

seminar



NOT FOR PROFIT  
**seminar**  
**GOVERNANCE**  
**FROM THE GROUND UP**

What does the LAW require?—  
What does the PUBLIC demand?

DATE

WEDNESDAY, JUNE 9, 2010

TIME

8 A.M. — 10 A.M.

PLACE

MT. WASHINGTON CONFERENCE CENTER  
PULLEN PLAZA • 5801 SMITH AVENUE  
BALTIMORE, MD



Scott D. Rodgvile, CPA

Officer  
**GORFINE, SCHILLER &  
GARDYN, P.A.**

10045 Red Run Blvd.  
Owings Mills, MD 21117  
(410) 517-6729



Abba David Poliakoff

Member  
**GORDON, FEINBLATT,  
ROTHMAN, HOFFBERGER  
& HOLLANDER, LLC**

233 East Redwood Street  
Baltimore, MD 21202  
(410) 576-4000



Steven M. Gevarter

Member  
**GORDON, FEINBLATT,  
ROTHMAN, HOFFBERGER  
& HOLLANDER, LLC**

233 East Redwood Street  
Baltimore, MD 21202  
(410) 576-4000

# Scott Rodgville, CPA



Officer

Gorfine, Schiller & Gardyn, P.A.

10045 Red Run Boulevard

Owings Mills, MD 21117

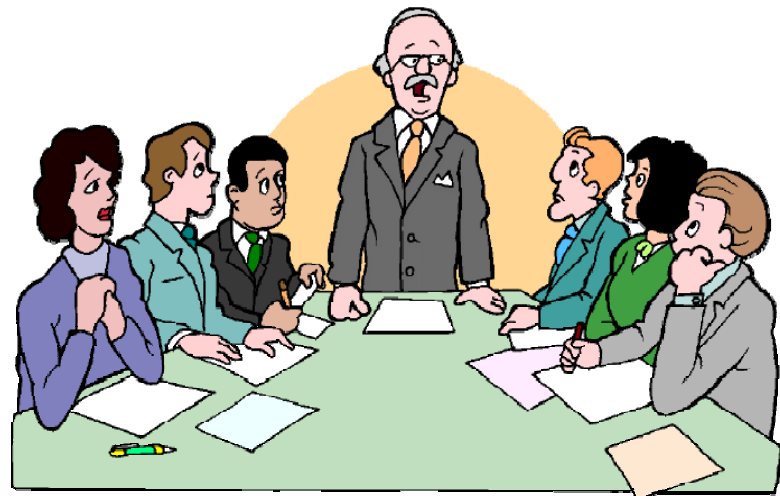
410-356-5900

SRodgville@gsg-cpa.com

www.GSG-cpa.com

# What Is Governance?

- How your organization is operated?
  - Governing documents
  - Transparency



# Governing Documents

- Articles of Incorporation
- By-laws
- Organizational policies
  - Investment policy
  - Conflict of Interest policy
  - Employment manual
  - Whistleblower policy
  - Travel reimbursement policy
  - Compensation policies

# Who Is Responsible For Governance?

- Board of Directors
- Executive Director/CEO
- Other members of management team
  - CFO/Director of Finance
  - Program directors
  - Directors of Development



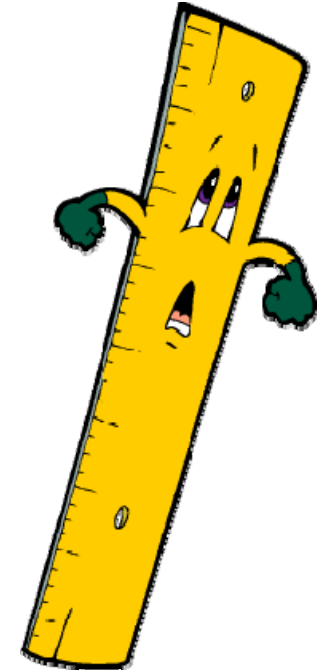
# How Is Governance Measured?

