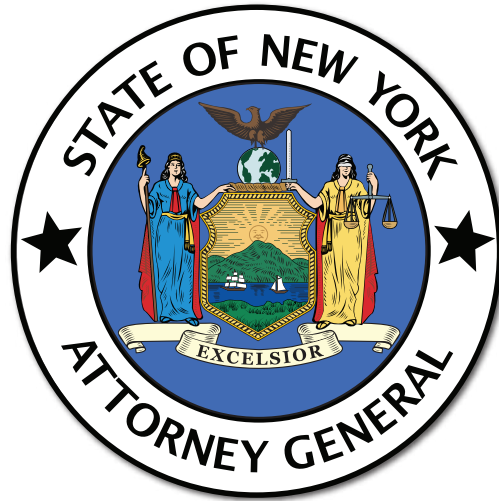


# RIGHT FROM THE START: RESPONSIBILITIES of DIRECTORS of NOT-FOR-PROFIT CORPORATIONS



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The Charities Bureau of the Office of the New York State Attorney General drafted this guidance to assist current and future boards of directors of not-for-profit corporations and trustees of charitable trusts to understand and carry out their fiduciary responsibilities to the organizations they serve. The information in this booklet reflects changes to the Not-for-Profit Corporation Law that were included in the Nonprofit Revitalization Act of 2013.

Charitable organizations contribute enormously to our society. They educate our children, care for the sick, find cures for disease, preserve our literature, art and music for us and future generations, house the homeless, protect the environment and much more. The fiduciaries of those charitable organizations are responsible for managing and preserving the charitable assets that benefit all of us. Whatever their mission or size, all organizations should have policies and procedures established so that (1) members of their boards understand their fiduciary responsibilities, (2) assets are managed properly and (3) the charitable purposes are carried out. A failure to meet these obligations is a breach of fiduciary duty and can result in financial and other liability for the board of directors.

Please read this booklet carefully. It contains general information to assist current and prospective members of nonprofit boards. It outlines some of the duties of board members and points out questions to ask and information to look for when considering and/or fulfilling the responsibilities of board membership. The Charities Bureau also publishes other guidance containing more detailed information on managing a charitable organization and overseeing its assets. That guidance and other publications of interest to board members are posted at [www.charitiesnys.com](http://www.charitiesnys.com).

This guidance is designed to assist board members by providing them with basic information. It is not a substitute for more detailed information or advice from an attorney, independent certified public accountant or other professional.

### ► . WHO MAY JOIN A BOARD?

Board members come from all backgrounds, bringing many different talents to the organizations they serve. Anyone over eighteen is legally qualified to serve on a board.

### ► WHAT SHOULD A PROSPECTIVE BOARD MEMBER KNOW BEFORE JOINING A BOARD?

Anyone thinking about joining a board should consider doing the following *before* joining:

√ Read the organization's certificate of incorporation, application for federal income tax exemption, by-laws and board and committee minutes for at least the last year to learn about its purposes, activities and concerns.

√ Obtain a current list of board and committee members and find out from the board chair and the organization's chief executive and financial officers what is expected of board members.

√ Talk to current and recent former board members to learn about what the board does. In addition, make sure that the board and committee meetings are usually well-attended.

√ If you know of any board members who recently left the board, see if you can find out why.

√ Review the organization's Internal Revenue Service Form 990, 990EZ or 990 PF and, if it has an outside auditor, its audited financial statements for at least the last two years as well as its current internal financial reports to see how the organization uses its assets and to evaluate its financial health. Ask some questions - Is its auditor's report on its financial statements unqualified? Has the auditor sent the organization a management letter identifying issues of concern? Has the Internal Revenue Service recently audited the organization? If so, what was the result to the audit?

√ Obtain an understanding of the internal control structure of the organization and the processes in place to monitor it.

√ Find out if the organization is required to register with the Attorney General's Charities Bureau and, if so, whether it has registered and filed all required reports. Find out if it has filed required reports with the IRS and any other government agencies.

√ Understand the organization's mission, learn about its programs, read its publications, visit its program sites, look at its website and talk to key staff and major donors. Find out about its reputation in the community.

