



**Cerini & Associates, LLP 2021 Nonprofit Update**

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# Legal Update

**TAKEAWAYS // WHAT WE CAN LEARN FROM  
THE NEW YORK ATTORNEY GENERAL'S COMPLAINT  
AGAINST**

**THE NATIONAL RIFLE ASSOCIATION OF AMERICA,  
INC., WAYNE LAPIERRE, WILSON PHILLIPS, JOHN  
FRAZER, and JOSHUA POWELL**

**8/6/20; Ongoing**

Certain provisions of the law and Board responsibility that we see repeatedly featured prominently in enforcement actions by the Attorney General's Charities Bureau, and also in actions brought by individuals with standing to sue under the law (directors, officers, members)

# Attorney General v. The Trump Foundation

- Related Party Transactions
- Absence of governance & oversight

## Bankruptcy Trustee v. Trustees and Officers of Dowling College

- Oversight Deficiencies
- Absence of timely and accurate information flow to the Board

## Litigations Against Nonprofit Boards // Internal Disputes

- Oversight Deficiencies
- Absence of timely and accurate information flow to the Board
- Related Party Transactions
- Absence of / deficiencies in governance

We see most of these same provisions of the law and Board responsibility at the heart of the allegations in the Attorney General's NRA enforcement action.



In addition, the critical role of the Audit Committee and audit oversight plays prominently in the Attorney General's NRA enforcement action.

## NY Attorney General v. NRA & Individual NRA Defendants

- 169-page complaint
- 666 numbered paragraphs chockfull of jarring detail
- Incredibly Egregious Behavior Alleged / Magnitude
  - Astronomical Compensation, much of it hidden (vendors pay the fee or expense, and then invoice the NRA for these payments disguised as a vendor charge)
  - No show jobs for insiders and relatives
  - Huge expenditures to facilitate lavish lifestyle (private flights, including for relatives; personal expenses paid)
  - Relative's wedding paid for using charitable assets

While the wrongdoing alleged in the NRA case is extreme and over-the-top, the legal underpinnings of the AG's case are incredibly relevant to every New York nonprofit because **your organization is governed by precisely the same provisions as the NRA**, and **your Board has the same responsibilities and compliance obligations as the NRA's Board**.

Put another way, when my firm is asked to become involved in internal disputes, litigation and AG investigations involving nonprofits, **we see the same legal underpinnings at play as in the AG's complaint against the NRA**.

So, there is plenty for all of us to learn from the AG's NRA complaint.

From Par. 581 of the complaint (referring to Wayne LaPierre, Executive Vice President of the NRA, and functionally running its operations):

LaPierre breached his **fiduciary duties of loyalty, care and obedience** to the NRA by using his powers as an officer and *ex officio* director of the NRA to obtain illegal compensation and benefits, to convert NRA funds for his own benefit, and to dominate, control, and direct the NRA to obtain private benefit for himself, his family members and for certain other insiders, including Defendants Phillips and Powell in contravention of NRA bylaws, policies and procedures, and applicable laws.

The basis of the AG's action comes from the fundamental premise that directors and officers of NY Nonprofits have 3 basic legal duties:

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

## Duty of Care:

- ❖ A director must discharge the duties of his/her position in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.
- N-PCL § 717(a)
  - Oversight function.
  - Requires familiarity with the organization's finances and activities and regular participation in its governance.

## Duty of Loyalty:

- ❖ A director must act in the interest of the organization.
  - Requires undivided allegiance to the organization's mission when using the power of his/her position, or information concerning the organization or its property.
  - Conflicts of interest; related party transactions.

## Duty of Obedience:

- ❖ to ensure that the organization complies with applicable laws and regulations and its internal governance documents and policies
  - Compliance with applicable laws and regulations is even more difficult than it sounds
  - Multiple layers of laws and regulations



## Audit Committee:

The only committee with an entire section of the N-PCL dedicated to it (§ 712-a; Audit Oversight).

The Audit Committee is a central component of the governance structure under the N-PCL.

