



Winding Down: A Risk Management Checklist

A wide range of options should be explored anytime a nonprofit faces serious operational challenges, financial shortfalls and other circumstances that make it impossible to continue normal operations. This “Risk Management Checklist” offers an overview of the process of dissolution (which is an action governed by state law) as well as a list of the issues that CEOs and board leaders should consider when planning to wind down the operations of a nonprofit.

Note: This checklist is not a substitute for legal advice from a competent attorney licensed in the state in which your nonprofit operates. Obtaining legal advice concerning your nonprofit’s specific circumstances is *highly recommended* if your organization is considering winding down, dissolution, filing for bankruptcy, or merger opportunities.

“Winding Down” – What are the Options?

One of the first steps that leaders must take is determining whether the nonprofit will be “dissolved” (after which it legally ceases to exist), placed in a “dormant” state (not operating, but retaining its corporate identity), or “reorganized” through bankruptcy proceedings. *For additional information on bankruptcy and dormancy, see the Appendix to this article.*

For organizations that decide to dissolve, the liquidation and distribution of *all remaining assets* must be conducted in accordance with (1) state law, (2) the bylaws or articles of incorporation of the nonprofit, and (3) a board-approved *plan of dissolution*. NOTE: In some states, such as New York, if assets remain, the plan of dissolution must additionally be approved by a court in the jurisdiction in which the nonprofit is located.

The board approved “plan of dissolution” must be filed with the state so that the state can be satisfied that the nonprofit has paid all its debts and appropriately transferred any remaining assets. The plan generally explains in narrative format what liabilities, if any, remain, or that all liabilities have been satisfied. The plan further describes what assets remain, if any, or how they have been disposed of.

- In an ideal dissolution process, the nonprofit’s assets will be sold or transferred to satisfy debts transferred and the organization’s liabilities will be fully satisfied. When the organization is ready to file the Plan of Dissolution, the board member(s) or officer(s) signing the certification of dissolution required by the state will therefore be able to certify that: “All assets of the organization have been transferred so that no assets remain.... and, “All debts and liabilities of the organization have been satisfied.”

KEY STEPS IN DISSOLUTION

Step 1 Identify Assets and Liabilities

Identifying assets and liabilities

- In cases where an existing tax-exempt organization has made the determination to cease to exist in the future through dissolution proceedings, one of the first necessary steps will be to identify all assets and liabilities of the organization.
- When identifying assets it may be helpful to look at the nonprofit's past and most recent audited financial statements because they may list assets, including those that have been fully depreciated but are still owned by the nonprofit. (Unfortunately, one cannot rely exclusively on audited financial statements because these statements are a dated "snapshot" of the nonprofit's status at a certain date in time. They should not be considered an up to date schedule showing the acquisition, sale and depreciation of assets.)
- During the process of identifying assets, it's important to remember that outstanding accounts receivable are assets. A concerted effort should be made to collect all collective receivables. In some cases the services of a debt collection agency may be worth the associated cost.
- When identifying liabilities, don't forget taxes (withholding taxes for final pay; unrelated business income taxes for final fiscal period; any outstanding state tax obligations or filings).

Step 2 Dispose of Assets

Disposition of assets

- Most nonprofits facing the difficult process of dissolution will have some assets of value on hand that can be sold to raise the funds needed to pay some of the organization's outstanding debts. In most cases, some assets will remain that cannot be sold, either due to the nature of the assets, time constraints, or the nonprofit leaders' desire to opt to transfer the assets.
- Consider whether the disposition of assets will include any intellectual property owned by the nonprofit, including publications, the results of research and other significant work product. The ownership of intellectual property may be transferred to another nonprofit or sold for fair market value.
- In order for a nonprofit organization to officially dissolve, the nonprofit must arrange for the transfer of any *remaining* assets to another tax-exempt entity (or to the US federal government). Assets may not be transferred (although they may be purchased at fair market value) to an individual entity or person because such a transfer would be a prohibited transaction under US tax law.
- The obligation to transfer remaining assets to another nonprofit or the federal government is usually set forth in the "dissolution clause" of the entity's articles of incorporation (or its corporate charter or "certificate of incorporation").

Step 3 Satisfy Debts and Liabilities

Before ceasing operations the organization must also satisfy, to the extent possible, all its debts and liabilities.

- The organization will continue to exist until all pending obligations have been met, so it should not conduct any new business during the winding down period.