- Objective measures
  - Percent of dollars spent on programs
  - Program accomplishments
    - Individuals served
    - Programs operated
    - Dollars awarded
  - Annual Reports
- Subjectively
  - Public perceptions
  - Charity Rating Agencies\*
  - Performance compared to peers



# How Is Governance Measured?

- Form 990
- BBB ratings
- Standards for Excellence – MANO
- Annual Reports
- Charity rating/information services
  - [www.Guidestar.org](http://www.Guidestar.org)
  - Charity Navigator



# How Outsiders Use Form 990 To Measure Governance

- Part III, Item 4 – Program Service Accomplishments
- Part IV, Items 25-28 – Excess Benefit Transactions and Transactions with Disqualified Person
- Part VI, Section A, Item 8 – Minutes
- Part VI, Section B, Item 11 and 11A – Copy of 990 to Governing Body

# How Outsiders Use Form 990 To Measure Governance

- Part VI, Section B, Item 12 – Conflict of Interest
- Part VI, Section B, Item 13 – Whistleblower Policy
- Part VI, Section B, Item 14 – Document Retention and Destruction Policy
- Part VI, Section B, Item 15 – Compensation Process

# How Outsiders Use Form 990 To Measure Governance

- Part VI, Section 17, Item 18 & 19 – Availability of Documents
- Part IX, Statement of Functional Expenses – Allocations
- Part XI, Item 1 – Method of Accounting
- Part XI, Item 2 – Audit, Review or Comp
- Part XI, Item 3 – Compliance with Audit Requirements

# What Steps Can You Take To Maximize Your Governance?

- Adoption of Policies
  - Conflict of Interest
  - Travel reimbursement
- Tone at the Top
  - What is the message that the Board sends to management?
  - What is the message that management sends to the rest of the organization?



# Abba David Poliakoff, Esq.



Member

Gordon, Feinblatt, Rothman, Hoffberger  
& Hollander, LLC

233 East Redwood Street

Baltimore, MD 21202

410-576-4067

[apoliakoff@gfrlaw.com](mailto:apoliakoff@gfrlaw.com)

# The Board of Directors

- Duties of the Board
  - Set corporate strategy
  - Give directions to management
  - Assure oversight and compliance



# The Board of Directors

- Fiduciary Duties of the Board
  - Duty of Care
  - Duty of Loyalty



# The Board of Directors

- Maryland Standard



Act:

- In good faith
- In a manner reasonably believes to be in best interest of the corporation; and
- With the care that an ordinarily prudent person in a like position would use under similar circumstances.”  
MD Code Corps. & Assocs. § 2-405-1

# Governance of Board and Committees

- Board of Directors
  - Independent Directors
  - Document meetings
  - Review critical documents

# Governance of Board and Committees

- Independent Committees
  - Audit Committee
  - Compensation Committee
  - Corporate Governance/Nominations Committee



# Policies

- No Conflicts of Interest
  - **define** conflict of interest
  - **identify** the classes of individuals covered
  - **facilitate** disclosure of information to identify conflicts, and
  - **specify** procedures to be followed in managing conflicts

# Policies

- Other Policies
  - Whistleblower Policy
    - Protect Whistleblower
    - Provide confidentiality and anonymity
    - Give perception and reality of safety
  - Document Retention and Destruction Policies
  - Compensation Policy
  - Disclosure



# Next Steps

- Relevance of Sarbanes-Oxley to Nonprofit Entities
  - Good reputation
  - Good for business
  - Reduces liability
  - Decreases insurance costs
  - Cleaner (less expensive) audit

# Next Steps

- Goals:
  - Oversight
  - Eliminate conflicts of interest
  - Better accountability and accuracy
  - Records retention program
  - Code of Business Conduct and Ethics
  - Procedures for confidential complaints

