



Serving on a Nonprofit Board of Directors: What Attorneys Need to Know

Presented by the Nonprofit Law Practice Group

Thursday, February 21, 2019



Serving on a Nonprofit Board of Directors: What Attorneys Need to Know

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February 21, 2019

AGENDA

- 8:55 a.m. Welcome & Opening Remarks**
- 9 a.m. Board Governance & Fiduciary Duties** **TAB A**
Matthew B. Lake, Esq., *Graydon Head & Ritchey LLP*
Beth Short & William A. Sieck, Esq., *Ohio Attorney General's Office*
- 10:30 a.m. Understanding Financial Statements & Internal Controls** **TAB B**
Stephanie Allgeyer, CPA, CFE, *VonLehman*
- 11:45 a.m. Group Luncheon**
- 12:15 p.m. IRS Form 990** **TAB B**
Stephanie Allgeyer, CPA, CFE, *VonLehman*
- 1 p.m. Adjourn**

TAB A





Matthew B. Lake

CONTACT

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Downtown Cincinnati

312 Walnut Street, Suite 1800
Cincinnati, OH 45202

EDUCATION

Indiana University School of Business, B.S.,
Finance with Distinction, 1994 Certified
Public Accountant, Ohio, 2000 (Inactive)
Certified Public Accountant, Illinois, 1997
(Inactive)

LAW SCHOOL

University of Cincinnati College of Law, J.D.,
1999 - Order of the Coif

BAR ADMISSIONS

State of Ohio

AREAS OF PRACTICE

Business
Business Planning & Entity Formation
Non-Profit
Private & Family Business
Real Estate Taxation
Start-Ups
Tax

COMMUNITY OUTREACH

Academy of Medicine Foundation - Member
Nativity School

AFFILIATIONS

Cincinnati Bar Association NonProfit
Committee Chair

Matt has worked extensively in corporate, pass through entity and state tax counseling various business types and has worked with may closely held and family held businesses. He has assisted these businesses from infancy through rapid growth and dispositions or ownership changes. His areas of focus have included entity formation, governance, restructuring, like kind exchange transactions and sales and use tax analyses. He has also developed an expertise in real property valuation complaints and has appeared in front of multiple boards of revision and the Ohio Board of Tax Appeals.

Matt has also developed in depth knowledge working with nonprofit clients. He has worked with public charities, private foundations, donor advised funds, community foundations and social clubs assisting in a broad range of topics. He has formed numerous nonprofit entities, obtained tax exempt status from the IRS, restructured entities, merged nonprofits, counseled on various governance issues, worked on donor agreements and obtained multiple real property tax exemptions. While he has worked with a variety of types of nonprofits, he has built a specialty in working with religious organizations such as churches, church schools and related social service agencies.

Matt's favorite thing about his practice is the diversity of his clients. "Working with for profit and nonprofit clients helps me appreciate the complexities of their issues and the commitments to their goals." "It is also exciting learning about the many products and services our clients offer and it is rewarding helping them improve their processes and structures so they can excel at delivering their processes and services.

Matt spends much of his time outside work with his wife Katie and their two children. He has volunteered extensively at his children's school and has coached baseball, volleyball and soccer.

Bill Sieck is a Senior Assistant Attorney General in the Office of the Ohio Attorney General's Charitable Law Section. Working with skilled investigators and accountants, he applies his extensive litigation experience to serve the public by investigating and resolving complaints involving charitable trusts, charitable solicitations, and Ohio's charitable gaming laws. Bill also helps nonprofit leaders focus on providing charitable services that strengthen Ohio's communities by providing training about board governance and fiduciary duties. He is a graduate of the University of Chicago and the University of Pennsylvania Law School.

Beth Short, who handles outreach and education for the Ohio Attorney General's Charitable Law Section, has spent her career working for and with nonprofit organizations. Her passion for the nonprofit sector is evidenced by her professional and volunteer background working with charities as a staff member, board member, consultant and volunteer for large and small organizations. She brings a background in journalism, legislative and public affairs and training, complemented by a master's in business that focused on nonprofit management issues. Her work in the Charitable Law Section focuses on the development of strategies aimed at strengthening the nonprofit sector. She is a graduate of the Ohio State University and Ohio University.

The 3Rs

Rules, Risks, & Responsibilities

of Non-Profit Directors

Matthew B. Lake, Esq.
FEBRUARY 21, 2019

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2 Questions

- ? **WHERE** can you go to find the general purpose and form of a nonprofit entity
- ? **WHERE** can you go to see what rules and procedures a Board of Directors should follow

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Articles of Incorporation Overview

- **Gives entity life/legal existence**
- **Establishes form** (corporation or LLC)
- **Lists broad purposes and limitations**
(Old Articles contain board procedures)
- **Appoints statutory agent**
- **Public document** (see www.sos.state.oh.us/)
- **Suggest minimalist approach**
- **Read Articles before joining board**

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Code of Regulations Overview

What is it?

- Governance document for the entity
- Roadmap
- Roles, responsibilities and limitations
 - Members, Directors and Officers
- Procedures
 - Meetings, approvals, action and inaction, notice
 - Committees
 - Indemnification
- Binding (not aspirational)
- Purposes (if restated should not conflict with Articles)
- Procedures (should not conflict with Articles)

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Articles/Code of Regulations

Questions new Director must ask

- Who drafted these
- How old are they?
- Are there other documents (i.e., Constitution)?
- Any conflicts between the documents?
- Have you been following the procedures?

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Who is Who?



Always know which hat(s) you are wearing

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Who Does What?

Member/Members

- Often another nonprofit corp.
- If no Member (Directors by Ohio law)
- Member \neq Owner
- Founder \neq Owner
- Member = Fiduciary
- Fiduciary = A person who has a duty to act primarily for the benefit of another
- Elect Directors
- Merge or Dissolve Entity

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Who Does What?

Directors

- Elected by Member(s)
- If no Member(s), self select
- Governing body
- Guide organization
- Hire and fire officers
- Fundraise
- Director \neq Owner
- Director = Fiduciary
- Fiduciary = a person who has a duty to act primarily for the benefit of another

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Who Does What?

Officers

- Selected by Directors
 - Report periodically to Directors
 - Accept additional responsibilities
- Examples:* Board Chairman, Secretary, Treasurer
- May or may not be Directors

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Who Does What?