- The board and CEO should work together to identify the point person who will coordinate the process of identifying all outstanding liabilities/recurring obligations. In large organizations this may be the CFO. In smaller nonprofits this task may be handled by the CEO working with the board treasurer.
- The board or a committee named by the board chair should determine whether all debts and obligations of the organization can be satisfied. If the board or special committee determine that all debts and obligations cannot be satisfied, the committee should work to formulate a recommendation (for presentation to and approval by the full board) about how best to satisfy those obligations to the fullest extent possible.
- If cash on hand plus the proceeds from the sale of other assets are not expected to cover all liabilities and efforts to make arrangements with creditors have proven unsuccessful, then bankruptcy should be considered. Legal counsel should be engaged to assist with bankruptcy proceedings. (*Note: the appendix to this document contains an article on nonprofit bankruptcy.*)
- Communicate with the nonprofit's creditors. Keep in mind that it may be possible to negotiate less than full payment of outstanding obligations. If discussions with vendors disclose that the nonprofit is winding down operations, be prepared for that information to be disclosed to a wider audience. If there are contingent liabilities notice of the impending dissolution should be given to each creditor. Consider publishing the notice in a newspaper of general circulation (but be comfortable with your message and have a press release in hand explaining the decision to close the nonprofit's doors). Notice of dissolution may be required in order to trigger creditors' obligations to file a claim. If no claim is filed and notice has been given, then depending on state law, the claim may be barred. If state law does not provide for a method of limiting contingent liabilities, or if the creditor is not correctly notified, the nonprofit may have left itself open to a claim from its creditors.

Issues to Consider When Winding Down

What will be the impact on the nonprofit's programs?

Consider whether there are any programs that could be transferred to another nonprofit in the community:

- Identify strategic partners for possible transfer of those programs.
- Determine when to open lines of communication and the preferred strategy in approaching these potential partners.

Consider the impact on clients who will no longer have access to services:

- Identify fragile clients/consumers who will be most at risk when programs cease and consider what steps may be taken to mitigate their risks.
- If the nonprofit delivers professional services, such as counseling, the leaders of the nonprofit should be aware of the applicability of any professional code of ethics on the topic of "client abandonment."

Determine whether there are any ongoing projects funded by restricted grants whose grant terms will not be met by the day of dissolution:

- Contact the funding source(s) as soon as appropriate to determine whether the funds need to be returned.

- Discuss the donor’s position with respect to requiring that funds be returned. Inquire about the donor’s willingness to permit the re-purposing of grant funds. If the donor agrees to permit the nonprofit to accept a new use of the funds (e.g. to cover dissolution-related expenses), request permission to modify the terms of the grant in writing. It pays to ask!

Closing Out Finance Accounts

- Consider the appropriate timing for closing financial accounts, including bank and brokerage accounts. Determine who is authorized to take the identified steps and establish a timetable.

Board governance during the winding down period

There is likely to be great angst among board members who want to support the organization at this critical time, and loyal members may also express anger that the organization is closing its doors.

- Some may have been present at the organization’s founding or be so closely aligned with the organization that they believe their own reputation is inextricably linked to the nonprofit’s and that dissolution equates to failure.
- It is especially important for board members to remember their duty of loyalty to the organization and to make decisions that are *in the best interests of the organization*.

By the time the decision to close the nonprofit’s doors is made, several board members may have resigned.

- State law determines the minimum number of board members for a nonprofit organization (it is generally two or three; a small minority of states permit single member nonprofit boards.)
- Be mindful of the minimum number of board members required. If appropriate, and at the appropriate time, all board members *except the minimum number* may resign during the winding down period.
- It is a violation of a board member’s legal duty of care to the nonprofit to resign if his/her resignation would leave fewer than the minimum number of board members in place.

Making the determination of who stays and who leaves is an important decision for the nonprofit during this sensitive period.

- Those remaining will have to ensure that all required filings are completed with the state and the IRS, and that correspondence with stakeholders, insurance carriers, and possibly vendors is handled professionally.
- The winding down process may require several months—those who remain may be involved in the nonprofit’s closure off and on for several months after the nonprofit ceases day-to-day operations.

Communications with Stakeholders

Strategize and prepare a message to stakeholders about the winding down process.

- Someone should be tasked with identifying who should be notified and when, as well as what the communication should say.
 - ✓ Board and employees should be notified first. They will want to know “when” and “why.” Answers to these two critical questions should be prepared in advance. Most

board members will be well aware of the plans for dissolution as they will have participated in the decision to dissolve.