# Next Steps

- Plan Implementation



- Focus on Board --- Assure Independence

# Next Steps

## – Process

- Directors
- Care
- Time
- Process
- Regular meetings
- Sense of mission
- Dedication to purpose/organization

# Next Steps

- Board Education
  - Define roles
  - Education programs
  - Corporate mission
  - Strategic planning



# Next Steps

## – Define Board Responsibilities

- Oversight
- Strategic direction
- Operations
- Performance
- Self evaluation

# Next Steps

– Create Committees with written charters

- Audit
- Compensation
- Corporate Governance
- Executive
- Committee Process



# Next Steps

- Adopt Corporate Policies
  - Code of Business Ethics and Conduct
  - Conflicts of Interest Policy
  - Ethical Conduct: Reporting & Investigations
  - Whistleblower Policy
  - Document Retention & Destruction Policy

# Next Steps

- Set the tone at the top
  - Integrity
  - Credibility
  - Scrupulous conduct

# Next Steps

- Establish Systems:
  - Financial reporting and disclosure systems
  - Records management
  - Verified internal controls

# Next Steps

- Good Directors Know –



- Duties
- Roles
- Mission
- Key programs
- Operations
- Finances
- Structure
- Key issues
- Strategic plan
- Potential opportunities
- Attainable goals
- Results of plans

# Steven M. Gevarter, Esq.

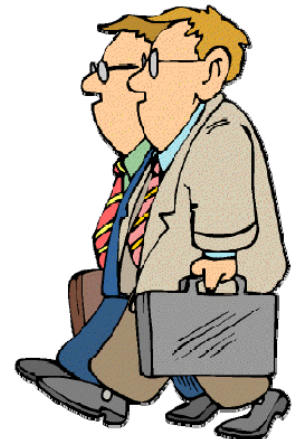


Member  
Gordon, Feinblatt, Rothman,  
Hoffberger & Hollander, LLC  
233 East Redwood Street  
Baltimore, MD 21202  
410-576-4260  
sgevarter@gfrlaw.com  
www.gfrlaw.com

# The Growing List of Traps In Running A Nonprofit

# Joint Ventures

- Key Considerations:
  - Is the activity in furtherance of an exempt purpose?
  - If not, how will possible “unrelated trade or business income” be handled?
  - Will a “blocker” corporation be needed?



# Joint Ventures

- Unrelated Trade or Business Income:
  - Subject to tax at the highest corporate rate; currently 35%
  - May threaten tax-exempt status
  - Defined as:
    - Any business;
    - Regularly carried on; and
    - Not substantially related to the exercise or performance of exempt activities
    - Need for money doesn't count

# Joint Ventures

- Partnership's activities attributed to the nonprofit for determining:
  - Whether the nonprofit is pursuing exempt activities; and
  - Whether the organization is engaging in an unrelated trade or business

# Joint Ventures



- A partnership (or LLC) is a flow-thru entity
  - Will not “block” UTBI
  - Primary reason for using a taxable corporate subsidiary

# Joint Ventures

- Evolving IRS and court analysis
  - GCM 36293 (May 30, 1975), *per se* inconsistent with exempt purpose
  - Plumstead Theatre Society, Inc. v. Comm’r, 74 T.C. 1324 (1980), *aff’d per curiam*, 675 F.2d 244 (9<sup>th</sup> Cir. 1982)(an IRS loss).



# Joint Ventures

- GCM 3905 (June 28, 1983), abandoned *per se* disapproval; replaced with a two-pronged “close scrutiny” test:
  - Does participation further nonprofit’s exempt purpose?
  - Can the exempt organization act exclusively in furtherance of its charitable purposes or does arrangement allow private inurement or more than incidental private benefit?

