

GUIDE TO TAX-EXEMPT NPOS Part 3 The Board & Initial Documents

Part 3 of a quick look at what it takes to set up a charitable-purpose nonprofit corporation in California and Arizona, motivate a Board of Directors, obtain and keep tax-exempt status, and maintain funding to permit the team to achieve charitable goals.

CHAPTER 4. The Board and Its Officers

- 4.1. Board Composition
- 4.2. Governance and “Best Practices” Guidelines
- 4.3. Director Agreement
- 4.4. Appointing Officers
- 4.5. Appointing Agents

CHAPTER 5. The basic policies

- 5.1. Compensation and Private Inurement
- 5.2. Conflicts of Interest
- 5.3. Whistleblowers

CHAPTER 6. The initial resolutions and action by Incorporator

- 6.1. Action by Incorporator
- 6.2. Initial Board Actions

CHAPTER 7. Maintaining corporate records

- 7.1. What records must Arizona nonprofits keep
- 7.2. What records must California nonprofits keep
- 7.3. Access to corporate records

CHAPTER 8. Creating corporate records on an ongoing basis

- 8.1. The Board meetings
- 8.2. Standing Committees of the Board
- 8.3. Written Consents
- 8.4. Notice of Meetings
- 8.5. Financial records

CHAPTER 9. The Initial State Filings

- 9.1. California Statement of Information – Form SI-100
- 9.2. Arizona requires Publication

CHAPTER 4. The Board and Its Officers

The Board should have an odd number of Directors to avoid deadlocks as much as possible. Although there is no required minimum number, for 501(c)(3) purposes the Board usually consists of between 5 and 9 members. They can serve staggered terms if desired, so there is always overlap between new and incumbent Directors. Remember that a majority of the Board must assemble together in person, or remotely with active participation, to have a quorum permitting it to conduct a meeting and take action.

Terms for Board members should be longer than one year, but short enough not to discourage involvement. Alternatively, Directors can serve until they resign or are replaced. Once you have a good Board you should try and keep it in place and avoid an annual desperate paroxysm of trying to find enough new Board members. Adding new people can bring new perspectives and is usually a good thing.

Unless you have Statutory Members, or the Bylaws provide otherwise, the new Directors are appointed by the old Directors by majority vote. Months before the current terms expire the Board can create an ad hoc Election Committee consisting of some Directors as well as outside assistants. This Committee could then meet independently to suggest names, have its members reach out to cajole and gently persuade prospects, and propose agreeable candidates for the Board's consideration and approval.

4.1. Board Composition

The Board may, but usually does not, appoint a Chairperson who is given powers to manage the Board and govern its actions, and who often rises to the level of Officer status. The Bylaws, or later Board action, must specify the powers of the position. Most Boards operate in a more informal manner, and depend on an Officer or employed Program Manager to develop the agenda and guide the meetings.

In California, "No more than 49 percent of the persons serving on the board of a California nonprofit corporation may be interested persons." The code defines "interested person" means either (1) any person currently being paid by the entity for services rendered within the previous 12 months, but excluding any reasonable compensation paid to a director as director or (2) such person's brother, sister, ancestor, descendant, spouse, brother-in-law, sister-in-law, son-in-law, daughter-in-law, mother-in-law, or father-in-law. (Cal Corp § 5227)

4.2. Governance and "Best Practices" Guidelines

I recommend that the Board be given a document which describes how the Board should work together, and the "best practices" to achieve that harmonious coordination. This can take many forms but should be drafted or reviewed by a lawyer.

4.3. Director Agreement

Although far from a universal practice, I recommend each Director sign a simple written agreement stating their rights, duties, and expectations concerning their Board tenure. This document educates the Directors while protecting the corporation.

4.4. Appointing Officers

The Bylaws will typically have provided for the corporation to have at least three Officers: (1) a President or CEO and/or a Chairperson of the Board; (2) a Secretary; and (3) a Treasurer and/or CFO. (Required by Cal Corp § 5213) While Arizona does not specify required titles for Officers (ARS § 10-3840), use of the above standard names is advisable. Other additional names are permitted, such a Chief Operating Officer or Chief Compliance Officer. The Bylaws specify the titles and duties.

The Board must appoint the officers at a duly convened meeting, or by unanimous written consent. Directors then serve at the Board's pleasure, or until their

specified term has expired and a replacement appointed.