Staff

- Top staff
 - Hired and fired by Directors
- Other staff hired by top staff
- Not voting members of the Board (typically)

Examples: President
Chief Executive Officer
HR Director
Development Director
Chief Financial Officer

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Duties of Directors

4 duties per Ohio Attorney General

- Duty of Care
- Duty of Loyalty
- Duty of Compliance
- Duty to Maintain Accounts

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Duty of Care

- **Active in Nonprofits Affairs**
- **Participate**
- **Act in Good Faith**
 - Honest belief, absence of malice
- **Stay Informed**
- **Exercise Care (ordinarily prudent person)**
 - Who is this?

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Duty of Care

Satisfied by

- Exercising independent judgment
- Attending meetings
- Overseeing executive director
- Asking questions
- Reviewing information/reports (e.g., audit reports, financial returns)
- Demanding books and records

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Duty of Care

Planning Points

- Distribute financials/reports before meetings
- Share Form 990/audits/reviews
- Board Trainings
 - ABCs – nonprofit statements
- Review/evaluate executive director

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Duty of Loyalty

To the Nonprofit

Act in manner director believes to be in, or not opposed to, best interests of the corporation

LOYALTY TO CORPORATION

Not Officers
Not Other Directors
Not to Founder
Not to Staff
Not to Family/Friends

FOUNDER ISSUE

Appreciation & Recognition
No Special Rights & Privileges
Operate in the Present

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Duty of Loyalty

Satisfied by

- Acting free from conflicts of interest
- Protecting confidentiality of nonprofit information
 - Not self appointed spokesperson (merger example)
- Corporate opportunities belong to nonprofit (lease/real estate example)

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Duty of Loyalty

Planning Point

- Review Conflicts of Interest Policy
- Understand what it means
- Avoid unnecessary conflicts
- Does your entity require annual waivers?

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Conflicts of Interest

Occurs When Director Has

- Material personal interest (direct or indirect)
- Contract/transaction

Point of Emphasis – IRS

- Private benefit/inurement – individual receives disproportionate benefit from transaction
- Fines for entity
- Fines for directors
- Loss of tax exemption

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Conflicts of Interest

EXAMPLE

Nonprofit needs a new website, Board member's spouse, best web designer in town, offers services at a discount

- ❓ Can Board accept bid
- ❓ What role should Board spouse play
- ❓ How to proceed

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Conflicts of Interest

How to Proceed?

- Not required to abandon contract/transaction
- Review/follow Conflicts of Interest Policy
- Director discloses potential conflict to Board
- Director exits process and meetings
- Remaining directors review data, multiple bids
- Remaining directors vote
- Retain evidence
- Discounted services may help

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Duty of Compliance

- **Faithful to the nonprofits purpose and mission**
- **Must act according to Articles, Code and other governing documents**
- **Must act according to state and federal statutes and regulations**
- **Comply with state and federal registrations (OH SOS, AG)**

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Duty of Compliance

Satisfied by

- Knowing/understanding Articles, Code and Mission
- Following Articles, Code and Mission
- Confused – seek help!!

Planning Point

- Board orientation for new directors
- Periodic distribution of Articles, Code and Mission
- Understand quorum and notice provisions

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Duty to Manage Accounts

- **Monitor financial stability & accountability**
- **Operate in a fiscally responsible manner**

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Duty to Manage Accounts

Satisfied by

- Developing annual budget
- Monitor changes in budget
- Ensure maintenance of accurate records
(Income, expenditures, cash flow)
- Establish internal controls (checks and balances)
- Prudently invest and reinvest assets

Example: CPA meeting

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Duty to Manage Accounts

Satisfied by

- Developing fundraising goals and gift acceptance policies
- Multiple bids for products and services

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Why Do Duties Matter?

Directors Who Know/Follow Duties Are Better Directors

Better Directors = Better Organization

Directors Can and Do Get Sued

Insurance May Not Cover

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Risks of Directors

EXAMPLE

Board removes long-time executive director (legally blind female, age 60) and replaces with a younger person, you as director abstain

Reminder: executive director reports to Board, not vice versa

Are you personally at risk?

What legal protections exist for Directors?

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Legal Protection for Directors

- **Statutory**
- **Indemnifications**
(see Code of Regulations/Ohio Statutes)
- **D&O Insurance**

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Director/Officer Protections

Statutory

- Ohio Corporation Law
- Federal Volunteer Protection Act
- Ohio Volunteer Protection Act
- Warnings:
 - ✓ do NOT protect organization
 - ✓ Do NOT stop lawsuits
 - ✓ Protection is limited

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Limits to Statutory Protections

- ✓ **Must act within “scope of authority”**
- ✓ **Not protected for most employment claims**
- ✓ **Only protects uncompensated volunteers** (Small gifts/rewards okay)
- ✓ **Do NOT cover transportation issues**
- ✓ **Do NOT cover federal tax violations**
- ✓ **Harm caused by willful conduct, gross neglect, fraud NOT covered**

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Indemnification – Ohio Law Concept

Mandatory for some cases

- Successful defense of lawsuit

Limits

- Ability to pay
- What actions must directors take to trigger indemnification?
- Who indemnifies (multiple entity structure)

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Directors & Officers' Liability

What is it?

- Liability (or exposure to litigation)
- Of Directors & Officers
- Arising out of actions or decisions they make or fail to make

What it is not

- Liability for actions of nonprofit on day-to-day basis
(third party contracts, lease issues, personal injury)
- Liability for actions requiring state licensure

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D&O Insurance

What is it?

- Insures personal assets of Directors & Officers
- From lawsuits & related expenses
- Resulting from allegations of wrongful acts committed
- In individual capacity as Director or Officer

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D&O Insurance

3 Types of Coverage

- Direct coverage for Directors and Officers
- Reimbursement for corporations that indemnify Directors and Officers
- Protection for the entity itself

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D&O Insurance

Why is it needed?

- Nonprofit lacks sufficient assets to indemnify
- Protects personal assets of Directors/Officers
- Personal umbrella policy may not cover
- General liability policy of nonprofit may not cover

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Coverage Tips

- **Policy should be non-cancelable**
(except for failure to pay premiums)
- **Review definition of “insured”**
- **Policy should extend to include Employment Practices Liability including “Third Party” discrimination and harassment claims**
- **Should cover punitive damages**
- **Review coverage cap**
- **Review defense costs and impact on cap**

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Employment Practice Liability

- **Most likely source of claims**
- **Almost 75% of all lawsuits against nonprofit corporations**
- **75% of claims brought against small entities**
- **Third party claims of discrimination and harassment on the rise**

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Minding the Business While Changing the World

Charitable Board Member Roles and Responsibilities

Ohio Attorney General's Office, Charitable Law Section





DAVE YOST
OHIO ATTORNEY GENERAL

1

“To pour forth benefits for the common good is divine.”