- ✓ Prepare a press release that can be provided in response to any press inquiries and make sure it is ready as soon as employees are notified. Anticipate that current and former employees may be contacted by the media.
- ✓ Communicate with consultants, vendors, funding sources, corporate sponsors, individual donors etc. These stakeholders will want to know “when,” “why” and “what was done” to avoid the final step of closing the nonprofit’s doors.
- ✓ Donors are likely to require customized messages to assure them that their gifts have been and are being used to advance the nonprofit’s mission.

Staff and Volunteers

Keep in mind that advance notice of termination may be required.

- While generally the employment-at-will doctrine does not require advance notice of termination, larger nonprofits need to be aware that a federal law may require advance notification when a nonprofit is closing its doors. The federal Worker Adjustment and Retraining Notification Act, (The WARN Act) [29 USC § 2 101 et seq. \(www.dol.gov/compliance/laws/comp-warn.htm\)](http://www.dol.gov/compliance/laws/comp-warn.htm) requires employers of more than 100 employees to provide at least 60 days notice prior to closing a site where 50 or more employees will lose their employment during a period of 30 days.
- The WARN Act doesn’t require severance pay. However, several states have their own WARN Acts, and some do require severance payments.

The following states have their own version of the WARN Act: *(Please note that this list was up to date as of February 2009, however, the Center encourages you to research the law of your own state or consult legal counsel licensed in your state to make certain that you are aware of the applicable state law that applies to your nonprofit.)*

- **California** [Cal. Lab. Code § 1400 et seq. (www.leginfo.ca.gov/cgi-bin/displaycode?section=lab&group=01001-02000&file=1400-1408)]
- **District of Columbia** [D.C. § 44 -1003.11. (<http://198.187.128.12/dc/lpext.dll?f=templates&fn=fs-main.htm&2.0>)]
- **Hawaii** [Chapter 394 B, Hawaii Rev. Stat. (www.capitol.hawaii.gov/hrscurrent/Vol07_Ch0346-0398/HRS0394B/HRS_0394B-.HTM)]
- **Illinois** [820 ILCS 65 /1 et seq. and 30 LICs 76 0/15. (www.ilga.gov/legislation/ilcs/ilcs3.asp?ActID=2617&ChapAct=820%26nbsp%3BILCS%26nbsp%3B65%2F&ChapterID=68&ChapterName=EMPLOYMENT&ActName=Illinois+Worker+Adjustment+and+Retraining+Notification+Act%2E)]
- **Maine** [Me. Rev. Stat. Title 26 Ch 7, § 625 -B (<http://janus.state.me.us/legis/statutes/26/title26sec625-B.html>)]
- **Maryland** [Md. Code Ann. Lab. & Empl. §§ 11-201(c), 11-302-304. (http://www.dsd.state.md.us/comar/Annot_Code_Idx/LaborEmployIndex.htm)]
- **Massachusetts** [Mass. Gen. L. c. 151A § 7 1B (www.mass.gov/legis/laws/mgl/151a-71b.htm)]
- **Minnesota** [Minn. Stat. Annot. § 116L.976 (www.revisor.leg.state.mn.us/stats/116L/976.html)]

- **New Hampshire** [New Hampshire Rev. Stat. Annot. 282 -A:45-a ([www.gencourt.state.nh.us/rsa/html/xxiii/282 -a/282 -a-45 -a.htm](http://www.gencourt.state.nh.us/rsa/html/xxiii/282-a/282-a-45-a.htm))]
 - **New Jersey** [N.J.S.A. 34:21 et seq.(www.njlawnet.com/njstatutes.html)]
 - **New York** www.labor.state.ny.us/workforcenypartners/warn/warnportal.shtm (effective 2/09)
 - **Ohio** [Ohio Rev. Code § 4141.28 <http://codes.ohio.gov/orc/41>)]
 - **South Carolina** [S.C. Code Ann. § 4 1-1-40 (www.scstatehouse.net/code/t41c041.htm)]
 - **Tennessee** [Tenn. Code Ann. §§ 5 0-1-601 through 5 0-1-604 (www.michie.com/tennessee/lpext.dll?f=templates&fn=main-h.htm&cp=tncode)]
 - **Wisconsin** [Wis. Stat. § 109.07 (http://folio.legis.state.wi.us/cgi-bin/om_isapi.dll?clientID=35329570&infobase=stats.nfo&jump=109.07)]
- Staff will be concerned about the loss their income and their benefits. Staff need to know how their health insurance will be impacted, how to obtain information about their potential eligibility for unemployment compensation and the impact of their separation of employment on their participation in other employee benefits such as retirement plans.
 - The Center recommends, that if it is possible to do so, that management inform the entire staff at the same time. Generally holding a “town hall meeting” to explain what is happening, (focusing on why and how it will impact them) as well as providing an opportunity for questions is preferable. Ideally, the CEO and Chair of the board will stand side-by-side when communicating the news.
 - Know whether your nonprofit has a policy or practice of providing severance pay and in what circumstances and determine whether severance pay liability will be triggered for some or all employees under the current circumstances.