√ Review the organizational chart and understand the accountability structure of the organization. Find out about the employee evaluation and compensation processes and due diligence procedures for entering into material contracts.

√ Make sure there is a conflict of interest policy and that it is provided to and signed by new directors and before they join the organization, and annually to directors, officers, and employees for review and signature annually. Find out how the organization addresses actual or potential conflicts.

√ Find out what committees the board has established and decide which (if any) to join. Make sure the committees appear to be sufficient (audit, investment, budget, finance, compensation, human resources, nominating, governance, etc.). Under New York's Not-for-Profit Corporation Law, corporations required to file an audit with the Attorney General's Charities Bureau must have an audit committee made up of independent directors or the board must assume that function with only independent members participating. Independent directors are members of the board who are not paid by the organization and neither they nor their family members have any financial relationship with the organization.<sup>1</sup>

√ Find out if materials to be considered by the board or its committees are distributed in advance of meetings and whether they provide sufficient information necessary to be part of the stewardship process. Find out how the meetings are structured: by consent agenda or other means.

√ Obtain the current year's budget and cash flow projections. Find out how they compare to actual income and expenses and what processes are in place to monitor these comparisons.

√ Find out whether the insurance coverage appears to be appropriate, including Directors' and Officers' liability and employee fidelity insurance. The latter is particularly important - it is surprising how often embezzlement is discovered.

√ Most important, make sure you are able to devote the time expected of a board member. Understand any responsibilities for fundraising, personal giving commitments and other functions expected of board members. Joining a board without sufficient time to devote to its business is often at the root of troubles faced by boards. A decision to

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<sup>1</sup> Section 102(a)(21) of the Not-for-Profit Corporation Law sets forth the definition of Independent Director.

decline an invitation to join a board because you don't have the time to devote to the board should be respected.

√ Learn what training (if any) is provided to board members.

## ► **WHAT ARE THE DUTIES OF BOARDS OF DIRECTORS?**

Most nonprofit organizations are created to achieve a specific purpose or purposes, such as making grants to operating charities, setting up a soup kitchen, teaching children to read, providing health care, supporting cultural institutions, preserving the environment, assisting senior citizens or one of the many thousands of other charitable activities conducted in our state and our country. Those purposes, or the mission of the organization, may be described in its certificate of incorporation, by-laws or other constituent document.

If an organization's purposes are not already clearly included in one of its organizational documents, one of the first activities of the board should be to draft a clear mission statement which should correspond to the purposes described in its certificate of incorporation and application for tax exemption submitted to the Internal Revenue Service. Everyone involved with the organization - directors and officers, employees, volunteers, fundraising professionals, and other professionals – should be familiar with and understand its mission. Those individuals plan its future, conduct its programs, raise its funds, make it known to the public, present its financial records to regulatory agencies and others and give it professional advice.

Unless they fully understand why the organization was formed and what it plans to accomplish, board members will not be able to perform their respective tasks appropriately. The mission should be periodically re-assessed and evaluated and amended as needed. Periodic review of an organization's structure, procedures and programs will assist board members in determining what is working well and what practices the organization might want to change in order to be more efficient, effective or responsible.

While the board is not usually involved in the day-to-day activities of the organization, it is responsible for managing the organization and must make decisions crucial to the life and direction of the organization, such as adding or removing board members, hiring and firing key officers and employees, engaging auditors and other professionals and authorizing significant financial transactions and new program initiatives. In carrying out those responsibilities, members of a board of directors must fulfill fiduciary duties to the organization and the public it serves.

Those primary legal duties are commonly referred to as the duties of *care*, *loyalty* and *obedience*. If the organization has affiliates or subsidiaries, the legal duty of impartiality and the duty of fairness to all the charitable interests, may also come into play.

