

Nonprofit Organizations

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What is a Nonprofit?

- Entity does not benefit any individual
- Receives federal tax exemption
- Restrictions on certain activities
 - Lobbying, political activity, private inurement, unrelated business income



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What is Tax Exempt?

- Tax & regulatory definition: an organization that
 - Enjoys special tax status
 - Faces a non-distribution constraint (profit=0)
- Functional definition: an organization that forms to
 - Perform “public tasks”
 - Perform tasks for which there is demand but no supply from for-profits or governments
 - Influence the direction of public policy
- Posts are generally filed under the Department’s blanket exemption



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Different Types of Tax Exempt Organizations

- 501(c)3 – Charities
- 501(c)4 – Social Welfare Organizations
- 501(c)19 – Veterans Service Organizations
- Others



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What About Contributions?

- 170(c)(3) of the Internal Revenue Code
- Contributions are deductible if made to a post or organization of **war veterans, or its auxiliary**
- 501(c)(19) requires at least 75 percent of the members must be past or present members of the Armed Forces of the United States
- 170(c)(3) requires at least 90 percent of the members are **war veterans**
- “Social Members” can be a problem
- Rev. Rul. 84-140



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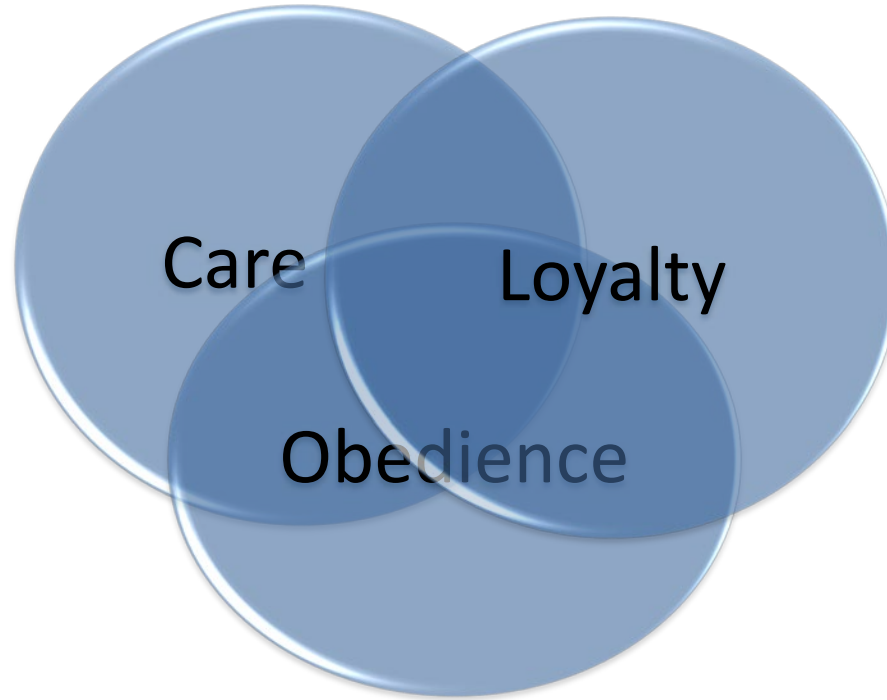
What must you do to keep your Tax Exempt status?

- Adhere to restrictions
- File IRS Form 990 annually
 - Failure to do so 3 consecutive years will result in exemption revocation
- File IRS Form 8822-B for changes in address & responsible party (officers)
- Fiduciary duties



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Fiduciary Duties



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Duty of Care

- Duty to Exercise Due Diligence in managing the organization's affairs
- Three Elements:
 - Must act in Good Faith – Intellectual Honesty – Can't ignore or hide important facts – Duty to Inquire
 - Must act with the same care that an ordinarily prudent person would use in a similar position under similar circumstances
 - Must act in what you reasonably believe is the organization's interest



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Practical Steps to Satisfy Duty of Care

- Retain competent help
 - You don't have to be an expert in everything, so rely on others
- Rely on management
 - Get recommendations from HQ staff
- Use committees
 - Allow committees to gather information and make recommendations
- Create a record of the decision-making process
 - Minutes of meetings can be helpful *at times*
- Promote open debate and record dissent
 - Let the minutes reflect dissenting views



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Duty of Loyalty

- Act with undivided loyalty to the organization and in the organization's interest rather than any personal interest or interest of some other person or organization
- Prohibits Conflict of Interest
- Absolute Duty to Disclose Financial Benefit from a transaction
 - Sitting quietly and/or abstaining is not enough
- Best to avoid even the perception of impropriety



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Practical Steps to Satisfy Duty of Loyalty

- What's in it for me?
 - Consider if you will personally benefit from a decision
- Disclose potential conflicts of interest
 - Is your gain a loss to the organization?
- Abstain from votes if there could be a conflict
 - If the conflict is strong enough to influence you, or may reasonably appear to look that way, abstain.
- Seek counsel
 - Getting legal advice can be helpful and demonstrates good faith in resolving the conflict



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Duty of Obedience

- An officer or director has a duty to assure that the organization is operated:
 - To fulfill its Mission.
 - In accordance with the law.
 - In compliance with its By-Laws
- Duties are imposed individually and collectively and we can be held personally liable.