NRA: Epic failure of the Audit Committee

“The Audit Committee failed to perform its statutory, bylaw, and charter responsibilities as set forth in the preceding paragraphs. **As a result**, the Board was unable to exercise its responsibilities to maintain a system that was reasonably effective in identifying violations of law. In turn, **the Board displayed a sustained and systematic failure to exercise their oversight function and stood by as various laws were violated by the NRA**, including

- ❑ violations of the NRA's tax exempt status,
- ❑ false reporting on annual filings with the IRS and the Attorney General's Charities Bureau,
- ❑ improper expense documentation,
- ❑ improper wage reporting,
- ❑ improper income tax withholding,
- ❑ failure to make required excise tax reporting and payment,
- ❑ payments in excess of reasonable compensation to disqualified persons,
- ❑ and waste of NRA assets.” (¶ 531)

In some critical respects, the NRA lacked appropriate policies and internal controls. But in others, the **policies and controls were present on paper, but ignored in practice.**

A prime example was that the NRA had controls and a process in place for entering into significant contracts, which – if followed – could have prevented many of the missteps. These controls and policies were ignored – with disastrous consequences.

“The culture of noncompliance and disregard for the internal controls was evident within the NRA Audit Committee, which similarly failed to fulfill its obligation to oversee internal controls. This lack of oversight resulted in waste and loss of the NRA's charitable assets and contributed to the NRA reaching its currently deteriorated financial state.” (¶ 476)

Making exceptions to the requirements of the contract approval process opened the door to rampant abuses, and permitted contracts and arrangements that improperly benefitted board members, officers, their family members and their business affiliates.

## File Cabinet Syndrome

- While not as headline-worthy as the NRA's missteps, in our practice we often see nonprofits fall victim to "file cabinet syndrome."
- A nonprofit goes to the trouble and expense of developing and adopting an effective policy, but then files it away, loses track of it, disregards it, and thereby creates a breach of fiduciary duty by its board members and officers.

Part of what facilitates **File Cabinet Syndrome** is that nonprofit board members and officers fall victim to the “T-Word” – which is a word that should not be uttered in the nonprofit governance and internal controls realm, because it is entirely incompatible with proper governance and adequate internal controls.

What is the “T-Word”?



# TRUST

“For example, the Vice Chair of the Audit Committee testified that he did not feel the need to ask RSM [the NRA’s external auditor] for external oversight of LaPierre's expenses because he "personally [had] a great deal of trust in Wayne LaPierre" and he didn't believe that LaPierre "expends money unnecessarily.”” (¶ 527)

Another syndrome that we see afflicting nonprofit officers and board members, and that also was part of the NRA dynamics, is:

**“Ostrich Syndrome”**

On July 30, 2018, whistleblowers on the NRA staff were scheduled to present their concerns in detail to the Board's Audit Committee, including a report, known as the Top Concerns Memo, that laid out the egregious conduct and financial improprieties at the NRA.

“Two of the five Audit Committee members – the [Audit Committee] Chair and the interim President of the NRA – left the July 30, 2018 Audit Committee meeting before the whistleblowers gave their presentation. Also, the minutes for that meeting fail to record the fact and substance of the complaints from whistleblowers. The Committee Chair was not even provided a copy of the Top Concerns Memo by the Vice Chair after the meeting.” (¶ 543)

# **N-PCL: Roadmap to Compliance with Fiduciary Duties for Board Members & Officers**

## Examples:

- ✓ Elections
- ✓ Meetings (notice; decision-making)
- ✓ Annual Report
- ✓ Documenting Corporate Meetings & Decisions
- ✓ Filing Requirements
- ✓ Conflicts of Interest & Related Party Transactions

# **NRA: The Road to Disaster When the N-PCL Roadmap is Rejected or Ignored**

## **Conflicts of Interest & Related Party Transactions**

“For years, Defendant Frazer [corporate Secretary and general counsel] failed to comply with his obligation under the NRA bylaws and internal policy to collect and submit to the NRA Audit Committee the annual Financial Disclosure Questionnaires that NRA board members and officers are required to fill out.” (¶ 540)

- “For years, the Audit Committee failed to adequately address related party transactions or conflicts of interest, in violation of both the N-PCL and the NRA's internal policy governing conflicts of interest.” (¶ 504)
- “The NRA Audit Committee failed to comply with its obligations to diligently review and approve (and document such review and approval of) related party transactions and conflicts of interest between the NRA and NRA officers, directors, and key persons.” (¶ 538)

