

NONPROFIT BOARD GOVERNANCE MONEY MATTERS



OREGON DEPARTMENT OF JUSTICE
CHARITABLE ACTIVITIES SECTION

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Overview of Topics Covered



- **Board Duties and Responsibilities**
 - Fiduciary duties
 - Director protections and liabilities

- **Special Attention to Finances**
 - Financial controls for all organizations
 - Embezzlement/Fraud

State Regulation of Nonprofits

- **Oregon Secretary of State, Corporation Division**
 - Formation – 3 types of nonprofit under Oregon laws
 - Annual report
- **Oregon Attorney General - DOJ, Charitable Activities Section**
 - Oversight of charities and charitable assets, not all nonprofits
 - Not dependent on tax-exempt status given by IRS

DOJ Oversight

- **Over 23,000 registered charities in Oregon**
- **Scope of DOJ oversight**
 - Supervision of charitable entities and fiduciaries
 - Charitable solicitation
 - Charitable gaming – raffle, bingo, monte carlo

Governance - Role of the Board

- Define and advance the organization's mission
- Manage the organization
- Exercise corporate powers

Board Duties and Responsibilities

- Maintain organization's tax-exempt status
- Financial oversight – fundraising, budgets, investments, restricted funds, endowments
- Administrative oversight – hire and evaluate staff, adopt and enforce policies, records retention
- Program oversight
- Develop and maintain positive communications and relationships with constituencies and public

Directors are Fiduciaries

A fiduciary relationship is one in which “one person is under a duty to act for the benefit of another on matters within the scope of the relationship.” Black’s Law Dictionary (9th ed 2009).

Fiduciary duties fall into three categories:

- Duty of Care
- Duty of Loyalty
- Duty of Obedience

Duty of Care

- Requires active participation
- Reasonable inquiry
- Informed decisions
- Use of any special skill or knowledge

Duty of Loyalty

Must act in the best interests of organization

Duty of Loyalty issues:

- Conflict of Interest transactions
- Loans to directors/officers are prohibited
- Corporate opportunity
- Private inurement
- Excessive compensation
- Distributions prohibited (profit share)

Conflict of Interest

A conflict of interest is a set of circumstances that creates a risk that individual's obligation to further the organization's charitable mission will be unduly influenced by their personal interests.

Arises whenever there is a transaction between director and organization or between director's relative and organization.

Not strictly prohibited in all cases, but must be handled properly. Overriding principle – must be fair to organization.

Consider having a policy. IRS asks about policy on 990

Conflict of Interest Transactions

- **Possible consequences of improper conflict of interest transaction**
 - Loss of exempt status
 - Intermediate sanctions
 - Personal liability
- **Disclosure requirements on IRS Form 990**
- **Certain conflict of interest transactions strictly prohibited – e.g., loans to officers and directors**

Conflict of Interest Transactions

Document that board followed proper procedure for approving transaction. ORS 65.361 requires

- Conflict must be fully disclosed
- Decision/vote by independent board members – decision cannot be made by a single director; if not sufficient independent directors, must seek approval from court or DOJ
- Must be fair to organization – how will you demonstrate it is fair?

Duty of Obedience

- **Compliance with Law**
- **Governing Documents**
- **Mission/Donor Intent**

Registration & Reporting

- **Secretary of State**
 - Maintain corporate status, registered agent
 - <https://sos.oregon.gov/business/Pages/domestic-nonprofit-corporation-forms.aspx>
- **Oregon Department of Justice**
 - Registration and annual financial reports, CT-12
 - Broad authority oversight of activities, whatever form or tax-status
 - Major events – merger, dissolution, sale of assets
- **IRS**
 - Informational tax returns – Forms 990
 - Maintain tax-exempt status

Maintaining Records is Required – ORS 65.771

- Minutes of board and member meetings
- Actions taken by board or members without meeting
- Accounting records
- Membership list, qualifications, communications
- Articles of Incorporation and amendments
- Bylaws and amendments
- Director and officer contact information
- Financial statements
- Form 990

Employment Issues

- Nonprofits are subject to payroll taxes and employment laws regarding employees/independent contractors
- Directors can be personally liable for unpaid payroll taxes
- Employee issues are a potential source of litigation/legal expenses

Lobbying and Political Activity

- **Lobbying - attempting to influence legislation, including ballot measures. Involves contacting or urges public to contact legislature and advocating for or against legislation. Limits on amount of activity for 501(c)(3) entities.**
- **Political activity – support or oppose candidate for political office, prohibited.**

Dissolution

Public benefit orgs must file plan of dissolution with DOJ

- No assets should be distributed prior to submission of plan, ORS 65.627
- Remaining assets must be distributed to another charitable organization per ORS 65.001(35)
- Restricted gifts may require special treatment
- “Reimbursements” or payouts to ED, directors, or the like are prohibited distributions

Gift Issues

Common Issues

- Is the gift restricted?
- Releasing restrictions - what if the donor's wishes cannot be fulfilled?
- Should the organization accept the gift?