4.5. Appointing Agents

Similarly, the Board must appoint any other agents of the entity, such as the agent for service of process, accountants, lawyers, real estate brokers, or others who may act on the corporation's behalf.

CHAPTER 5. The basic policies

The corporation should adopt a set of written policies as part of its organizational resolutions by the initial Board. These include at least the following stand-alone written policies:

5.1. Compensation and Private Inurement

A written policy describing who is to be paid what, and under what terms, is crucial to eliminate inappropriate expectations of compensation. This policy underscores the corporation's charitable mandate and reinforces that no person or company can unduly benefit from their relationship with the nonprofit, which is called "private inurement". Compensation, when appropriate at all, must be reasonable in light of the activities performed and resources of the entity, and approved by the Board.

5.2. Conflicts of Interest

A conflict of interest policy educates the Directors, Officers, and other agents about prohibited self-dealing transactions. Not all transactions between the nonprofit and a Director or Officer are improper, but each raises the question whether an inappropriate profit is being made. It is not uncommon for Board members to run local businesses and to lend, rent, or sell services and assets to the entity, often at deep discount, for the entity's use or benefit. A clear conflicts policy helps present private inurement by someone who benefits too much from a transaction.

Arizona requires that the Board "shall adopt a policy regarding transactions between the corporation and interested persons...For the purposes of this subsection, 'interested person' means an officer or director of a corporation or any other corporation, firm, association or entity in which an officer or director of a corporation is a member, officer or director or has a financial interest..." ARS § 10-3864. Conflicts of interest transactions are also governed by ARS § 10-3860 to 3864.

California generally permits interested transactions if the transaction is "fair and reasonable" and pre-approved as such by a disinterested majority of the Board. (Cal Corp § 5233)

5.3. Whistleblowers

A policy protecting Whistleblowers is common these days. This encourages someone to speak up if they see inappropriate or illegal activities by the Board, Officers,

or corporate employees or agents.

CHAPTER 6. The initial resolutions and action by Incorporator

6.1. Action by Incorporator

The person who signed the Articles of Incorporation and caused them to be filed is usually called the Incorporator. As soon as possible after the entity is formed this person should (1) adopt an initial set of Bylaws (2) appoint the initial Directors, and (3) resign as Incorporator. These actions are usually expressed in a document called “Action By Incorporator”, which the Incorporator executes and delivers to the entity for inclusion in its records.

6.2. Initial Board Actions

The Board should then actively take over and conduct its first organizational meeting, in person or remotely. The Bylaws will allow remote meetings provided that all of the participants can hear each other and engage in Board discussions. I suggest the first meeting be an actual in-person or remote meeting. The actions can be taken by unanimous written consent, but the detail and importance of the initial resolutions warrant the interactive process. This meeting results in a set of initial resolutions which are needed to get the corporation up and going. These resolution include the following:

- (1) a statement of the filing and date of the Articles, attaching a copy;
- (2) ratifying the actions of the Incorporator;
- (3) approving the agent for service / statutory agent;
- (4) adopting (or modifying) the Incorporator’s Bylaws;
- (5) confirming the number and terms of Directors and appointing them;
- (6) electing any Board Chair and designating the duties;
- (7) electing Officers;
- (8) designating the principal office;
- (9) authorizing the opening of a bank account;
- (10) authorizing reimbursement of incorporation expenses;
- (11) directing any required registration with state charity regulators;
- (12) filing any required statement or report with any state;
- (13) obtaining an Employer Identification Number; and
- (14) adopting the key written policies.

CHAPTER 7. Maintaining corporate records

7.1. What records must Arizona nonprofits keep

An Arizona nonprofit corporation must maintain a copy of the following at its principal office or with its statutory agent. Records shall be maintained in written form or in any another form capable of conversion into written form within a reasonable time.

- (1) its articles or restated articles of incorporation and all amendments to them;
- (2) its bylaws or restated bylaws and all amendments to them;
- (3) minutes of all meetings of the Board;
- (4) minutes of, and actions taken by, any standing committee of the Board;
- (5) a list of names and business addresses of current directors and officers;
- (6) appropriate accounting records; and
- (7) its most recent annual report required by section 10-11622.