- “The NRA entered into numerous unlawful related party transactions in violation of N-PCL § 715 and EPTL § 8-1.9, including those detailed above. These transactions were outside of the NRA's authorized corporate purposes.” (¶ 631)
- The complaint notes the NRA’s “failure to conduct reviews of related party transactions specifically required by the N-PCL until September 2018, followed by an Audit Committee "review" and approval of all related party transactions before them, with minimal inquiry or detail.” (¶ 663)



## Related Party Transaction Basics:

“Under N-PCL § 715 and EPTL § 8-1.9, the NRA is prohibited from entering into any related party transaction unless the transaction is **determined and documented** by the Board or an authorized committee of the Board to be **fair, reasonable, and in the corporation's best interest** at the time of the determination in compliance with that section.” (¶ 39)

## Related Party Transaction Basics:

“In addition, every director, officer, trustee, or key employee who has an interest in a related party transaction **must disclose** in good faith to the Board or an authorized committee of the Board "the material facts concerning such interest," **and the corporation must conduct a process before approving a related party transaction and document that process.**

N-PCL § 715; EPTL § 8-1.9” (¶ 40)

## Related Party Transaction Basics:

“Similarly, the NRA's Board is required to **adopt, implement** and **assure compliance with** a conflict of interest policy that ensures that the NRA's trustees, directors, officers and key persons act in the corporation's best interest and comply with applicable legal requirements, including those concerning related party transactions. N-PCL § 715-a; EPTL § 8-1.9. The policy must provide for **annual** conflict of interest disclosures by trustees and directors, and **procedures** for the disclosure and determination of conflicts of interest, which must prevent the person with the conflict from influencing the determination. *Id.* **The policy also imposes recordkeeping requirements on the existence and resolution of conflicts.** *Id.*” (¶ 41)

# **GOVERNANCE: IT'S NOT ROCKET SCIENCE!**

## “VII. The NRA's False Regulatory Filings”

“CHAR500s must be signed by: (i) the organization's President or Authorized Officer and (ii) its Chief Financial Officer or Treasurer, both of whom, by their signatures, **certify under penalties of perjury that the report, including all attachments, is true and accurate.**” (¶ 545)

“Defendant NRA made **materially false and misleading statements and omissions** in its 2015, 2016, 2017, and 2018 CHAR500 filings with the Attorney General. These statements included, but were not limited to

- **false statements about compensation and benefits for officers and directors,**
- **false statements about diversion of corporate assets,**
- **false statements about enforcement of its conflict of interest policy,**

- **false statements about its processes for determining compensation of officers,**
- **false statements about compensation and benefits to directors,**
- **false statements about compensation policies and reviews,**
- **and false statements about transactions with interested persons.” (¶ 547)**

# **PRIMACY OF THE IRS FORM 990**

## **TRAPS FOR THE UNWARY**



“In its Forms 990 for 2015, 2016, 2017, and 2018, the NRA falsely reported that it was not a party to business transactions with current or former officers, directors, relatives thereof or entities affiliated therewith and failed to disclose those transactions on Schedules L and/or R of its IRS Forms 990. As set forth above, the NRA has been a party to multiple business transactions with current or former officers, directors, relatives thereof or entities affiliated therewith that the NRA failed to report.”

“In its Form 990 for 2018, Defendant NRA answered "No" to the question "Did the organization become aware of a significant diversion of the organization's assets." This statement was false, since the organization did become aware of significant diversions through whistleblower reports and its own inquiries into billing by Ackerman [Ackerman McQueen, the NRA's public relations and advertising marketing firm] and McKenna [consulting firm, McKenna & Associates].”

“In its Forms 990 for the relevant time period, Defendant NRA answered "Yes" to the question "Did the organization regularly and consistently monitor enforcement with [its conflict of interest policy]." Based on the evidence gathered in the Attorney General's investigation, as set forth above, this statement was false, as Defendant NRA repeatedly permitted violations of its conflict of interest policy, including, without limitation, by Defendant LaPierre.”

