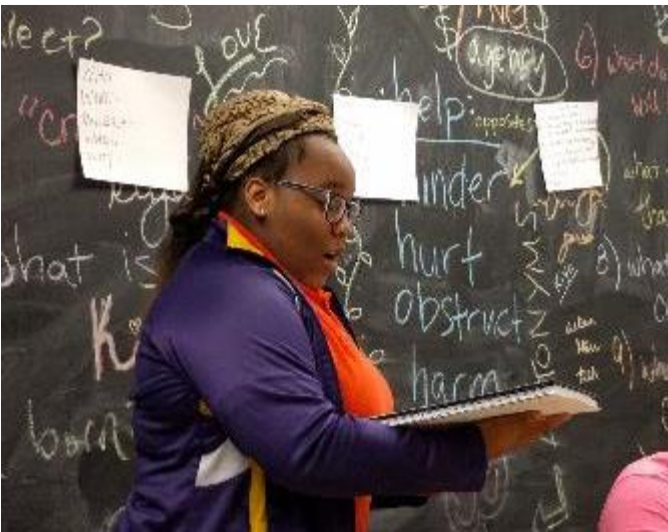


The Basics of Nonprofit Governance

November 4, 2022



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Special thank you to **Dinsmore & Shohl LLP in Cincinnati and **Bricker & Eckler** in Dayton for donating office space to PBPO*



Our Mission

Powered by attorney volunteers, we strengthen our community by providing free business legal services and education to nonprofits.

PBPO By the Numbers

875+

*volunteer attorneys provided
free legal assistance to*

300+

local nonprofits on over

2,300+

different legal matters

\$8M

in free legal services

130+

workshops to nonprofit leaders

300+ Local Organizations Strengthened

- 1N5
- 4Paws for Ability
- Black Achievers
- BLOC Ministries
- Circle Tail
- Clothes That Work
- Community Matters
- Co-Op Dayton
- Dress for Success
- Greater Cincinnati Book Bank
- iSpace
- Immigrant & Refugee Law Center
- La Soupe
- Miami Valley Nonprofit Collaborative
- Mercy Neighborhood Ministries
- MORTAR
- NEST Community Learning Center
- Price Hill Will
- ProKids
- Santa Maria Community Services
- Sew Valley
- Tender Mercies
- Therapeutic Riding Institute
- Toolbank
- UpSpring
- Women Helping Women
- WordPlay

Who Qualifies to Become a Client?

501(c)(3) nonprofits that meet the following criteria:



Serve low income or disadvantaged people or significantly enhance the quality of life in our neighborhoods; and



Are located in or serve the Cincinnati or Dayton areas; and



Offer programs that have a demonstrable impact on the community; and



Are unable to pay for legal services without significant impairment of its program services



Hallmarks of PBPO



- Quality legal services from experienced company and law firm attorneys
- Work with PBPO attorneys skilled in the areas of nonprofit law to help you identify legal issues; areas of potential risk for your organization; and implement best practices
- We place matters with subject matter experts
- PBPO attorneys oversee each matter
- PBPO Employment Helpline (for clients!)



What We Do

We **strengthen the foundations** of our nonprofit clients by assisting them with their business legal needs:



- Contracts
- Corporate Structure
- Governance
- Employment
- Intellectual Property
- Merger/Collaboration
- Real Estate
- Waivers
- Other business law matters*

Educational Outreach for All Nonprofits

We don't know what we don't know...



Workshops

- Low cost or free in-person seminars & webinars
- In partnership with OneSource, Leadership Council, Miami Valley Nonprofit Collaborative, Dayton Metro Library, Cincinnati Bar Association, etc.
- Geared towards nonprofit leaders and board members
- Wide range of topics

Publications

- Pro Bono Brief: Nonprofit Legal News + Legal Alerts



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Please Note:

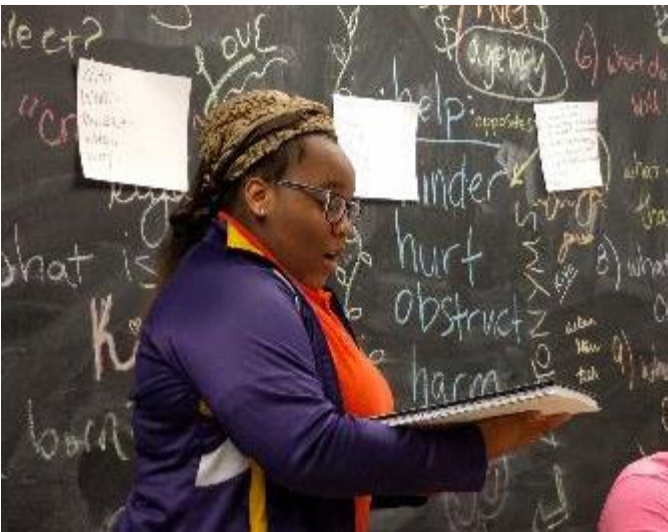
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It should not be construed as, and does not constitute, legal advice on any specific matter, nor does this presentation create an attorney-client relationship.