- Benjamin Franklin



2

Thank You!



The quality of life of all Ohioans is enriched by the important efforts of the charitable sector.

3

Role of the Attorney General

- Assisting board members in knowing and fulfilling their duties. Many resources are available through the web page.



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Role of the Attorney General



- Attorney General's role in oversight of charitable trusts is one of the most ancient duties of the Attorney General
- Dates to the Elizabethan period
- Standing in the shoes of those with no voice

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Do you know the basics about your group?

- The Ohio Secretary of State handles incorporation matters.
- The IRS grants EINs and tax exempt status. More than 1.1 million organizations are 501(c)(3) organizations.
- Ohio charities and those that solicit Ohioans need to make annual filings with the Ohio Attorney General's Office.



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Ex-nonprofit employee charged with embezzlement

Man allegedly took \$67,000 from Partners in Education

Former hospice worker indicted

Officials advise all nonprofits to routinely audit procedures, books

BY JOSH JARMAN
THE COLUMBUS DISPATCH

NEWARK, Ohio -- All nonprofit organizations need to guard themselves against long-term embezzling such as that alleged against a former employee of a local hospice that is out more than \$400,000, officials said this week.

Kathleen Lee, 60, of Heath, was arrested Oct. 28 after police say she admitted to stealing \$411,868 over five years from Hospice of Central Ohio, her former employer. She has been indicted on felony counts of aggravated theft, forgery and engaging in a pattern of corrupt activities and faces 18 years in prison if convicted on all counts.

A Deitz Avenue woman was accused of forgery Aug. 16. She is accused of writing a check to herself from the Glover Elementary School PTA for \$2,400. Reports said that she is one of the signers of the check, but she forged the signature of the secondary signer.

PTA treasurer ordered to pay restitution

By Beacon Journal staff report

A treasurer of an Akron elementary school PTA has been ordered to pay restitution for stealing money from the organization.

Katherine F. Delaney pleaded guilty last month to a felony theft charge stemming from the the alleged embezzlement of more than \$12,425 from the Sam Salem Elementary School PTA over a three-year period.

She was sentenced to 100 hours of community service.

Last week, Summit County Common Pleas Judge Brenda Burnham Unruh ordered Delaney to pay the organization \$3,961 — the balance owed to the organization.

Delaney told the court she already had paid part of the restitution.

Akron police have said the alleged theft came to light following a recent audit of the PTA's books for 2004 through 2007.

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What's the role of a state charity regulator?

- Help us stop problems before they become major headaches – contact us with concerns
- Last year, the Charitable Law Section fielded more than 750 complaints



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Online Charitable Registration System

An intuitive system that, based on the information provided, determines what filings or fees might be needed under the various statutory provisions

Related

- Charitable Registration User Guide
- Online Charitable Registration Tool Tips
- Research Charities
- Services for Charities

Publications

Links

BUSINESS > SERVICES FOR CHARITIES > CHARITABLE REGISTRATION

Charitable Registration

Please be aware that the filing system may experience slowdowns during peak hours.

Ohio requires charitable organizations located in Ohio and groups that ask Ohioans for contributions to file annual reports with the Attorney General's Office. These filings are public and contribute to accountability and transparency within the charitable sector.

Groups are required to use the online system to fulfill their duties under the Charitable Trust Act (RC 109.23) and the Charitable Solicitations Act (R.C. 1716.02). Multiple individuals from each organization are encouraged to create accounts in order to receive reminders on filing deadlines, confirmation of filings, and other important information.

[File Online >](#)

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Research Charities

- Check on registration status and filings with our office
- Other research information

Research Charities

Search Criteria:

Organization Name:

Employer identification number (EIN XXX-XXXXXXX):

Search Results:

The form, **Verification of Registration** with the Ohio Attorney General's Office, is no longer available. Instead, charities and donors can use this page and search for a charity. The resulting information will indicate whether the organization is registered and current and can be printed as verification of registration.

Learning about an organization and its activities can help donors make wise-giving decisions. In addition to checking whether an organization is current with its registration requirements with the Ohio Attorney General's office, other good sources of information include:

- The IRS's Exempt Organizations Selection Check can be used to verify if an organization has a valid 501(c)(3) or other tax-exempt designation. The [IRS also lists organizations](#) that have had their tax-exempt status revoked.
- Private watchdog organizations often review data and reports on organizations and may grade them based on various spending standards and other procedures. Some of those groups are [CharityWatch](#), [Charity Navigator](#) and the [Better Business Bureau Wise Giving Alliance](#). Your local Better Business Bureau may also be a resource and can be identified through the Wise Giving Alliance link above.

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Organization Details:	Description of Organization's Purpose: Strengthen the capacity of
Organization Name: Ohio U	Organization:
DBA Names:	DBA Name: Is the organization's registration status current? Yes
Employer identification number:	Employer identification number (EIN): 31-4379529
Address line 1: 395 E Broad	Address line 1: 395 E Broad Ste 320
Address line 2:	Address line 2:
City: Columbus	City: Columbus
State: Ohio	State: Ohio
ZIP code: 43215-3844	ZIP code: 43215-3844
County: Franklin	County: Franklin
Country: United States	Country: United States
Telephone: (614)224-8146	Country: United States
Web address: www.ouw.org	Telephone: (614)224-81
Date of formation: 07/04/1	Web address: www.ouw
Organization type: 501(c)(3)	Date of formation: 07/04/1913

Total Revenue: \$863,085.00

Total Expenses: \$843,472.00

Total Program Expenses: \$743,179.00

Percent of Total Expenses: 88%

Total Assets: \$672,066.00

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Ohio Attorney General Responsibilities



- Common law authority
- Statutes
 - Charitable Trust Act (ORC 109)
 - Charitable Organizations (Solicitation) Act (ORC 1716)
 - Gambling Code (ORC 2915)
 - Ohio Nonprofit Corporations Act (ORC 1702)
- Ohio Administrative Code

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Ohio Charitable Trust Act

RC 109



- Charitable trust defined:
- Not limited to formal trust agreements
- Broadly defined as any organization that holds money or property for charitable, religious or educational purposes
- Applies to the “nature” of the organization