Donations – Ways Gifts Become Restricted

- Donor Request
- Soliciting for Restricted Funds, e.g., Specific Purpose
- Having Articles with Limited Purpose
- * Board Designation – restriction imposed by board can be released by board

Is a Gift Restricted?

- **Overriding Goal/Analysis – Determine Donor Intent**
 - Look to communications, writings
 - Look to course of conduct
- **Courts Reluctant to Infer Restrictions**
- **Language Used is Important: Precatory Instructions vs. Restrictions**

Enforcing Gift Restrictions

- **Attorney General can seek to enforce donor restrictions**
- **More and more often donors are seeking legal redress for misuse of gifts**

Releasing Donor Restrictions

- **Get donor agreement to use for another charitable purpose**
 - UTC, ORS 130.045
 - UPMIFA, ORS 128.328(1)
- **Court Proceeding/Cy Pres**
 - UTC, ORS 130.200, 130.205, 130.210
 - UPMIFA, ORS 128.328(2)
- **Attorney General is a necessary party**

Gift Acceptance Policies

- **Unless it is an unrestricted gift of money, some evaluation is appropriate by recipient organization**
- **Gifts of noncash items can present issues**
 - real estate
 - personal property
 - securities/ownership of companies
- **Gift may not be compatible with organization's mission or image; gift may be too expensive to maintain**

Gift Agreements

- Useful to clarify donor intent
- Can provide recipient organization some flexibility while balancing donor's goals
- Consider contingent plans and disposition

Protections for Directors

- Corporate form – not personally liable for corporate debts
- Statutory protection for volunteer directors (ORS 65.369) - volunteer directors not liable for simple negligence, but no immunity for gross negligence or intentional misconduct
- Indemnification rights under law and bylaws
- D & O Insurance – particularly important if there are employees

Solicitations

- False or misleading representations in charitable solicitation are violations of Unlawful Trade Practices Act
- No third party can use name of charity in solicitations without written consent of charity
- Presumed breach of fiduciary duty for board to enter into contract with professional fund raiser for period longer than 2 years, unless board obtained at least 2 other bids or if implied purpose is for professional firm to obtain donor list

Who Can Engage in Charitable Gaming?

Nonprofit that has federal tax-exempt status and has held tax-exempt status for at least one year

Broader category than that required to register and file annual reports with DOJ

Encompasses fraternal organizations, chambers of commerce, etc

Raffles

- Only permissible for charitable, fraternal or religious organizations
- Organization must have had tax-exempt status for at least one year
- Gaming FAQs at <https://www.doj.state.or.us/charitable-activities/charitable-gaming/charitable-gaming-faqs/>

What Keeps Us Busy

- Registration and Reporting, Licensing
- Complaints and Investigations
- Litigation and Required Reviews
- Education

DOJ Investigations

- Investigate complaints received from public, other agencies, and interested parties
- Follow internal leads – delinquent filers, unusual changes or information in annual reports
- Review required notices
- Media inquiries and reports of significant events

DOJ Investigations

- Approach to Enforcement
 - Protect charitable assets
 - Protect donors
- Generally do not intervene in internal matters – employment issues, member disputes, conflicts among directors
- Confidential complaints can be submitted and DOJ will seek to protect identify

DOJ Investigations

- **ORS 128.680 –authority to investigate transactions and relationships to determine:**
 - Whether charitable purposes are being fulfilled
 - Whether there has been a violation of charitable statutes
 - Whether there has been a violation of fiduciary duty
- **ORS 128.690 - DOJ can subpoena records and witnesses before filing a lawsuit**
- **Scope of investigation not limited to original complaint**

Attorney General Oversight

Enforcement Remedies/Options

- Consent
- No Action
- Audit/Notice Letters
- Civil Penalties
- Assurances of Voluntary Compliance
- Injunctive Relief, Removal of Directors, Dissolution
- Appointment of Receiver
- Damages for Waste/Loss
- IRS Referrals
- Criminal Referrals

Common Problems from the DOJ's Perspective

- **Embezzlement**
- **Mishandling of restricted funds**
- **Violations of IRS rules for private foundations**
- **Member disputes, internal conflict**
- **Inattentive board/lack of oversight**
- **Operating charity as personal business**
- **Poor record keeping, lack of internal controls**

2020 Report to the Nations

Association of Certified Fraud Examiners

- **Median length of fraud – 14 months**
- **Median loss - \$125,000**
- **Discovery of fraud**
 - 43% from tips
 - 12% from management review
 - 4% from external audit