You should seek advice based on your circumstances from an independent legal advisor.

The Basics of Nonprofit Governance

November 4, 2022



Topics to Be Discussed

- 1 Formation of Nonprofit, Tax-Exempt Organizations
- 2 Board Composition and Operations
- 3 Fiduciary Duties of Nonprofit Board Members

Part I:

Formation of a Nonprofit, Tax-Exempt Organization

Nonprofit Formation

Are you ready to form a nonprofit?

If you are thinking about starting a nonprofit, assess your readiness with this nonprofit startup assessment tool:

<https://learning.candid.org/resources/nonprofit-startup-resources/>

Nonprofit v Tax Exempt Status

Charities have 2 “classifications” –
NONPROFIT & TAX EXEMPT:

- **Nonprofit/Not-for-profit corporations:** function of state law
- **Tax Exemption:** granted by the IRS
- Many Categories - common types include
 - (c)(3) “charitable” organizations
 - (c)(4) social welfare organizations
 - (c)(6) business leagues (trade associations)
 - (c)(7) social clubs

Today’s presentation will cover the “501(c)(3)” public charities
PBPO clients are established §501(c)(3) public charities

Nonprofit Formation

Nonprofit corporations are formed upon filing Articles of Incorporation

- **State mission of organization**
 - Carefully craft because stated purpose is only purpose for which organization may legally operate & will help determine if corporation qualifies as tax-exempt.
 - Must **state** corporation's activities will be limited to purposes set out in section 501(c)(3) of the IRC (eg, *charitable*).
 - Must **state** that upon dissolution of corporation, any remaining assets will be distributed to another nonprofit, government agency, or for another public purpose.

Internal Revenue Code – The 501(c)(3) Organization

Exempt purpose: charitable*, educational, religious, scientific, literary, fostering national or international sports competition, preventing cruelty to children or animals, and testing for public safety

***Charitable:** includes relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erecting or maintaining public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency

Obtaining 501(c)(3) Tax-Exempt Status

1. IRS Form 1023-Application for Tax Exemption

Are your activities consistent with those listed in the Form 1023?

2. IRS determination letter

Public charity v. private foundation

3. IRS Form 990: annual informational tax return

**** NOTE: organization must disclose #1-3
to the public when requested**

Internal Revenue Code – The 501(c)(3) Organization

§501(c)(3):

The organization must continue to satisfy the criteria for continued classification as a §501(c)(3) organization

Test:

Must be ORGANIZED &

Must be OPERATED

“Exclusively”

For Exempt Purposes

Advantages of Tax-Exempt Status



- No federal income tax on related business income and donations
- Donors can deduct charitable contributions
- Eligibility to receive grant funding and other support from private foundations, government agencies, or other exempt organizations
- Exemption from certain state taxes (no sales tax on purchases and property taxes)
- Public image - increased goodwill and credibility

Disadvantages of Tax-Exempt Status

Operational Limitations

- Activities limited to exempt purposes
- No inurement and limited private benefit
- No political activities & limited lobbying

Increased Scrutiny

- Annual tax returns & applications filed with IRS available for public inspection

Determination of Tax-Exempt Status

The IRS may take many months to review your Form 1023 Application for Tax Exempt Status.

As long as the Form 1023 was filed within 27 months of formation, tax-exempt status is generally retroactive to the date of formation.

Activities and donations made in the interim are generally tax-exempt to the organization and deductible to the donor.



Questions?

Part II:

Board Composition and Operations

Board Composition

In Ohio, a nonprofit board must have at least 3 board members

Potential sources of board members:

- Initial board members are often founders of the Organization who are:
 - *passionate* about the Organization's mission
 - *experienced* with nonprofits boards
 - *possess skills* relevant to the Organization or board operations

In addition, replacement board members might be:

- volunteers, donors, participants

PRO TIP: Research leadership and professional groups that identify potential board members and match them with Organizations in need of board members

Board Composition

Officers and Meetings

The board elects 3 officers: President, Treasurer, Secretary and other officers if desired.

- Officers need not be Directors

- One person can hold more than one office

The board will hold an organizational meeting and must meet at least once per year.