Health Insurance

COBRA (or the state law equivalent for workplaces with fewer than 20 employees) will require the nonprofit to provide various notices to employees about how their separation of employment will impact their right to continuation benefits. Know in advance what the obligations of the nonprofit will be going forward and plan accordingly. Also, be aware that the recently enacted American Reinvestment and Recovery Act of 2009 has expanded COBRA considerably.

Web Site Hosting

When considering winding down contractual relationships consider the timing of shutting down the nonprofit’s web site, and also making sure that access to “stale” sites is limited. However, it may be advisable to maintain a copy of the nonprofit’s web site in an archival venue for at least two-six years after the close of business, in the event that it could be helpful to refer back to the site’s content for legal defense purposes. (Six years is the statute of limitations for breach of contract claims in some states).

Other Contracts

In order to prepare to terminate ongoing contracts, read the contracts to determine what is required in connection with notice of termination (e.g., how many days or months’ notice is required by the contract to cancel/terminate). Also consider the penalties if the notice provisions is not followed.

Examples of contracts that should be reviewed include:

- ✓ Leases, including leases for office equipment
- ✓ Website hosting
- ✓ Future special events/venue contracts
- ✓ Vendor contracts such as housekeeping/cleaning

Document Retention/Storage

Decide where significant documents will be stored for what period of time and where and who will have custody, post dissolution.

State Law Process of Dissolution

1. State law requirements: The dissolution process must be conducted in accordance with regulations of the state in which the organization was incorporated. Review your state's law. The state generally provides a form to be filed called the "certificate of dissolution" that should be reviewed. Usually the state requires certification (signature and date) by one or two officers of the corporation on the dissolution form. Signatures may need to be witnessed or notarized. An initial "notice of election to dissolve" may be required to be signed by the president and secretary and filed with the Secretary of State in some state. This step is not required in all states.
2. Published Notice. Some states require a notice to be published in a newspaper of general circulation in order to complete the dissolution process.
3. Board Action: Review the nonprofit's bylaws and articles of incorporation for guidance on the steps necessary to obtain board approval for dissolution. The bylaws may require a majority or a supermajority vote to dissolve the corporation. (If the corporation has members, a vote of the members may be required.) The remaining board of directors¹ should convene a final meeting, where a quorum is needed. Notice of the meeting should be provided in accordance with the bylaws or a waiver of notice signed by all board members attending the meeting. vote to distribute the remaining assets to another nonprofit with a similar mission (or whichever organization is identified in the nonprofit's bylaws or articles of incorporation, if any are specified).
 - One board member may be authorized in the final meeting to handle all affairs, such as the final IRS filing, after the corporation has been officially dissolved. Alternately, a staff member, usually the CEO, may be compensated, as approved as part of the plan of dissolution, to handle the final winding down steps, as needed, after the official closure of the organization.
4. Approval of a Plan of Dissolution: a formal document, in most states referred to as a *plan of dissolution*, should be drafted that explains how the assets have been distributed and how the liabilities have been addressed. If all assets are distributed and all liabilities addressed then the

¹ In the winding down process some but not all board members may resign, however, enough board members should remain to carry on the necessary obligations of the organization. State law will determine the minimum number of board members for the operations of a nonprofit corporation. In most states it is one, two or three board members.

plan can state: “All liabilities and debts have been satisfied and the assets of the organization have been transferred to XYZ organization. There are no remaining assets.”

5. Filing the Certificate of Dissolution: The state should provide explicit directions for filing corporate dissolution forms. Look on the web site of your state’s Secretary of State or the state government agency that handles business filings. There is generally a fee for filing dissolution forms. Follow the directions carefully and enclose (or bring with you if you are filing in person) an extra copy of the certificate of dissolution for the state to return to you as proof that the dissolution was filed.