# Joint Ventures

- How much control must the nonprofit have?
  - PLR 9736039 (September 5, 1997)
    - Exempt organization had to have actual control
  - Redlands Surgical Services v. Comm’r, 113 T.C. 47 (1999); *aff’d*. 242 F. 3d. 904 (9<sup>th</sup> Cir. 2001)
    - U.S. Tax Court held charitable organizations participating in joint ventures with for-profit interests must have formal or informal control over the venture
    - 9<sup>th</sup> Circuit affirmed stating that ceding “effective control” of partnership activities impermissibly serves private interest

# Joint Ventures

- Revenue Ruling 98-15, 1998-1 C.B. 718
  - Issued while Redlands still pending
  - Intended as guidance for exempt organizations participating in joint ventures
  - Will meet the “operational test” of § 501 if:



- Participation furthers a charitable purpose, and
- Partnership arrangement permits the exempt organization to act exclusively in furtherance of its exempt purpose and only incidentally for the benefit of the for-profit partners

# Joint Ventures

- The ruling identifies a “good” fact pattern that effectively creates a safe harbor for participation in whole-hospital joint ventures
- The ruling also identifies a separate “bad” fact pattern that will cause loss of exempt status for participation in a whole-hospital joint venture
- The key distinction turns on whether the exempt organization effectively controls the joint venture
- Revenue Ruling 98-15 implicitly suggests a need for a nonprofit to have majority governing board control
- Still not clear how flexible the IRS will be on the amount of necessary voting control

# Joint Ventures

- St. David’s Health Care System v. United States, 89 AFTR 2d 2002-2998 (W.D. Tex. 2002).
  - Exempt hospital contributed substantially all of its assets to a newly-created limited partnership
  - The hospital had the power to appoint one-half of the partnership’s board members
  - Chair of the governing board had to be a member appointed by St. David’s
  - St. David’s also had the power to unilaterally remove the partnership’s CEO
  - The partnership agreement required that all hospitals owned by the partnership operate in accordance with the “community benefit” standard of Revenue Ruling 69-545

# Joint Ventures

- Every hospital owned by the partnership provided emergency care without regard to the patient's ability to pay
- After an audit, the Service revoked St. David's tax-exempt status retroactively
  - Participation in the partnership did not permit the hospital to act exclusively in furtherance of its charitable purposes
  - Allowed for greater than incidental benefits for the for-profit partners



# Joint Ventures

- The U.S. District Court for the Western District of Texas granted summary judgment in favor of St. David's
- On appeal, the 5<sup>th</sup> Circuit vacated the decision and remanded the case to the District Court for further proceedings 349 F3d 232 (2003)
- Whether taxpayer still operated “exclusively” for exempt purposes was a material fact question
- Depended on whether taxpayer retained control of partnership activities or ceded them to for-profit partner

# Joint Ventures

- Revenue Ruling 2004-51, 2004-22 I.R.B. 974 (May 6, 2004)
  - University offered summer seminars to enhance the skill level of elementary and secondary school teachers
  - To expand the reach of its seminars, the university formed the joint venture with a for-profit corporation
  - The university and the for-profit each held a 50% ownership interest
  - Venture would be managed by a governing board composed of three directors chosen by the university and three by the for-profit



# Joint Ventures



- University had exclusive right to approve curriculum, training materials and instructors
- University had exclusive right to approve standards for successful completion of the seminars
- For-profit had the exclusive right to select the locations where the participants could receive a video link to the seminars
- For-profit had the exclusive right to approve the other personnel (such as camera operators) necessary to conduct the video teacher training seminars
- All other actions required the mutual consent of the university and the for-profit entity
- Ruling concludes the university's activities conducted through the joint venture constituted a trade or business that was substantially related to the exercise and performance of the university's exempt purposes and function

# Benefit Corporations



- Preliminary Questions
  - What is this new entity?
  - Should a client consider being such an entity?