## ● Duty of Care

The *duty of care* requires a director to be familiar with the organization's finances and activities and to participate regularly in its governance. In carrying out this duty, directors must act in "good faith" using the "degree of diligence, care and skill" which prudent people would use in similar positions and under similar circumstances. In exercising the duty of care, a responsible board of directors should, among other things, do the following:

√ The directors as a group, and the officers of the corporation, should exercise their responsibility to undertake reasonable efforts to assure that the organization is operating in compliance with the law. For directors, this means assuring that there is an effective compliance program reporting ultimately to the directors, that there is a policy for protection of whistleblowers which has been communicated to employees, that there are effective internal controls, that there is an effective external audit by an independent auditor, and that allegations of violations of law are investigated and addressed. (Although New York law only requires organizations with over 20 employees and over \$1 million in revenue to have a whistleblower policy, smaller organizations might find it helpful to adopt such a policy as well.)

√ Attend board and committee meetings and actively participate in discussions and decision-making, such as setting of policies. Carefully read the material prepared for board and committee meetings prior to the meetings and note any questions they raise. Allow time to meet without senior management present.

√ Read the minutes of prior meetings and all reports provided, including financial statements and reports by employees. Do not hesitate to suggest corrections, clarification and additions to the minutes or other formal documents.

√ Make sure to get copies of the minutes of any missed committee or board meeting, read them timely and suggest any changes that may be appropriate.

√ Make sure there is a clear process for approval of major obligations such as fundraising, professional fees (including auditors), compensation arrangements and construction contracts.

√ Make sure that board minutes reflect any dissenting votes in action taken by the board or that any dissenting vote is expressed in writing by letter to the board. Such records are necessary in order for a board member to disclaim responsibility for any particular decision. Absent board members must do this promptly in writing.

√ Read literature produced as part of the organization's programs.

√ Make sure that monthly financial reports prepared for management are available to the board or finance and audit committees, and that they are clear and communicate the information needed for proper stewardship. Make sure there is an ongoing actual to budget comparison with discrepancies explained.

√ Participate in risk assessment and strategic planning discussions for the future of the organization.

√ Ensure that the organization has addressed the sufficiency of its written internal financial controls and written policies that safeguard, promote and protect its assets and that they are updated regularly, and has considered an employees', officers' and directors' fidelity bond to protect the organization from embezzlement.

√ Assure that the organization has a background check policy for prospective employees.

√ Determine whether or not the organization indemnifies its officers and directors from liability and has directors' and officers' liability insurance. If it does, find out what is covered and what is not. If it does not, find out why.

√ Encourage diversity among board members. Diversity will help insure a board committed to serve the organization's mission with a range of appropriate skills and interests.

√ Be involved in the selection and periodic review of the performance of the organization's Chief Executive Officer, Chief Financial Officer and other key employees responsible for the day-to-day activities of the organization. The board is responsible for ascertaining whether these individuals have the appropriate education, skills and experience to assume a key position; communicating duties, expectations and goals; and then evaluating their performance at least annually, first in an executive session and then with the officer directly.

### ● **Duty of Loyalty**

Directors are charged with the duty to act in the interest of the corporation. This duty of loyalty requires that any conflict of interest, real or possible, be disclosed in advance of joining a board and when they arise. So that all members are aware of - and avoid - transactions in which the nonprofit's interests are not primary, New York law requires nonprofits to have a written "conflicts of interest" policy. Among the provisions that should be included in such policies are provisions that:

√ Define the circumstances that constitute a conflict of interest;

√ Set forth procedures for disclosing a conflict of interest to the audit committee or the board;

√ Prohibit anyone with a conflict of interest from being present during or participating in the deliberation, voting on the issue that resulted in the conflict, or influencing the deliberation or vote on the issue that resulted in the conflict;

√ Require the nonprofit to document the existence and resolution of each conflict;

√ Require directors to sign annually a statement that identifies entities in which they serve as an officer, director, trustee, member, or employee and with which the corporation has a relationship; as well as any transaction of the nonprofit in which the director might have a conflicting interest.

### ● **Duty of Obedience**

A board has a *duty of obedience* to ensure that the organization complies with applicable laws and regulations, its mission and its internal governance documents and policies, including:

√ Dedicating the organization's resources to its mission.