Final Step: Notify the State and the IRS

After the State has accepted (“filed”) the dissolution:

1. Notify the other state departments, such as the state department of taxation and the department responsible for charitable registration/solicitation by sending a letter enclosing the certificate of dissolution (as stamped “filed” and dated by the State)
2. Notify the IRS by filing the IRS 990/990 EZ (and 990-T as applicable) for the final fiscal year of operations and sending a letter enclosing the certificate of dissolution (as stamped “filed” and dated by the State) to EO Customer Account Services:

Internal Revenue Service
TE/GE Customer Account Services
P.O. Box 2508
Cincinnati, OH 45201

When filing the final Form 990/990 EZ after the conclusion of the organization’s fiscal year, check the **Final Return box** in the header areas on page 1 of the return.

Appendix:

Resources on Dissolving a Nonprofit Corporation

Nonprofit Law Blog posting, October 7, 2008, that contains tips on considerations of dissolving a nonprofit:

www.nonprofitlawblog.com/home/2008/10/dissolution.html

Fieldstone Alliance's "Nonprofit Decline and Dissolution" report:

www.fieldstonealliance.org/client/client_images/pdfs/nonprofit_decline_report.pdf

La Piana Associates, Inc.'s "Deciding to Restructure: Tips on Dissolutions"

www.lapiana.org/resources/tips/deciding/02_2003.html

Bankruptcy in the Nonprofit Sector

Google Book Excerpt on bankruptcy for nonprofits: Guidebook for Directors of Nonprofit Corporations
By George W. Overton and Jeannie Carmedelle Frey

<http://books.google.com/books?id=uwfc4Pg8J2sC&pg=PA177&lpg=PA177&dq=nonprofit+bankruptcy&source=web&ots=3ShAYwREf6&sig=iLwLZy-Z3dho4LpFbwFgz2PMjWM>

Going Dormant

*What follows is adapted from an excerpt of a longer article on the topic of nonprofit mergers, dissolutions and dormancy, found on the web site of the **National Association of Veterans' Research and Education Foundations** that discusses the pros and cons of dormancy as opposed to dissolution: The complete article may be found at this URL:*

[www.navref.org/library/Mergers_Dissolution_Dormancy.htm#1. %20Types%20of%20Mergers%20and%20Consolidations](http://www.navref.org/library/Mergers_Dissolution_Dormancy.htm#1.%20Types%20of%20Mergers%20and%20Consolidations)

Rather than dissolution, an organization may determine that "dormancy," putting the nonprofit into an inactive state, may be the best option. This would avoid the need to create a nonprofit organization in the future from scratch should there be a change in circumstances. However, even a nonprofit in a dormant state must meet state and federal requirements and maintain specified registrations. See below for recommended actions.

1. Determine the state, IRS and state regulations applicable to nonprofits that cease operations (no revenues; expenditures only to maintain state registration), but do not dissolve.

IRS: Beginning in 2008, exempt organizations with gross receipts under \$25,000 must file an annual notice (Form 990N), that includes the requirement to provide evidence of the organization's continuing basis for its exemption. If an organization fails to meet its filing obligation to the IRS for three consecutive years, the organization's tax exempt status will be revoked.

State: Notify the state that the nonprofit has ceased operations and become "inactive," but has not decided to dissolve. Determine whether nonprofits that are "inactive" have to submit an annual

report to state. Consult an accountant and state regulators to determine the minimum requirements for maintaining a nonprofit corporation in the state. Generally, this requires a nonprofit to:

- Pay an annual state registration fee and to submit certain forms.
 - Ensure that the board meets the minimum number of times required by the state and bylaws.
 - Prepare minutes to document that the nonprofit remains compliant with minimum requirements.
 - Keep the registered agent information current (name and address of the person responsible for receiving legal).
 - Maintain accurate signature cards for bank accounts.
2. Determine whether to continue Directors' and Officers' (D&O) liability insurance coverage. With no financial activity and no employees, the board's risk level will be very low. However, the board should make a conscious choice about maintaining or terminating D&O coverage. Extended reporting period coverage may be available to protect the board against suits alleging improprieties that may have occurred while the NPC was active, but which were filed after the organization became dormant. Unfortunately, the cost of such coverage is likely to be comparable to the annual premium paid while the organization was active. Review the bylaws to determine whether they require the organization to maintain D&O coverage. If so, the board will have to change the bylaws prior to terminating coverage.