PRO TIP: At the annual meeting, the board should elect board members and officers, consider updating regulations and policies, review a draft of the Form 990 Tax Return and keep minutes of the meeting

Board Governance Bylaws (Code of Regulations)

The “operating manual” for the board

- Bylaws are an internal document
- Keep them streamlined and flexible
- Should not contain programmatic information

Were they properly adopted? Amended?

**** ASK: Do your actual practices conform to the bylaws?
If not, need to change practices or amend the bylaws**

Board Governance

Recommended Bylaw Provisions

- Directors/trustees: number, qualifications, term lengths & limits, procedures for resignation & removal
- Meetings: quorums, conference call participation, unanimous written consent
- Committees (if any)
- Officers
- Board's power to hire/supervise an executive director (if applicable)
- Financial matters
- Indemnification provisions
- Conflict of Interest and other policies
- Procedure for amending and any amendments

Corporate Governance

Accountability Recommended Best Practices

Executive Director, CFO/Treasurer, and the board should review the Form 990 prior to filing to ensure accuracy, completeness and timeliness

**** Form 990 asks about this**

Board Governance Accountability

IRS Form 990 (revised in 2008)

- Contains many inquiries about corporate governance, e.g.:
 - Executive compensation
 - Documentation & maintenance of board minutes of meetings
 - Conflict of interest policy & enforcement*
 - Whistleblower & document destruction policies*

**Not required by law but IRS looks for them and you should have them - even if no paid employees*
- What constitutes “good governance” will **differ** based on the needs of each organization - **no one size fits all**

Transitioning from Working Board to Governing Board

STAGE 1:

When nonprofits start out, they often are run completely by volunteer board members. The board is a "working board" that must run the organization itself because there is not paid staff.

STAGE 2:

As the organization grows, it might hire a paid executive director. It is not uncommon for an original board member or founder to become the first paid executive director.

STAGE 3:

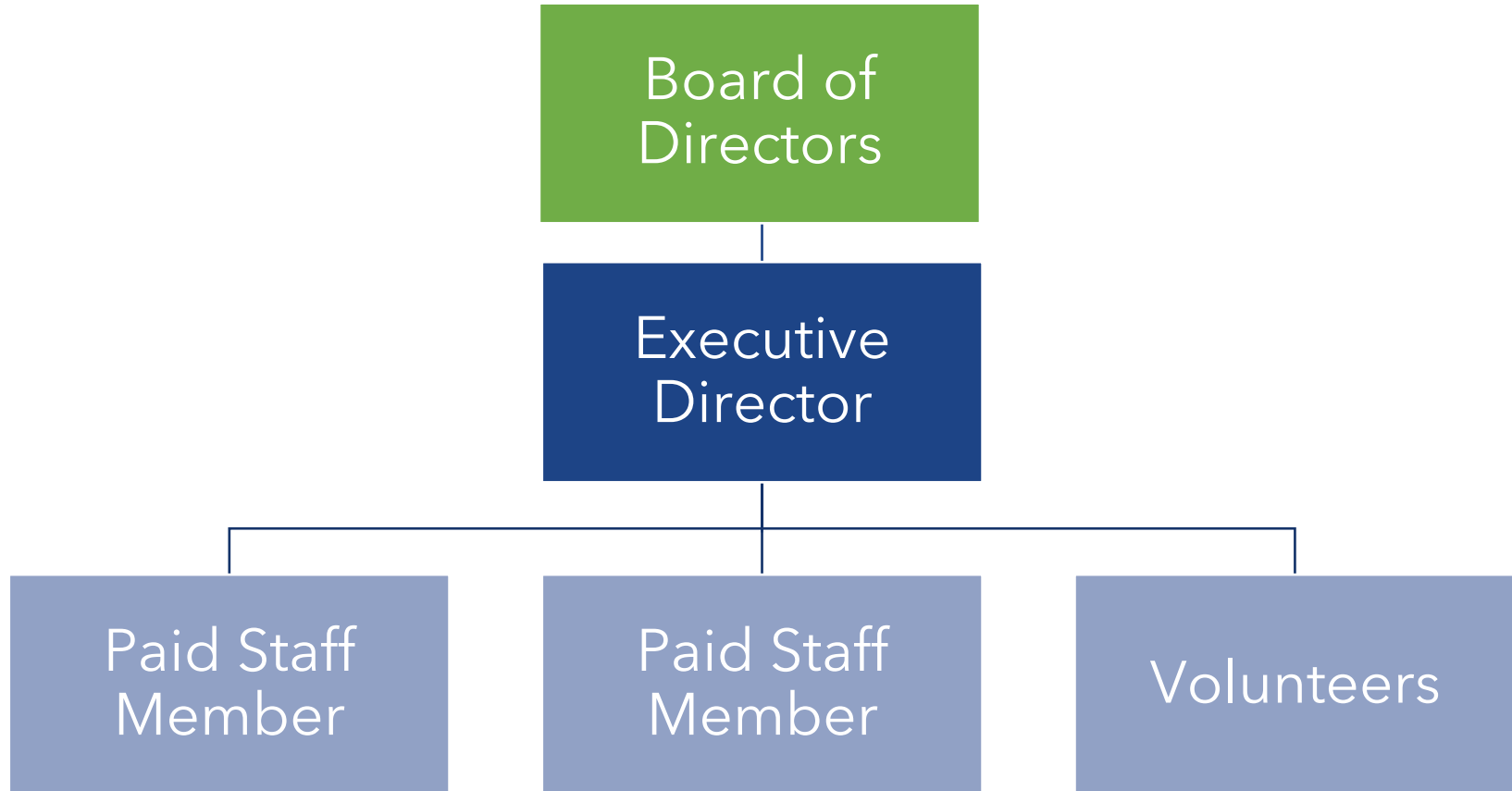
If the organization continues to build resources, it may be able to hire additional paid staff. At this stage, the board would be called a "governing board."