2020 Report to the Nations

Association of Certified Fraud Examiners



Behavior Warning Signs

- Living beyond means
- Financial difficulties
- Unusual close association with vendor/customer
- Control issues – unwilling to share duties
- Irritability, defensiveness
- Divorce/family problems, addiction issues

Embezzlement



Feb 8 Purchase w PIN 180934 *****3121	→	PCA*SPIRIT MOUNT GRANDE RONDEOR On 020813 ILK1TERM REF 303908180934	340200104	1,000.00-
Feb 8 Purchase w PIN 862303 *****3121	→	PCA*SPIRIT MOUNT GRANDE RONDEOR On 020813 ILK1TERM REF 303909862303	0302080822	1,000.00-
Feb 14 Visa Purchase (Non-PIN) OFFICE DEPOT #10 *****3121	→	On 021213 800-463-3768-WA REF # 24445743044100499701625	4100499701	227.78-
Feb 19 Purchase w PIN 043929 *****3121	→	PCA*SPIRIT MOUNT GRANDE RONDEOR On 021713 ILK1TERM REF 304802043929	2902170145	1,000.00-
Feb 19 Purchase w PIN 847517 *****3121	→	PCA*SPIRIT MOUNT GRANDE RONDEOR On 021713 ILK1TERM REF 304807847517	1702170629	1,000.00-
Feb 25 Purchase w PIN 875722 *****3121	→	PCA*SPIRIT MOUNT GRANDE RONDEOR On 022413 ILK1TERM REF 305522875722	2202242144	1,000.00-
Feb 25 Purchase w PIN 272857 *****3121	→	PCA*SPIRIT MOUNT GRANDE RONDEOR On 022413 ILK1TERM REF 305600272857	5702242324	1,000.00-
Feb 25 Purchase w PIN 072391 *****3121	→	PCA*SPIRIT MOUNT GRANDE RONDEOR On 022513 ILK1TERM REF 305601072391	9102250039	1,000.00-
Feb 25 Purchase w PIN 888543 *****3121	→	PCA*SPIRIT MOUNT GRANDE RONDEOR On 022513 ILK1TERM REF 305602688543	4302250158	1,000.00-
Feb 25 Purchase w PIN 199795 *****3121	→	PCA*SPIRIT MOUNT GRANDE RONDEOR On 022513 ILK1TERM REF 305611199795	9502251009	2,000.00-

Embezzlement Prevention



- **Implement basic internal controls**
- **Someone other than check signer should review and reconcile bank statements**
- **Limit access to corporate debit/credit cards**
- **Create and follow procedure for reimbursements**
- **Establish and track budgets**
- **Require regular financial reports**
- **Audits are useful, but limited**

Internal Controls Matter

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- **Prevent and detect fraud**
- **Prevent and detect errors**
- **Efficiency and best use of resources**
- **Inspire confidence in your stakeholders and funders**

Internal Controls – Separation of Duties

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At least two people should be involved in all key financial activities.

For example:

- Bank accounts - someone other than the bookkeeper should review activity online or receive unopened statements
- Revenue - someone other than the bookkeeper should make the bank deposits
- Payments - someone other than the check writer should review and sign checks

Internal Controls – Debit/Credit Cards

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Keep control and set limits

- Limit the number of cards issued
- Set spending limits on each card
- Written agreements with each card holder
- Original receipts for every purchase
- Reconcile statements monthly
- Cancel cards immediately when the card holder separates from the organization

Internal Control – Budgets are Key

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Budgets are a key internal control

- Should be developed in advance
- Can be revised within reason
- Help maintain compliance with grant/contract spending requirements
- Board and management should be familiar with the budget and notice deviations
- Analytics: compare budget to actuals; compare current period to prior periods; adjust expectations when warranted
- Ask questions and inspect supporting documentation

HELENA HOUSE				
BUDGET TO ACTUALS	Actual	Budget	\$ Over Budget	% Over Budget
Income				
Contributions	63,643	20,000	43,643	218%
State grants	223,440	225,000	(1,560)	-1%
County contracts	250,000	250,000	-	0%
Total Income	537,083	495,000	42,083	9%
Expense				
Accounting Fees	10,198	7,800	2,398	-31%
Legal Fees	6,200	200	6,000	-3000%
Interest expense	723	2,000	(1,277)	64%
Direct client support	16,575	10,000	6,575	-66%
Depreciation & amortization	7,369	-	7,369	100%
Equip Rental and Maintenance	3,667	3,700	(33)	1%
Rent	70,241	70,200	41	0%
Books, Subscriptions, Reference	153	150	3	-2%
Postage, Mailing Service	295	300	(5)	2%
Printing and Copying	322	350	(28)	8%
Supplies	52,198	35,000	17,198	-49%
Telephone, Telecommunications	1,577	1,800	(223)	12%
Insurance - Liability, D and O	2,449	3,500	(1,051)	30%
Payroll Expenses	362,595	347,000	15,595	-4%
Travel and Meetings	3,746	3,000	746	-25%
Utilities	10,774	10,000	774	-8%
Total Expense	549,082	495,000	54,082	-11%
Net Income	(11,999)	-	(11,999)	