# Benefit Corporations

- Background
  - Maryland is the only state with such a legal entity
    - Adopted in the 2010 legislative session
    - Cross-filed in House and Senate: HB 1009 and SB 690
    - Approved in the House 135-5; in the Senate 47-0
    - Signed into law April 13, 2010
    - Effective October 1, 2010
    - Amendments to bills changed the name from B Corporation to Benefit Corporation

# Benefit Corporations



- Maryland General Corporation law generally applies unless
  - Context clearly requires otherwise
  - A specific provision of the new law overrides the MGCL

# Benefit Corporations

- Requirements
  - Must elect to be a Benefit Corporation
    - Charter and stock certificates must contain the legend “Benefit Corporation”
  - Must have the purpose of creating a general public benefit
    - Material, positive impact on society and the environment
    - Measured by a third party standard
    - Through a combination of activities that promote a combination of specific public benefits

# Benefit Corporations

- Specific public benefit includes
  - Promoting economic opportunity for individuals or communities beyond the normal course of business
  - Preserving the environment
  - Improving human health
  - Promoting the arts, science or advancement of knowledge
  - Increasing the flow of capital to entities with a public benefits purpose
  - Accomplishing any other particular benefit for society or the environment

# Benefit Corporations

- Third-party standard
  - A standard for defining, reporting and assessing the best practices in corporate, social and environmental performance
    - Developed by an entity independent of the Benefit Corporation
    - Transparent because the information about the standards are publically available or accessible
- Creation of a general or specific public benefit is in the best interests of a Benefit Corporation

# Benefit Corporations

- In determining a belief as to the best interests of a Benefit Corporation, a director must consider the effect of any action or inaction on:
  - Stockholders of the Benefit Corporation
  - Its employees and workforce
  - The interests of customers as beneficiaries of the general or specific public benefit purposes
  - Community and social considerations
  - Local and global environment

# Benefit Corporations

- A director may consider other pertinent factors or the interests of any other group that he/she determines are appropriate to consider
- These are in addition to his/her duties described in § 2.405.1 of the MGCL
- Director does not have a duty to a person that is a beneficiary of the public benefit purposes
- In the reasonable performance of his/her duties, a director has immunity from liability. See § 5-417 of the Courts & Judicial Proceedings Article

# Benefit Corporations

- A Benefit Corporation must deliver reports to each stockholder describing the ways the corporation:
  - Pursued the general public benefit and extent to which a public benefit was created
  - Pursued specific public benefit and the extent created
  - Circumstances that have hindered the creation of the public benefit
  - An assessment of the societal and environmental performance of the Benefit Corporation prepared in accordance with a 3rd party standard

# Benefit Corporations

- The annual Benefit Report must be delivered to each stockholder within 120 days following the end of the fiscal year
- Must post most recent Benefit Report on its website or, if it doesn't have one, on demand without charge



# Benefit Corporations

- What's the downside?
  - Maryland is the only state to have such an entity.
  - If the Benefit Corporation is engaged in interstate activity, how will it be treated in other states?
  - Is there a cost to become certified?
  - Who is the 3<sup>rd</sup> party generating the “certification” standards?
  - Who can bring a suit against the director?
  - What must a director do in order to avoid liability?

# Maryland Uniform Prudent Management of Institutional Funds Act

- Estates and Trusts Article; §15-401 through 15-409
- Adopted in Maryland on April 14, 2009
- Effective immediately
- Replaced the Maryland Uniform Management of Institutional Funds Act (UMIFA)
- UMIFA had governed the management and investment of funds held by charitable organizations

# Maryland Uniform Prudent Management of Institutional Funds Act

- Excluded from UPMIFA's coverage are:
  - “Program-related assets” (i.e. non-investment assets used to accomplish the charity's purposes)
  - Funds in which a non-charitable beneficiary has an interest
  - Charitable trusts are covered if it has a charity as a trustee subject to UPMIFA
- UMIFA had liberalized the rules for endowment fund spending
  - Allowed the use of “historic appreciation”

# Maryland Uniform Prudent Management of Institutional Funds Act

- UPMIFA:
  - Updates the standards that apply to managing and investing institutional funds
  - Modernizes the rules governing expenditures from endowment funds
  - Brings greater efficiency to the process of modifying restrictions on charitable funds
  - Gives additional oversight to the Maryland Attorney General