PRO TIP

As your organization moves from one phase to the next, these transitions are a good time to review roles, policies, and operations. PBPO can help!

Lines of Communication





Questions?

Part III:

Fiduciary Duties of Nonprofit Board Members

Fiduciary Duties of Nonprofit Board Members

- **Duty of care** – This involves being active in the organization’s activities and understanding its mission.
- **Duty of loyalty** – Board members must acknowledge that the interest of the charity and its work must be the top priority. Charitable boards should develop and follow conflict of interest policies to avoid transactions that unfairly enrich the charity’s leaders.
- **Duty to manage accounts** – A charity must be fiscally accountable. Board members must track budget data and establish and monitor internal controls.
- **Duty of compliance** – Charities have important legal obligations. Board members must ensure that their charity follows registration requirements, solicitation laws and tax provisions.

**** Ohio Attorney General’s Guide for Charity Board Members:**

<https://www.ohioattorneygeneral.gov/GuideforCharityBoardMembers>

Duty of Care:

Be active in the affairs of the organization.

Board members should:

- Prepare for and regularly attend meetings. Ask questions and engage
- Do not defer
- Use independent judgment
- Always cast a vote

The Organization can help board members to fulfill this duty.

The Organization should:

- Ask new board members to sign a board expectations agreement
- Schedule board meetings far in advance and track each members' attendance
- Send information in advance of meetings: agenda, financials, prior minutes
- Encourage questions and discussion. Do not just say "All in favor"

Duty of Loyalty:

Act in the best interest of the charity, not yourself, family, or friends

Board members should:

- Disclose conflicts
- If you have a conflict, excuse yourself from discussion and voting
- Don't compete with the charity
- Don't divert corporate opportunities from the charity
- Keep confidential information confidential

The Organization can help board members to fulfill this duty.

The Organization should:

- Establish a conflict-of-interest policy that board members sign
- Collect disclosure forms from board members when there is a conflict or at least once a year

Duty to Manage Accounts:

Board members are responsible for charity's financial stability

Board members should:

- Establish financial policies and procedures
- Develop an annual budget
- Create fundraising goals
- Establish internal accounting systems

The Organization can help board members to fulfill this duty.

The Organization should:

- Keep the board informed of adjustments to budget
- Implement accounting systems established by the board

Duty of Compliance:

Be faithful to the Organization's purpose and mission

Board members should:

- Review your Organization's documents on a regular basis. Make sure you are complying with them and, if you don't, amend them
- Comply with state and federal registration and reporting requirements including filings with: Ohio Attorney General, Ohio Secretary of State, Internal Revenue Service

The Organization can help board members to fulfill this duty.

The Organization should:

- Provide Orientation for new board members
- Track donor information including what state(s) donors are from
- Make sure statutory agent stays up to date

Consequences of Violations of Fiduciary Duties

Trustees can be held **individually responsible** for breaches of fiduciary standards within a charity.

For example, if charitable assets are sold at less than their fair market value, trustees may be held personally accountable for any shortfalls.

Transactions involving conflicts of interest also can result in fiscal penalties.

Sometimes criminal fraud charges can result when board members and key staff ignore their charitable obligations and personally profit from assets that should be used for community purposes.

Corporate Governance

Accountability
Recommended
Best Practices

Directors and Officers
("D&O") Insurance



Final Questions?



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Questions?
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