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Ohio Charitable Trust Act



- Registration and Reporting
- Investigative powers and enforcement authority
- Necessary party to certain litigation
- Involvement in certain transactions

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Ohio Charitable Organizations (Solicitation) Act (ORC 1716)



- Applies when an appeal is used that suggests a charitable purpose for a solicitation
- Registration of professional solicitors and fundraising counsel
- Enforcement and investigation powers
- Annual report on professional solicitors

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Nonprofit Corporation Law- Chapter 1702

- Public benefit corporations
- Notice to Attorney General on certain sales of assets and mergers/consolidations

P₃ U₁ B₃ L₁ I₁ C₃

B₃ E₁ N₁ E₁ F₄ I₁ T₁

C₃ O₁ R₁ P₃ S₁

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Gambling-Chapter 2915

- Bingo licensing, investigations, enforcement
- Raffles and games of chance
- Definition of eligible organization
- Restrictions on activities



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Regardless of size of the nonprofit, all board members share important duties

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Fiduciary Duties

- Duty of care
- Duty of loyalty
- Duty to maintain accounts
- Duty of compliance



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Duty of Care



- Standard of Care
- Directors of unincorporated charitable trusts must conduct themselves with the level of care, skill and diligence that an ordinarily prudent person would exercise in the handling of his or her own affairs.

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Duty of Care

- Attend meetings
- Prepare for meetings
- Actively participate
- Establish policies
- Selection of organization's key staff members



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Duty of Care Policies




Financial controls




Conflict of interest

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Duty of Care Policies




Major expenditures



Hiring professionals


Spending, investment and gift acceptance policies




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Duty of Care Policies

Conduct of meetings



Whistleblower protection



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Duty of Care

In short



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Duty of Loyalty

Requires that the interest of the charity is foremost and is placed above any personal interest



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Duty of Loyalty

Conflicts of Interest!



Types of conflict situations:

- Personal financial interest
- Loyalty or relationship that can influence decision

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Duty of Loyalty

Conflict of interest policy




A 3D rendering of a blue folder with the text "CONFLICT OF INTEREST POLICY" printed on its top flap. The folder is shown at an angle, revealing a red interior.

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Duty of Loyalty

Conflict of interest policy




Gathers information on board members' affiliations and those of the board members' families

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Duty of Loyalty

Conflict of interest policy



Requires disclosure of conflicts

This slide features a central graphic of a film strip frame with a large number '2' in the center. The frame is divided into four quadrants by a vertical and a horizontal line. The background of the frame is a light gray with a subtle gradient and a dark gray shadow on the left side.

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Duty of Loyalty

Conflict of interest policy



Prohibits board members with conflicts from voting or seeking to influence decisions

This slide features a central graphic of a film strip frame with a large number '3' in the center. The frame is divided into four quadrants by a vertical and a horizontal line. The background of the frame is a light gray with a subtle gradient and a dark gray shadow on the left side.

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Duty of Loyalty

Conflict of interest policy



Requires that minutes reflect when a member is excluded from discussion and voting

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Duty of Loyalty

To avoid problems:

- Regularly update the disclosure statements.
- Cultivate a board culture that invites candid discussions of potential conflicts.



"Well, now we know what not to do."

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Duty to Maintain Accounts

Requires that accurate records are maintained and that financial matters are properly managed.



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Duty to Maintain Accounts



- Keep accurate records of income, investments, expenses
- Develop and monitor budgets
- Establish internal control systems – checks and balances

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Duty to Maintain Accounts

- Maintain accurate records of all organization activities
- Records retention policy
- What records do you have? Are they stored safely?



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Duty of Compliance

Board must comply with all legal requirements and other obligations, including:



- Federal and state law
- Governing documents
- Agreements, contracts
- Representations made in solicitations

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Duty of Compliance

Federal law



- Compliance with IRS regulations
- Filing of annual returns
- Sarbanes-Oxley (whistle-blower protections and prohibits destruction of documents if under investigation)

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Duty of Compliance

State law

- Registration and filing with Attorney General
- Secretary of State
 - Incorporation, continued existence filings
- Other employer and industry regulations



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Board Governance



Where to begin??

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Special Challenges

Fiscal Management – Board Overview



Just like household budgets, charity budgets reflect projections of income and expenses. Just like household resources, you need to protect the charity's resources.

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Know the basics



Sources of revenue:
donations, grants,
pay for services,
etc.

Expenses: salaries,
supplies,
overhead, etc.

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- Are there expectations and restrictions that come with some funding?
- Do the revenues and expenses come at specific times of the year?
- How does this affect cash flow? Can the bills be paid? Do the numbers match with the budget projections? Can deviations be explained?
- Do the numbers match trends of prior years? If not, why not?
- Do we need to do something differently?

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Preventing Theft



Internal Controls

Boards are the first line of defense in adopting and monitoring sound internal controls.

Processes protect the people and the organization.

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Boards must review and discuss financial reports. Staff can assist in compiling reports, but **boards need to exert independent oversight.**

Board treasurer, audit and budget committee members and others may play a crucial role in this.



What works best for your group?

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Oversight of the Executive Director



Boards are sometimes guilty of failing to provide appropriate oversight of the executive director and relying too heavily on staff.

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Oversight of the Executive Director


Board Policies and Practices

- ❖ Hiring process (what skills are needed, job description, ensuring wide pool of qualified candidates, objective interview process, references, background check, etc.)
- ❖ Performance and communications expectations
- ❖ Evaluations



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Board Policies To Consider:




<ul style="list-style-type: none"> - Budget policies - Gift acceptance and receipt policies - Reserve funds policies - HR Policies - IT Policies - Fundraising policies - Audit policies - Whistleblower 	<ul style="list-style-type: none"> - Investment policies - Policies on purchasing/expenses (bidding, approval levels, etc.) - Recordkeeping policies - Communication/media policies -Volunteer management policies
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Other Best Practices

- Annual 'check up' on organization's well-being and compliance (review of by-laws, policies, conflict of interest policies, document review, etc.)
- Timelines and transition documents reviewed annually to note important dates and deadlines for filings and reports (AG, Secretary of State, IRS, employment taxes, budgets, audits, staff evaluations, officer nominations, annual meetings, etc.)