If the entity has Statutory Members, then it must also maintain the following records:

- (8) resolutions adopted by the Board relating to the characteristics, qualifications, rights, limitations and obligations of any Statutory Members or any class or category of members;
- (9) minutes of any meetings of Statutory Members and actions taken without a meeting for the past three years;
- (10) all written communications to Statutory Members within the past three years, including the financial statements furnished for the past three years under section 10-11620;
- (11) a record of its Statutory Members in a form that permits preparation of a list of the names and addresses of all members and in alphabetical order by class of membership showing the number of votes each member is entitled to cast and the class of memberships held by each member.
- (12) any Statutory Member agreement as permitted by section 10-3732.

7.2. What records must California nonprofits keep

California law (Corporations Code §§ 6320) requires that each nonprofit public benefit corporation shall keep the following records:

- (1) adequate and correct books and records of account;
- (2) minutes of the proceedings of its members, board and committees of the board; and
- (3) a record of any Statutory Members giving their names and addresses and the class of membership held by each.

These minutes and records shall be kept either in written form or in a form capable of being converted into clearly legible tangible form.

All actions of the Board must be accurately set forth in either written minutes of a Bylaws-compliant Board meeting, or a unanimous written consent signed by all Directors. Some states, like Arizona, permit less than unanimous written consent if permitted by the Bylaws. These records go into the entity's permanent records

The corporation can adopt a document destruction policy providing what kinds of documents are to be kept, for how long before they may be destroyed.

7.3. Access to corporate records

Every Board member has unlimited access to all corporate records. Unless the corporation has Statutory Members, no other people have access rights. The California Attorney General, however, has the power to investigate every charity and nonprofit. The IRS and state taxing agencies may require the entity provide some documentation in support of the application for tax-exemption.

CHAPTER 8. Creating corporate records on an ongoing basis

8.1. The Board meetings

There are two kinds of meetings which may be held by the Board, Regular and Special Meetings. Regular meetings are those set by the Articles, Bylaws, or Board resolution, to occur on a regular periodic basis, such as an annual meeting. Special meetings are this which are called on an as-needed basis to address the need for some specific Board resolution. The Bylaws may require that notices of meetings of the Board contain specific language about matters to be discussed, and the length of advance notice.

The Board minutes must be written up in draft form by the Secretary and circulated to all Board members for review. The minutes must then be discussed, corrected as needed, moved for approval, and approved by the Board, often at its next meeting.

8.2. Standing Committees of the Board

If the Board has created and appointed a standing committee to assist it on an ongoing basis, then the meetings of these committees should also be documented and kept with the corporation's other records. Meetings of a temporarily or "ad hoc" committee of the Board typically does not need to document its proceedings.

8.3. Written Consents

In addition to minutes, which report what happened during a meeting of the Board, the Board can act without any meeting if all of the Directors sign a unanimous written consent that sets forth the resolutions. Some states, like Arizona, allow less than unanimous written consent if permitted by the Bylaws. These records have the same significance as approved minutes, and are included in the entity's permanent records.

8.4. Notice of Meetings

Directors are entitled to advance notice of upcoming meetings together with an agenda of matters to be considered. The Bylaws will specify how such notices may be communicated, how long in advance notice must be given, and what the notice must say. Copies of all notices with an indication of the date and manner of service, is required and must be kept for all notices.

8.5. Financial records

All donations are received as “trust” assets. The entity must treat them with the highest level of care and documentation. Professional accounting or CPA assistance is advisable, and probably soon required. The California Attorney General has the authority to inspect the financial records of nonprofits at any time upon reasonable advance notice. Remember to file an Initial Registration Form (CT-1) with the California Attorney General within 30 days of receiving any form of charitable assets, whether or not tax-exempt.

CHAPTER 9. The Initial State Filings

States have their own requirements for quick action after incorporation.

9.1. California Statement of Information – Form SI-100

All corporations formed in California, or which are then qualified to do business in California, must file a Statement of Information every year with the Secretary of State. The first form must be filed within 90 days for the corporation’s creation, and then every other year thereafter (for nonprofits) before the end of the month in which it was created. If you register with the Secretary of State and are given corporate access, then you can file the Statement online.

9.2. Arizona requires Publication

Every Arizona corporation, including nonprofits, must publish a Notice of Formation in one of the several ACC-designated “qualifying” newspapers within 60 days of the entity’s formation. Proof of publication should be filed with the ACC within 90 days after formation. The notice must run for three consecutive publications. The Affidavit of Publication may be submitted by mail, in person, or uploaded as a .pdf through an eCorp business account. Acceptable newspapers are listed at the ACC website.