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Internal Control - Failure

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Former ED guilty of embezzling from Gales Creek Camp

Pamplin Media Group Monday, November 05, 2018

A plea deal requires Cheryl Sheppard to pay nearly \$364,000 in restitution to her old employer.

A former top official at a camp for diabetic kids and teenagers in Gales Creek has pleaded guilty to stealing from her old employer.

Multnomah County Circuit Court records indicate that Cheryl Sheppard, who was indicted in January on multiple counts of theft and computer crime, reached a plea agreement with prosecutors to avoid a criminal trial. As part of the deal, Sheppard agreed to pay nearly \$364,000 in restitution to the Gales Creek Camp Foundation.

Sheppard worked at the foundation from 2005 to 2016, serving as executive director for some 10 years before camp officials uncovered evidence that she had been diverting checks to her personal accounts. A 2017 lawsuit suggested Sheppard embezzled about \$480,000 over a six-year period.



Cheryl Sheppard

Gales Creek Notes

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- \$341,843 = checks written to “vendors” but deposited to the executive director’s bank account
 - \$134,081 = checks mailed to Gales Creek but stolen from mail and deposited to the executive director’s bank account
 - \$32,960 = unauthorized ATM withdrawals and checks made payable to “Cash”
 - \$31,239 = unauthorized bonuses and “retirement payouts”
 - \$30,983 = forged checks altered in QuickBooks to obscure the payee’s identity
 - \$21,696 = organization’s debit/credit cards used for the executive director’s personal expenses
 - \$77,325 = additional potential loss (unauthorized salary increases, cell phone payments, car allowance, etc.) for which the board had inadequate documentation to prove the loss
- \$670,127 total estimated loss over 7 years
-

Discovery of Embezzlement

- Promptly notify board of directors
- Conduct investigation to determine facts and loss
- Report to police - may be prerequisite for insurance coverage
- Determine what remedies available to recover losses
- Disclosure on Form 990 if exceeds lesser of 5% of gross receipts, 5% of total assets, or \$250,000

Scammers are Out There!

- There are a number of scams that target or impact nonprofits. Be prepared to recognize them.
- The Dishonest Donor
 - Donation comes in through cashiers' check, ACH, credit card company or other payment processor. Shortly after, donor contacts charity and says they accidentally made payment in the wrong amount (too much) and asks for a refund. Charity's refund check is good. Donor's donation payment is not.

Scammers are Out There!

From: [REDACTED]
Sent: Tuesday, January 14, 2014 2:50 PM
To: [REDACTED]
Subject: Donation Made In Error

Greetings

Compliment Of The Season.

I got to know about your Foundation through Donors mailing send to my mail box.

After i visit the Foundation homepages i was moved and touched, today i make donation to this organization but I m really very sorry to tell you that my intended donation was just \$300.00 and not \$3300.00.

Please i will be very appreciate to your Organization to issue a refund credit of \$3000.00 back to my Visa card Account Number list below.

Visa Card : [REDACTED]

Expiry Date: 02/2016, on my authorization.

Do not hesitate to contact me if you have any question, and also forward to me a copy of the refund receipt.
 Thanks for Cooperation

[REDACTED]

Cyber Security Resources

- Oregon law requires notification in event of data breach and data breaches affecting more than 250 Oregonians must be reported to the Department
 - <https://www.doj.state.or.us/consumer-protection/id-theft-data-breaches/data-breaches/>
- <https://cyberoregon.com/non-profits/>
- FTC cybersecurity resources
 - <https://www.consumer.ftc.gov/blog/2018/10/cybersecurity-resources-non-profits>

When to Contact the Attorney General's Office

- Any action challenging charitable gift
- Any litigation involving charitable fiduciaries' breach of duties or mismanagement of charitable assets
- Proposed modifications to terms of charitable gifts
- Plans to borrow against or make extraordinary distributions from endowments or other restricted gifts
- To register charities or charitable remainder trusts
- When planning to dissolve or terminate charitable organizations or trusts
- When considering the sale or transfer of all or substantially all of a charity's assets

Contact and Resources

Charitable Activities Section
Oregon Department of Justice
100 SW Market St.
Portland, OR 97201
(971)673-1880

DOJ Website:

<https://www.doj.state.or.us/charitable-activities/>