√ Ensuring that the organization carries out its purposes and does not engage in unauthorized activities.

√ Complying with all appropriate laws, including registering and filing annual financial reports with the Attorney General's Charities Bureau in New York State, complying with similar laws in other states in which it conducts activities and/or solicits contributions, filing required financial reports with the State Worker's Compensation Board, the State Department of Taxation and Finance and the Internal Revenue Service; and paying all taxes such as Social Security, income tax withholding (federal, state and local) and any unrelated business income tax. Board members may be personally liable for failing to pay employees' wages and benefits, and for failing to withhold, escrow and pay over to state and federal authorities withholding taxes on employees' wages.

√ Providing copies of its applications for tax-exempt status (IRS Form 1023), federal reports (IRS forms 990, 990 PF, 990 EZ) and its financial reports filed with the Attorney General's Charities Bureau to members of the public who request them. Many organizations post their annual reports and other information on the Internet.

### ► **MONITOR FUNDRAISING CONDUCTED ON BEHALF OF THE ORGANIZATION**

Many organizations contract with outside organizations or individuals to raise funds on their behalf. Since the fundraiser represents the organization to the public, the selection of a fundraising professional is extremely important. Establishing and following procedures for selection of a fundraiser can avoid future problems. Board members



should assess whether management has undertaken reasonable procedures to protect the organization, including:

√ Obtaining bids from several fundraising professionals before entering into a contract. Services and fees differ, and comparing bids will aid in the selection of the best contractor for the organization.

√ Checking with the Attorney General's Charities Bureau to see if the fundraising professionals being considered are registered and have filed all required contracts and financial reports.

√ Asking the Charities Bureau for copies of the fundraising professional's contracts with other charities to determine the services performed for and the fees charged to those charities.

√ Asking the fundraising professional for references. Reputable fundraising professionals should be happy to provide a potential client with the contact information for some of its clients.

√ Contacting some of the fundraising professional's other clients to see if they were satisfied with the services received.

√ Finding out whether the organization's fundraising contracts contain the clauses required by Article 7-A of the Executive Law.

√ Reviewing written solicitations and scripts used by the fund raising professional to make sure that solicitations appropriately describe the organization and its activities, include the name of the organization as registered with the Attorney General and advise potential contributors that they may obtain the organization's financial report from the organization itself or from the Attorney General.

√ Requiring, as mandated by New York law, that the fundraising professional and any of its representatives ("professional solicitors") disclose the name of the specific professional solicitor and the employing fundraising professional and state that the solicitor is being paid to raise funds.

√ When considering engaging a fundraiser to solicit via the telephone, reviewing *Pennies for Charity*, the Attorney General's annual report on telemarketing by professional fundraisers, to see the results of those fundraisers' campaigns.

#### ► MAKE USE OF AVAILABLE RESOURCES

In carrying out their responsibilities, board members should realize that they need not do it alone. Board members should consider the need for advice from professionals or experts to assist them in the performance of their duties, and make appropriate requests

for such advice. There are many other resources available to assist nonprofit organizations in fulfilling their fiduciary duties.

Following are some of those resources:

√ **The Attorney General's Web site** – [www.charitiesnys.com](http://www.charitiesnys.com) - posts all forms and instructions for registration and annual filing with the Charities Bureau and publications of interest to nonprofit organizations, including guidance on the Nonprofit Revitalization Act of 2013.

√ **Contact Us** - If the material on the Attorney General's web site does not answer your particular questions -

For questions about nonprofit organizations, contact:  
[charities.bureau@ag.ny.gov](mailto:charities.bureau@ag.ny.gov) or (212) 416-8401

For questions about fundraising professionals, contact:  
[charities.fundraising@ag.ny.gov](mailto:charities.fundraising@ag.ny.gov) or (518) 776-2160

√ **Other Helpful Web Sites** - Many more resources are available on the Internet and in communities around the state. Links to some of those resources are posted on the Attorney General's web site – [www.charitiesnys.com](http://www.charitiesnys.com) Please note that inclusion of any particular entity should not be construed as an endorsement by the Attorney General of that entity or the services it renders.