# Maryland Uniform Prudent Management of Institutional Funds Act

- UPMIFA governs the administration of virtually all funds held by charitable organizations
- UPMIFA
  - Requires the exercise of ordinary business care and prudence under the then-prevailing facts and circumstances
  - Requires that fund managers minimize costs and investigate all facts relevant to a particular decision or action
  - Requires an institution to consider its charitable purposes and the purposes of the fund
  - Requires reasonable efforts to verify facts

# Maryland Uniform Prudent Management of Institutional Funds Act

- Factors to consider may include
  - General economic conditions
  - Possible effect of inflation or deflation
  - Tax consequences, if any
  - Role of each investment in the overall investment portfolio
  - Expected total return from income and appreciation
  - Other resources of the institution
  - Needs of the institution to make distributions and preserve capital
  - Any special relationship or value of the asset to the charitable purposes of the institution

# Maryland Uniform Prudent Management of Institutional Funds Act

- UPMIFA generally obligates charitable institutions to diversify fund investments
- Generally may delegate management and investment to an external agent or to internal committees, officers or employees
  - Delegation does not relieve institution from liability for its agent's action or its own duty of care
- For endowment fund spending, UPMIFA replaces the historic-dollar value threshold with prudent-spending guidelines

# Maryland Uniform Prudent Management of Institutional Funds Act

- An “endowment fund” is
  - A fund held by a charitable organization
  - Under the terms of the gift instrument (including solicitation materials) it cannot be spent down in its entirety on a current basis
- An endowment fund does not include otherwise unrestricted funds set aside by the charity’s governing board



# Maryland Uniform Prudent Management of Institutional Funds Act

- UPMIFA's spending rules are subject to the intent of the donor as expressed in the gift instrument
  - For example, the gift instrument directs that a specific dollar amount or percentage of an endowment funds be distributed each year
- However, language limiting distributions to "income" or a general direction to "preserve principal" is not sufficient to avoid UPMIFA's new spending rules
- Creates the need for the charity to review all gift instruments and solicitation materials

# Maryland Uniform Prudent Management of Institutional Funds Act

- UPMIFA permits a charity to spend so much of an endowment fund as it deems prudent
- Prudence requires a consideration of:
  - Duration and preservation of the fund
  - Purpose of the charity and the fund
  - General economic conditions
  - Possible effect of inflation or deflation
  - Expected total return from investments
  - Other resources of the charity
  - The charity's investment policy

# Maryland Uniform Prudent Management of Institutional Funds Act

- UPMIFA creates a presumption that appropriating more than 7% of the fund's fair market value (using a 3-year rolling average) for expenditure is imprudent
  - Expenditures of less than 7% are not presumed to be prudent
- UPMIFA also requires the institution to notify the Attorney General if more than 7% is appropriated for expenditure
- Under UPMIFA a charity could only modify restrictions on the use or investment with donor or court consent

# Maryland Uniform Prudent Management of Institutional Funds Act

- UPMIFA permits a charity to unilaterally change or remove a donor-imposed restriction
  - Restriction must be unlawful, impractical or impossible to achieve
  - Value of the fund is less than \$50,000
  - In existence for more than 20 years
  - Charity uses the funds in a manner “clearly consistent” with the charitable purposes set forth in the gift instrument
  - Attorney General must be given at least 60-days advance notice



# Maryland Uniform Prudent Management of Institutional Funds Act



- Accounting profession was quick to respond to UPMIFA
  - In August 2008 the FASB issues FAS 117-1
  - “Endowments of Not-For-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management and Institutional Funds Act”

# Maryland Uniform Prudent Management of Institutional Funds Act



- Affects all not-for-profits with endowments
- Amounts classified as permanently restricted should be determined by a governing board
- Interpretation will be disclosed in the organization's financial statements

# Questions?