“In its Forms 990 for 2015, 2016, 2017, and 2018, Defendant NRA answered "No" to the question "Did the organization engage in an excess benefit transaction with a disqualified person during the year?" In fact, Defendant NRA engaged in multiple excess benefit transactions, including without limitation the compensation paid to Defendants LaPierre and Powell, and a former President.”

“In its Forms 990 for the relevant time period, the NRA filed false and/or materially incomplete responses on Schedule J, which reports information on compensation for officers, directors, key employees, and highly compensated employees, including without limitation:

1. Failing to report that the NRA paid for travel for companions until its 2018 Form 990, when in fact the NRA repeatedly paid for travel for LaPierre's wife and other family members;
2. Failing to report that it provided a housing allowance until its 2017 Form 990, when in fact it paid for housing for certain officers.”

“In its Forms 990 for 2015, 2016, 2017, and 2018, Defendant NRA made false statements in Part VI, line 16 about its process for determining the compensation of officers and directors.”

“In its Forms 990 for the relevant time period, the NRA failed to disclose in response to question 25a in Part IV of the IRS 990 for each relevant year that it engaged in an excess benefit transaction with a disqualified person during the year, and failed to file Form 4720 reporting such transactions pursuant to Section 4958 of the Internal Revenue Code, which governs excise taxes for excess benefit transactions.”

“In its Forms 990 for at least 2014 to 2018, the NRA failed to disclose taxable personal income for LaPierre, Phillips, and Powell. For example, as set forth above, LaPierre and Phillips permitted NRA executives and personnel to use vendor credit cards, alter ego accounts, and vendor charges to disguise payments to LaPierre, on LaPierre's behalf, for LaPierre's personal benefit, and as reimbursements of LaPierre's personal and family expenses, inconsistent with the reporting requirements of Section 527 of the Internal Revenue Code.”

“In its Forms 990 for the relevant time period, Defendant NRA failed to disclose the complete amounts paid to LaPierre in the form of gifts from vendors, "out of pocket" expenses originally paid for by Ackerman [Ackerman McQueen, the NRA's public relations and advertising marketing firm] and then paid for by the NRA [reimbursing Ackerman in an effort to hide the compensation to LaPierre], and other forms of compensation.”



## **“VIII. The NRA's Violation of its Duties under the New York Prudent Management of Institutional Funds Act”**

“Under NYPMIFA, the obligations of the NRA are also **imposed upon the governing board of directors** of the NRA.”

“In managing institutional funds, pursuant to NYPMIFA, the NRA must manage institutional funds in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.”

- “The NRA, during the period 2015 to the present, did not manage its institutional funds in good faith, or with the care and prudence an ordinarily prudent person would exercise under similar circumstances.”
- “The NRA has failed to incur only costs that are appropriate and reasonable in relation to its assets and the purposes of the NRA.”

- “The NRA has failed to make reasonable efforts to verify facts relevant to management of its institutional funds.”
- **“The NRA has failed to make reasonable efforts to keep its Board and relevant committees of the Board apprised** of the financial status, risks, and commitments of institutional funds.”

- ❑ “The NRA has permitted its **Audit Committee** to fail to evaluate or report on the requirements of NYPMIFA, and the NRA's compliance with those requirements.”
  
- ❑ “The NRA has permitted its **auditor** to fail to evaluate or report on the requirements of NYPMIFA, and the NRA's compliance with those requirements.”

- ❑ “The NRA has **failed to assure that institutional funds are not subject to waste or misappropriation.**”
- ❑ “The NRA has engaged "faithless fiduciaries" including Defendants LaPierre, Powell, and Phillips, who were given authority to manage and invest institutional funds, but failed to do so prudently.”

- “The NRA has committed the NRA to undertake **undisclosed future obligations to senior executives**, including a **ten-year post-employment obligation to Defendant LaPierre** at an amount per year in excess of **\$1 million**, a **no-show consulting contract** with Defendant Phillips, and a no-show consulting contract with the former Executive Director of General Operations.”