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Other Best Practices

- Consideration of Directors and Officers (D&O) insurance coverage
- Board orientation
- Strategic planning – development of goals and assessment of performance (operational and mission delivery)



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In effective organizations, the boards regularly evaluate themselves, too.



How well are you doing in being accountable to the organization?

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Good Resources

- Ohio Attorney General's web page -- <http://www.ohioattorneygeneral.gov/>

Check out Resources for Board Members under Services for Nonprofits:
-Publications, Newsletter, Webinars, FAQs, etc.

-

A photograph of Ohio Attorney General Dave Yost speaking at a podium. He is wearing a dark suit and a red tie. To his left, a woman is partially visible, looking towards him. The background is dark with a logo for the Ohio Attorney General's Office and the text "DAVE YOST OHIO ATTORNEY GENERAL". A blue banner at the top of the photo reads "How May We Help You?".

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Good Resources

- Better Business Bureau and Charity Seal Program (www.give.org)



- Ohio Association of Nonprofit Organizations and Standards of Excellence (www.oano.org)



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Good Resources

- BoardSource at www.boardsource.org

BoardSource

- IRS Resources at www.irs.gov and www.stayexempt.org



- Chronicle of Philanthropy

THE CHRONICLE OF
PHILANTHROPY

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Other Resources:

- Numerous books at libraries and bookstores on many nonprofit topics
- Talk with other nonprofits about how they have responded to specific issues
- Ask local businesses if they have an expert on a specific area who might volunteer, consult or serve on your board

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If you haven't got charity in your heart, then
you've got the worst kind of heart trouble.

-Bob Hope



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How to contact us

Ohio Attorney General's Office
Charitable Law Section
150 East Gay Street 23rd Floor
Columbus, OH 43215-3130
(800) 282-0515

Fax Number (614) 466-9788
CharitableLaw@ohioattorneygeneral.gov



DAVE YOST
OHIO ATTORNEY GENERAL

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TAB B



Stephanie Allgeyer is a Shareholder with VonLehman CPA & Advisory Firm specializing in Nonprofit and Governmental entities, including a concentration in single audits. She serves as the head of the firm's Nonprofit/Governmental Industry Service Group and is also a member of the firm's Quality Control Committee. Stephanie has also achieved the designation of Certified Fraud Examiner and serves the firm's clients by resolving allegations of fraud and assisting in the prevention and detection of fraud and white-collar crime.



nonprofit board involvement and 990 review

stephanie allgeyer

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stephanie allgeyer

SHAREHOLDER, CPA, CFE

EXPERIENCE

Stephanie is a shareholder with VonLehman & Company specializing in Nonprofit and Governmental entities including a concentration in single audits. Stephanie's public accounting experience includes attestation and business advisory services to a wide range of nonprofit and governmental entities. She serves as the head of the firm's Nonprofit/Governmental Industry Service Group and is also a member of the firm's Quality Control Committee and serves as the firm's representative of the AICPA Governmental Audit Quality Center. Stephanie has also achieved the designation of Certified Fraud Examiner and serves the firm's clients by resolving allegations of fraud and assisting in the prevention and detection of fraud and white-collar crime.



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agenda

Nonprofit Financial Reporting

- New reporting model
- Board involvement

Upcoming Pronouncements

- Revenue Recognition
- Lease Standards

Internal Controls

- Overview
- Board Responsibility

990 Overview



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nonprofit financial reporting

FASB ASU 2016 -14 - Presentation of Financial Statements of Not-for-Profit Entities

- Attempt to help Nonprofits (NFPs) “tell their story”
- To provide more relevant information about the organization’s resources and the changes in those resources
- Financial statement users felt that reports were too complex, provided insufficient transparency, and found them to be limited in their usefulness

Effective Date: Fiscal year beginning AFTER December 15, 2017

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new reporting model

Primary Components of the New Standard

- Improve the net asset classifications
- Provide information on liquidity
- Require further information about expenses
- Decrease complexity of the direct method cash flow statement
- Enhanced disclosures
- Changes in reporting investment return
- Changes in reporting for underwater endowments
- Placed in service approach for long-lived assets

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net asset classifications

Removal of the terms

- Unrestricted
- Temporarily Restricted
- Permanently Restricted

Addition of the terms

- Without Donor Restriction
- With Donor Restriction

Eliminating the distinction between resources with permanent restrictions and those with temporary restrictions from the face of financial statements will reduce complexity

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net asset classifications

Statement of Financial Position – Option #1

Net Assets:

Without Donor Restriction	\$ 150,000
With Donor Restriction	<u>200,000</u>
Total Net Assets	<u>\$ 350,000</u>

Statement of Financial Position – Option #2

Net Assets:

Without Donor Restrictions	
Designated by the Board	\$ 50,000
Undesignated	<u>100,000</u>
	<u>150,000</u>
With Donor Restrictions	
Perpetual in Nature	25,000
Purpose Restricted	150,000
Time Restricted	<u>25,000</u>
	<u>200,000</u>
Total Net Assets	<u>\$ 350,000</u>

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net asset disclosures

Amount and purpose of board designations (not previously required)

Note X: The Organization's governing board has designated \$50,000 of net assets without donor restrictions of \$150,000 for the following purposes as of December 31, 2018:

Board-designated endowment	\$ 31,000
Capital projects reserve	<u>19,000</u>
	<u>\$ 50,000</u>

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net asset disclosures

Subject to expenditure for specified purpose:

Program A Activities	
Purchase of equipment	\$ 26,880
Research	100,000
Program B Activities:	
Disaster relief	1,120
Educational seminars and publications	<u>22,000</u>
	<u>\$ 150,000</u>
Subject to passage of time	<u>\$ 25,000</u>
Subject to NFP spending policy and appropriation:	
Investment in perpetuity, the income from which is expendable to support:	
Program A activities	\$ 12,000
Any activities of the organization	<u>13,000</u>
	<u>\$ 25,000</u>
	<u>\$ 200,000</u>

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net asset disclosures

Expiration of Time Restrictions	\$ 15,000
Satisfaction of Purpose Restrictions	
Operation of the Training Center	801,146
Educational Programs	247,793
Financial Aid	219,021
Distributions	
Beneficial Interests in Charitable Trusts	
Held by Others	<u>36,872</u>
	<u>1,319,832</u>
Restricted-Purpose Distributions and Appropriations	
Educational Programs	130,619
Financial Aid	75,240
General Use	<u>398,301</u>
	<u>604,160</u>
Total Net Assets Released From Restrictions	<u>\$ 1,923,992</u>