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Practical Steps to Satisfy Duty of Obedience

- Review Charter and By-Laws
 - Have a thorough understanding of our general purpose
- Consider whether proposal is consistent with our Purpose
 - The activity should be covered by at least one of the seven stated purposes in Title 36 USC § 230102.
- Annually review activities
 - Each year, review activities for conformity with our mission and objectives



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Fiduciary Duties Conclusion

Common Sense Rule – In accepting a position of leadership we understand that:

- We must always be thinking about, and focusing on, priorities of the nonprofit, and not that of ourselves or another organization
- We must represent the nonprofit in a favorable light
- We must use good judgment in handling the organization's business
- We must act in the interests of the organization as a whole and not our own self interests
- We must follow the rules if we expect others to follow the rules



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Fiduciary Duties Summary



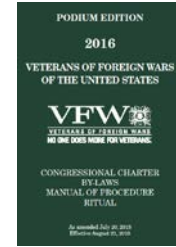
DUTY of CARE

- Decide and act in good faith
- Prudent person level of care
- Act in organization's best interest



DUTY of LOYALTY

- Act with undivided loyalty to the organization
- Avoid conflict of interest
- Avoid the perception of impropriety



DUTY of OBEDIENCE

- Faithful to founding documents
- Obey the law
- Adhere to Mission



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Practical Steps Summary



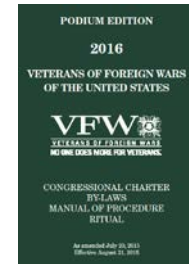
DUTY of CARE

- Retain competent help
- Rely on Management
- Use Committees
- Create a record of decision-making process
- Promote open debate and record dissent



DUTY of LOYALTY

- Ask, what's in it for me?
- Disclose potential conflicts of interest
- Abstain from votes if there could be a conflict
- Seek counsel



DUTY of OBEDIENCE

- Review Charter and By-Laws
- Consider whether proposal is consistent with our purpose
- Annually review activities



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How do these duties apply to your position in the VFW?



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Detecting, Preventing and Investigating Fraud

- 10% of all fraud recorded occurs in nonprofit organizations
- The median loss suffered is \$100,000.
- Most perpetrators are first time offenders with clean employment histories.



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Factors Contributing to Fraud

- Nonprofit Organizational Issues
 - ❖ Under-resourced with focus on mission rather than administrative practices
 - ❖ Assume people working for them are trustworthy
 - ❖ Lack of internal controls
 - ❖ Lack of management review
 - ❖ Small staff may limit ability to segregate duties



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Factors Contributing to Fraud

- Personnel Issues
 - ❖ Economic distress including financial difficulties, overspending, gambling, etc.
 - ❖ Employee has significant access to organizational funds and financial records and believes they can commit fraud without detection.
 - ❖ Rationalize their unlawful conduct as compensation for lower salary or unfair treatment or as a legitimate arrangement whereby the employee is simply borrowing money.



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Warning Signs

- Significant or unexplainable drop in profits or asset balances
- Lack of original receipts for reimbursements
- Disorganized financial records or lack of documentation
- Excuses for why financial reports are not available at meetings or when requested
- Refusal to take vacation, continually works overtime, or takes work home
- Employee exhibits signs of financial hardships or personal issues
- Lavish spending by employee that does not seem reasonable based on salary
- Attempts to bully or intimidate anyone who asks questions
- Slowness in paying bills or making deposits



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Fiduciary Responsibilities

- Department Council of Administration
 - ❖ Charged with conducting and overseeing the management of the Department
 - ❖ Maintain the ultimate authority and responsibility for the Department's activities
 - ❖ Fiduciary duties of care and loyalty
 - ❖ Must employ a degree of diligence, care and skill



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What Controls Does are in Place to
Prevent or Identify Fraud or
Embezzlement?



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Preventative Measures

- Two signatories for checks over certain dollar amount
- Original invoice or other appropriate documents required
- Never pre-sign checks
- Credit cards should not be allowed for personal use
- Review every credit card statement, transaction, and support
- If possible, segregate duties
- Whistleblower and Conflict of Interest Policies
- Background checks
- Review all disbursements made to the signatories on the accounts
- Properly train Trustees or Audit Committee Members that perform reviews



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Recovery of Funds

- Council has fiduciary obligation to attempt to recover funds
- Consult with employment counsel
- Resignation/Restitution Agreements
- Do not threaten criminal prosecution as negotiating tactic



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Other Fraud Issues

- May be required to report material diversion of assets on Form 990
 - ❖ Amount or property involved
 - ❖ Corrective actions taken
- Potential harm to reputation of the nonprofit
- Possible loss of tax-exemption



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Questions?

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