# **GOVERNANCE: IT'S NOT ROCKET SCIENCE!**

# Traps for the Unwary

## Annual Financial Report:

- Mandated by §519 and §513 of the N-PCL
- Specific information required by law



## Annual Financial Report Timing Trap

- The annual financial report requirement mandates that the financial information presented be for a twelve-month fiscal period terminating not more than six months prior to the meeting
- So, if your fiscal year is the calendar year, then for your financial information not to be stale, you need to have your annual meeting, and present the annual financial report, before the end of June

- ❖ Because of this rule, June tends to be my busiest month of the year, as many of my clients schedule their annual meeting in June to maximize the amount of time their accountant has to prepare the financial data, but still meet the “not older than 6-month requirement.”

## Traps for the Unwary

*continued*

- ED's and board chairs tell me that their inclination is to cut back on the amount of information flowing to directors and the length of meetings.
- Conscious effort to keep meetings held via videoconference more manageable.
- Assumption that too much information, and meetings that are too lengthy, are less tolerable in video format than in person.  
– *continued . . .*

## Traps for the Unwary

*continued*

- An understandable adjustment, but this is a dangerous dynamic.
- **Timely and adequate flow of information to the board is required for the board's mandatory oversight function.**
  - **Unintended Consequence: breach of fiduciary duty claim.**

## More Traps for the Unwary

*continued*

### Email voting by the board of directors – another impermissible shortcut to avoid

- ✓ There are only 2 ways for the board to act under the law:
  1. At a meeting (which can be in person; by conference call; or by videoconference);
  2. By unanimous consent in lieu of a meeting (which can be email or written)
    - Must be unanimous (≠ voting)
  
- ✓ Effect of missteps

# DOCUMENTING CORPORATE ACTION & COMPLIANCE

As important now as ever; no dispensation for extraordinary circumstances

## Minutes, Minutes, Minutes

➤ Too much detail

➤ Too little detail

➤ Checklist to demonstrate that the board fulfilled its fiduciary duties

## Conflicts & Related Party Transactions (annual + ongoing)

## Effect of missteps

# **GOVERNANCE: IT'S NOT ROCKET SCIENCE!**

- ✓ Process, Process, Process
- ✓ Procedures
- ✓ Mandatory Requirements
- ✓ Board Education
- ✓ Awareness Even Under Extraordinary Circumstances
- ✓ Discipline & Commitment to Compliance



## CENTRAL ROLE OF BYLAWS

- Bylaws: contract between the organization and the board (and members, if applicable) as to how the organization will operate
- Bylaws are rules by which legitimate corporate decisions are made
- Following these rules is a roadmap to protect directors from breach of fiduciary duty allegations
- Not reviewed by the State – so amendments can be too easy!

- ✓ *Always follow the roadmap that your Bylaws provide!*
- ✓ *Make sure that your Bylaws are consistent with the Not-for-Profit Corporation Law of the State of New York!*
  - Bylaws should be drafted by an attorney; no changes except by an attorney
- ✓ *Failure to strictly adhere to requirements of Bylaws, or having Bylaws that are inconsistent with the law, is a **breach of the Duty of Obedience**. Consequences can include undermining the validity of corporate decisions and actions.*
- ✓ *Governance mistakes in these areas are another potential trap for nonprofit directors & officers*

# Risks of governance mistakes in these areas:

- **Board decisions can be challenged as illegitimate**
- **Breach of duty & personal liability**

➤ **N-PCL TRAP**

**(Examples: supermajority requirement for officer compensation; executive committee; supermajority quorum for removal; member notice; notice requirements for dissolution)**

➤ **PROCESS TRAP**

**(Required filings; amend purposes; mission statement in Bylaws)**

# **GOVERNANCE: IT'S NOT ROCKET SCIENCE!**

# COMMITTEES

## ➤ Board Committees

Examples: Executive; Audit; Nominating & Governance; Development

- At least 3 directors
- Only board members can vote

## ➤ **Committees of the Corporation**

- Misnomer
- **Advisory only**

Who is on the committee

Description of responsibilities:

✓ Charter, board resolution or Bylaws

# ADEQUATE OVERSIGHT

- Adequate Oversight  $\neq$  trust
- Volunteers doing good
- Smart and accomplished board
  - ✓ Dowling; Adelphi



# OVERKILL

## ➤ Provisions that are too demanding

-- examples

- ✓ Bylaws: frequency of meetings; quorum
- ✓ Conflicts Policy: application too broad in terms of covered persons