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functional expenses

Expenses by function and natural classification is now required by ALL organizations

Function Represents

- Program Services**
- General and Administrative
- Fundraising

Natural Classification Represents

- Salaries
- Rent
- Professional Fees
- Office Expenses
- Interest Expense

** Optional to provide individual programs

Required to be presented as a basic financial statement OR in the footnotes

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functional expenses

	Program Services			Management and General	Fundraising and Development	Total
	Advisory	Training	Total			
Grants and Other Assistance	\$ 294,261	\$ -	\$ 294,261	\$ -	\$ -	\$ 294,261
Salaries and Wages	6,769,754	1,061,585	7,831,339	370,234	254,176	8,455,749
Employee Benefits	1,398,503	310,865	1,709,368	99,963	26,222	1,835,553
Payroll Taxes	541,580	84,927	626,507	29,619	19,823	675,949
Professional Services	1,306,807	87,197	1,394,004	12,780	1,704	1,408,488
Accounting Fees	-	-	-	40,073	-	40,073
Legal Fees	-	7,939	7,939	-	-	7,939
Advertising and Promotion	33,085	21,006	54,091	79,261	132,478	265,830
Office Expenses	87,071	56,654	143,725	9,867	22,794	176,386
Information Technology	37,858	606,535	644,393	12,399	14,653	671,445
Occupancy	446,601	29,799	476,400	14,918	55,427	546,745
Travel	170,957	18,283	189,240	149,292	-	338,532
Conferences, Conventions and Meetings	32,516	66,287	98,803	11,505	-	110,308
Interest	394,867	483	395,350	130	9,548	405,028
Insurance	198,174	12,556	210,730	5,443	1,022	217,195
Training and Development	457,617	20,659	478,276	9,113	33,669	521,058
Depreciation	1,139,747	73,942	1,213,689	19,982	13,869	1,247,540
Bad Debt Expense	-	-	-	16,892	-	16,892
Other	31,569	5,977	37,546	2,122	7,474	47,142
Total Expenses by Function	\$ 13,340,967	\$ 2,464,694	\$ 15,805,661	\$ 883,593	\$ 592,859	\$ 17,282,113

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functional expenses

New disclosure requirements to provide transparency on any expenses that are allocated among functions

Functional Allocation of Expenses

The costs of program and supporting services activities have been summarized on a functional basis in the statements of activities. The statements of functional expenses present the natural classification detail of expenses by function. Accordingly, certain costs have been allocated among the programs and supporting services benefited. The expenses that are allocated include occupancy, depreciation, and amortization, which are allocated on a square footage basis, as well as salaries and wages, benefits, payroll taxes, professional services, office expenses, information technology, interest, insurance, and other, which are allocated on the basis of estimates of time and effort.

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liquidity

Quantitative information, either on the face of the balance sheet or in the notes, and additional qualitative information in the notes as necessary, that communicates the availability of an NFP's financial assets at the balance sheet date to meet cash needs for general expenditures within one year of the balance sheet date. Availability of a financial asset may be affected by

- (1) its nature
- (2) external limits imposed by donors, grantors, laws, and contracts with others, and
- (3) internal limits imposed by governing board decisions.

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liquidity

Financial Assets at Year End*	\$ 234,410
Less: Financial Assets unavailable for general expenditures within one year due to:	
Contractual or donor-imposed restrictions:	(11,940)
Restricted by donor with time or purpose restrictions**	(144,500)
Amounts held by bond trustees	(30,200)
Board designations:	
Quasi-endowment fund, primarily for long-term investing**	(36,600)
Amounts set aside for liquidity reserve	<u>(1,300)</u>
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 9,870</u>

*Total assets, less nonfinancial assets (e.g. PP&E, inventory, prepaids)

**Excludes amounts that have been appropriated for next 12 months that do not have purpose restrictions

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liquidity

Nonprofit Entity A is substantially supported by restricted contributions. Because a donor's restriction requires resources to be used in a particular manner or in a future period, Nonprofit Entity A must maintain sufficient resources to meet those responsibilities to its donors. Thus, financial assets may not be available for general expenditure within one year. As part of Nonprofit Entity A's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, Nonprofit Entity A invests cash in excess of daily requirements in short-term investments.

Occasionally, the board designates a portion of any operating surplus to its liquidity reserve, which was \$1,300 as of June 30, 20X1. There is a fund established by the governing board that may be drawn upon in the event of financial distress or an immediate liquidity need resulting from events outside the typical life cycle of converting financial assets to cash or settling financial liabilities. In the event of an unanticipated liquidity need, Nonprofit Entity A also could draw upon \$10,000 of available lines of credit (as further discussed in Note XX) or its quasi-endowment fund.

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board involvement

Review the financial statements in their entirety – from not only your personal perspective, but the public as well...

- Are you comfortable telling the public how you allocate expenses?
Did you even know?
- How scary is your liquidity number, and is the qualitative explanation easing the concerns?
- Does it make sense to continue to have the Board Designations in place, or should there be more?
- Are you properly using your restricted monies and sticking to your spending policies?

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upcoming standards

Revenue Recognition 12/31/2019

Entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services

That didn't exactly fit the nonprofit revenue models

Clarify and improve current guidance about whether a transfer of assets is a contribution or an exchange transaction by evaluating whether the resource provider is receiving commensurate value in return for the resources transferred.

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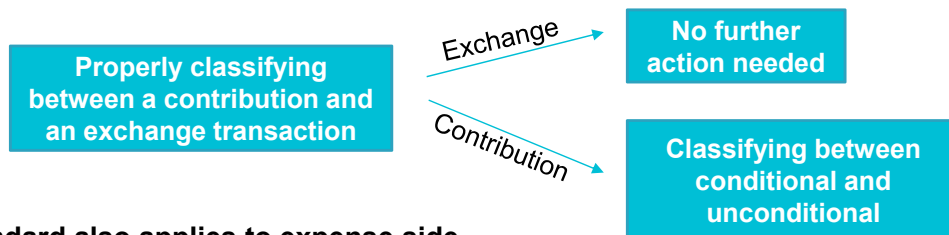
revenue types

Contributions (non reciprocal transactions):

- An unconditional transfer of cash or assets in a voluntary non-reciprocal transfer
- No change in accounting method

Exchange Transactions (reciprocal transactions):

- A reciprocal transaction where two parties exchange something of value
- Accounted for under the new standard



Standard also applies to expense side.

