporting Organizations

- Supporting organizations are charities that carry out their exempt purposes by supporting other exempt organizations, usually other public charities.
 - 509 (a), (b), (c)



What is a Subsidiary?



- Nonprofit or for-profit corporation or LLC controlled by parent or member
- Control is 51% or more of membership shares or as provided by bylaws; 100% is wholly owned
- Typically, parent entity is sole member and “elects” subsidiary board
- Can have board overlap
- Issue - how much real control do you want or need?
- Has veto power over subsidiary board members

Where Does Best Practices Fit



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



Keeping Corporations Separate

- Maintain corporate walls, or else risk:
 - attribution of debts, income, liability of one to the other
 - Tax-exempt status of non-profit parent
- Separate board committee meetings and minutes
- Boards can overlap, but not identical
- Separate financial records and bank accounts, audit financial statements
- Written agreement for shared resources
- Fair allocation of costs



Non-Profit Board Role

- Board role in oversight, has ultimate responsibility, cannot delegate
- Oversee investment, but don't manage on a day-to-day basis
- Ensure appropriate controls
 - Elect directors
 - Regular reporting
- If grant funds used as investment, ensure grant terms are followed



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)