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upcoming standards

Lease Accounting Standards

12/31/2020

Lessee should recognize the assets and liabilities that arise from leases that are not excluded by this standard. Such leases create an asset and a liability for the lessee, and therefore, recognition of those lease assets and lease liabilities represents an improvement over previous GAAP, which did not require lease assets and lease liabilities to be recognized for most leases.

Assets and corresponding liabilities could be placed on the Statement of Financial Position

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internal controls

Internal control is a process - effected by an entity's board of directors, management, and other personnel - designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (1) reliability of financial reporting, (2) effectiveness and efficiency of operations, and (3) compliance with applicable laws and regulations.

How does this involve me, as a Board Member?

21



the fraud triangle



According to Donald Cressey, the creator of the fraud triangle, all three factors **MUST** be present at the **SAME** time for an **ORDINARY** person to commit fraud:

1. Financial Pressure
2. Rationalization
3. Opportunity

The only piece of the triangle that you truly have control over is **OPPORTUNITY!**

Image courtesy of <https://www.acfe.com/fraud-101.aspx>

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opportunity

Opportunity = Solution

With the **PERCEPTION** of opportunity, an employee has a method in which to remove the pressure and make the rationalization a reality

What can you do?
...remove the opportunity and the perception of it!

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internal controls

The Board is the governing body of an organization and therefore is tasked with setting the tone and taking on fiduciary responsibility.

Some ideas to remember:

- The Executive Director reports to the Board
- The Board is responsible for governing, and the ED is responsible for managing
- Management develops and sets a structure of internal control, however the Board is responsible for monitoring that structure
- Smaller organizations may require a working board in excess of a governing board

WHY IS IT IMPORTANT?

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dixon, illinois

Dixon, Illinois

- Population: 16,000
- Annual budget: \$6M to \$8M...or so they thought.

Rita Crundwell

- First employed by the city at 17 years of age
- Became Comptroller and Treasurer in 1983
- In 1990, she expanded her quarter horse operations
- Within that same year, she opened a secret bank account

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dixon, illinois

Reserve Sewer Capital Development Bank Account

<u>Year</u>	<u>Money transferred...</u>
1991	\$181,000
1993	\$225,287
2001	\$2.6M
2004	\$3.5M
2007	\$4.75M
2008	\$5.8M
2009	\$5.6M
2011	Someone else finally opened the mail...

20 Years and approximately **\$54 million!**

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dixon, illinois

The **financial pressure** was there, she had an incredibly lavish lifestyle.

The **rationalization** was there, she needed to uphold appearances and continue her reign in the world of horses, but had to do it with a salary of \$80,000 a year.

However, more than anything, the vast amount of **opportunity**:

- ✓ No controls.
- ✓ No oversight.
- ✓ No accountability.
- ✓ Too much trust.

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dixon, illinois

- Bank account at Fifth Third opened by one account holder: RSCDA c/o Rita Crundwell
- Transfers were made from the City's tax revenue account into the Capital Improvement account and checks would be written to the RSCDA account made out to "Treasurer"
- Not a single sole knew of the RSCDA account
- Utilized approximately 180 fictitious invoices from the State of Illinois and posted them as payments to the State for work performed in the City
- There was no work being performed in the City; a bank should never allow a check written out to "treasurer," an auditor should never have a conflict of interest, and no one person should ever have as much control as she did

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dixon, illinois

Rita singlehandedly:

- Opened the mail
- Made deposits
- Wrote checks and signed checks
- Moved money
- Reconciled bank accounts
- Recorded all entries and activity
- And always had an answer for the deficits and was never actually required to submit full financial information, just summaries
- In 2011, the City Commissioner was quoted, "...[Rita] looks after every tax dollar as if it was hers"

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meetNKY

meetNKY

\$3,840,500 in 16-18 months

*"Johnson **allegedly** exploited her position and **leveraged our internal processes and safeguards** we had in place for her personal gain by **allegedly** stealing organizational funds and betraying our trust," Brandt said. "We are currently evaluating and refining our internal controls and will make changes to ensure that similar criminal activity does not occur in the future."*

"allegedly"

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meetNKY

Management apparently set policies that were leverage able and safeguards that weren't guarding anything. How involved was the Board in monitoring?

	General Fund					Variance Favorable (Unfavorable)
	Original Budget	Final Budget	General Operations Actual	Reserved For Future Projects Actual	Total	
EXPENDITURES						
Salaries and benefits	1,590,000	1,590,000	1,522,428	-	1,522,428	67,572
Marketing	1,770,000	1,770,000	2,379,644	-	2,379,644	(609,644)
Regional tourism	1,649,160	1,649,160	1,769,095	-	1,769,095	(119,935)
General and administrative	450,000	450,000	451,427	7	451,434	(1,434)
Capital outlay	24,458	24,458	1,506	-	1,506	22,952
TOTAL EXPENDITURES	5,483,618	5,483,618	6,124,100	7	6,124,107	(640,489)

“allegedly”

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example controls – two people

<u>Bookkeeper</u>	<u>Executive Director</u>
<ul style="list-style-type: none"> • Write checks • Record general ledger entries • Reconcile bank statements • Record credits/debits in accounting records • Receive cash • Authorize check requests 	<ul style="list-style-type: none"> • Sign checks and mail checks • Complete deposit slips • Perform interbank transfers • Reconcile petty cash • Approve vendor invoices • Review bank reconciliations

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oversight & monitoring

Monitoring is a significant control - Most can be performed by the board if limited employees

- Review of bank reconciliations WITH supporting documentation
- Receive the bank statements
- Review payroll reports for fictitious employees and reasonable pay
- Don't just sign checks, review invoices along with the checks
- Utilize budgets that are prepared
- Request supporting documentation when reviewing financials
- BE AWARE!

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recognition and triggers to watch

- Living beyond means
- Increased stress
- Recent divorce or family issues
- Changes in behavior:
 - Unusual tardiness
 - Changes in attitude
 - Unscrupulous behavior
 - Changes in behavior
 - Increased complaining or negativity

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board responsibilities

- If you don't like or understand the information that you are receiving, say something
- Inquire of your Executive Director how they structured the internal controls
- Are you aware of the vulnerable areas and risks of your Organization?
- What part of internal controls do you play, and do you understand them?
- Remember... Just because the Executive Director performs a procedure, that doesn't mean the task is always a safe guard. The ED is still an employee of the Organization.

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form 990

Form 990 – Return of Organization Exempt From Income Tax

Form 990	Long Form
Form 990-EZ	Short Form – Gross Receipts < \$200,000 AND assets < \$500,000
Form 990-N	Dubbed “e postcard” Gross Receipts < \$50,000
Form 990-PF	Return of Private Foundation
Form 990-T	Exempt Organization Business Income Tax Return

Due Date 15th of the 5th Month

Extension 1 extension for 6 months using Form 8868

Late Filing Up to \$20 per day, maximum of \$10,000
OR \$100 per day, max of \$50,000 (if receipts > \$1M)

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form 990

Filed with the Internal Revenue Service and:

Ohio Attorney General's Office - with a maximum fee of \$200
 Kentucky Attorney General's Office – no fee due

Guidestar (now Candid.org)

Automatically updated with information from the IRS
 You CAN send them information directly.
 Recommend taking a look at your Organizations profile

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transparency – tell your story

- 1** Briefly describe the organization's mission or most significant activities
Empowering the lives of people with special needs

- 1** Briefly describe the organization's mission
Empowering the lives of people with special needs

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transparency – tell your story

4a (Code) (Expenses \$ 368,917 including grants of \$) (Revenue \$ 273,358)
 Empowering the lives of individuals with special needs through musical expression and performance by providing adaptive group guitar and piano lessons

Would you as the general public consider giving to them if you knew:

- How many people they serve?
- What is the footprint they leave behind?
- What is their outcome or their “success”?

Could you tell what benefit your dollar has on their mission?

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statement of functional expenses

Readers can determine how you spent every dollar during the year

Accounting and allocations methods should be reasonable and it is important to review on a periodic basis if not every year.

The public is OBSESSED with nonprofit administrative percentages

TED TALK: Dan Pallotta: “The way we think about charity is dead wrong”

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statement of functional expenses

Part IX | Statement of Functional Expenses

Section 501(c)(3) and 501(c)(4) organizations must complete all columns. All other organizations must complete column (A).

Check if Schedule O contains a response or note to any line in this Part IX

Do not include amounts reported on lines 6b, 7b, 8b, 9b, and 10b of Part VIII.	(A) Total expenses	(B) Program service expenses	(C) Management and general expenses	(D) Fundraising expenses
1 Grants and other assistance to domestic organizations and domestic governments. See Part IV, line 21 ...				
2 Grants and other assistance to domestic individuals. See Part IV, line 22	1,297,752.	1,297,752.		
3 Grants and other assistance to foreign organizations, foreign governments, and foreign individuals. See Part IV, lines 15 and 16				
4 Benefits paid to or for members				
5 Compensation of current officers, directors, trustees, and key employees	978,312.	272,696.	705,616.	
6 Compensation not included above, to disqualified persons (as defined under section 4958(f)(1)) and persons described in section 4958(c)(3)(B)				
7 Other salaries and wages	21,928,832.	20,293,285.	1,510,616.	124,931.
8 Pension plan accruals and contributions (include section 401(k) and 403(b) employer contributions)	559,514.	499,718.	52,463.	7,333.
9 Other employee benefits	2,124,970.	1,804,634.	294,720.	25,616.
10 Payroll taxes	1,857,306.	1,718,085.	131,478.	7,743.

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schedule b – list of contributors

Some organizations no longer have to file a Schedule B – Most do

Contributions of \$5,000 or more must be listed (additional rules apply)

Schedule B is NOT required for public viewing, you CAN remove for:

- Providing the 990 on your website
- Filing with the State, unless the State requires Schedule B
- Uploading directly to Guidestar
- Providing copies to the public

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checklists

The “Good Governance” part of the 990

Part IV – Checklist of Required Schedules

Part V – Statements Regarding Other IRS Filings and Tax Compliance

Part VI – Governance, Management and Disclosure

Section A – Governing Body and Management

Section B – Policies

Section C – Disclosure

READ THEM

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unrelated business income tax (UBIT)

Unrelated business income tax is income from a trade of business, regularly carried on, that is NOT substantially related to the charitable, educational, or other purpose that is the basis of the organization’s exemption

An organization with \$1,000 or more of gross income from unrelated business must file Form 990-T

Reminder: It is not always about where the income will be spent and what the money will go towards, it’s more about how you obtain the money

Is it subject to UBIT...answer is always...“it depends”

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common UBIT activity

Commercial Advertising

Ex: Sale of advertising in a magazine or periodical

Administrative Services

Ex: Providing services to other organizations

Rental Income from Debt-Financed Property

Ex: Property held for rent that is debt financed

Gift shop or book store sales

Ex: Only items unrelated to the organization itself

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UBIT general exclusions

Use of Volunteers

Activity generating money substantially staffed with volunteers

Sale of Donated Goods

Example: Goodwill

Passive Income

Investment earnings (majority of) or rental income (non debt financed)

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new tax law

Previously, UBIT activities were combined to arrive at a net income. Under the new tax law, activities are separated and tax is calculated on individual components. Therefore, all forms of UBIT activities will need to be tracked separately for financial reporting

Certain benefits that were previously tax free to employees could become taxable. Can elect to either include on W-2 as taxable income or pay tax on the benefits on the Form 990-T

Examples:

- Bus passes, parking reimbursement/passes
- Parking facility expenses associated with employee parking
- Athletic facility benefits

Some colleges and universities could be subject to a 1.4% excise tax on net investment income

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sales tax

YOU ARE NOT EXEMPT SIMPLY BECAUSE YOU ARE A NONPROFIT

OHIO - What's exempt (and it depends):

- Sales by churches and nonprofit charitable organizations (excluding sales of motor vehicles, titled watercraft, titled outboard motors, off-highway motorcycles, all-purpose vehicles and personal watercraft) NOT exceeding SIX day in ANY calendar year
- Sales to organizations that have been granted and have maintained 501(c)(3) status by the Internal Revenue Service.

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sales tax

YOU ARE NOT EXEMPT SIMPLY BECAUSE YOU ARE A NONPROFIT

KENTUCKY - Transactions that apply (and it depends):

- Facilities/Event Admission Fees/Tickets
- Sponsorships (which include admission or tickets as a benefit)
- Auction Items

There is an exemption up to the first \$1,000 of sales

Exempt purchases still available for tangible property and certain services, etc.

There are still things included above that are considered exempt

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thank you!
questions?

**your
choices,
our
advice.**

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