LEGAL RESPONSIBILITIES OF BOARD MEMBERS

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  - ✓ Be a 501(c)(3) nonprofit organization.
  - ✓ Be located in or serve the greater Atlanta area.
  - ✓ Serve low-income or disadvantaged individuals.
  - ✓ Be unable to afford legal services.

- ***Visit us on the web at www.pbpatl.org***
- **Host free monthly webinars on legal topics for nonprofits**
  - ✓ To view upcoming webinars or workshops, visit the Workshops Page on our website

AGENDA

- **Chapter 1: Some Basic Nonprofits and Directors**
  - Nonprofit – 501(c)(3) Organization
  - Main Documents: Articles and Bylaws
  - Legal Constituents: Members, Directors, Officers
  - How the Board of Directors Acts
- **Chapter 2: The General Duties of Directors**
  - Duty of Care – Active and Informed Decision Making
  - Duty of Loyalty – Best Interest of the Corporation
  - Duty of Obedience - Faithful to the Corporation's Mission
- **Chapter 3: Liability of and Protection for Directors**
  - Who Can Bring an Action Against Directors
  - Indemnification Obligations of the Corporation
  - Insurance

Chapter 1: Nonprofit – What Is It?

- **What Is It?**
  - Public charity recognized by the IRS (most common 501(c)(3) captures: religious, charitable, educational, literary scientific, prevention of cruelty to animals and children, fostering amateur sports, and testing for public safety purpose)
  - Must be **Organized** and **Operated** for charitable purpose
- **Benefits**
  - No Federal Income Tax and Maybe No State and Local Tax
  - Contributions by Donors are Tax Deductible
  - Grant Qualifications
- **Restrictions**
  - No Substantial Unrelated Business Activity
  - No Private Inurnment
  - No Substantial Lobbying
  - Absolutely no Political Campaign Activities

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Chapter 1: Main Documents: Articles and Bylaws

- **Articles of Incorporation**
  - ➢ Filing with Secretary of State Creates the Corporation
  - ➢ Important Provisions (Georgia Nonprofit Code)
    - → purpose and activities
    - → distribution of assets upon dissolution (charitable purpose)

- **Bylaws**
  - ➢ Rules Adopted to Govern the Corporation and its Constituents, including:
    - → number, term, powers, election, removal and succession of directors
    - → calling of meetings, quorum and voting rights
    - → board committees
    - → officers (titles and descriptions)
    - → indemnification and insurance

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Chapter 1: Legal Constituents

- **The Members:** Voting, Cosmetic, None at All

- **The Board of Directors**
  - Direct: Business affairs to be managed under direction of Board
  - How: In furtherance of the mission of the corporation
  - Examples:
    - → establish mission; create strategic plan to further mission; monitor and review actions of corporation with a view to the mission
    - → hire competent executive director and management team to implement strategic plan and mission
    - → seek and appoint competent board members
    - → create policies (conflict of interest, ethics code, document retention)

- **The Officers**
  - Directors may name such officers as they want (must have secretary)
  - Manage the day-to-day business and implement the Board's policies and plans
    - → sign contracts on behalf of corporation

Chapter 1: How the Board Acts

- Board acts by consensus at a duly called meeting (mostly majority) or by unanimous written consent
- No individual director has power or authority to act alone simply by virtue of being on the board
- Board may delegate authority to act to committees (audit committee; compensation committee), but ultimately remains responsible

Chapter 1: Director to Do List

Questions to be asked by new directors and for all others at least annually (in consultation with accountants and counsel):

- Is my organization a 501(c)(3) and exempt from federal income **tax**? If not, have we informed donors that their contributions are not tax deductible? Who prepares tax filings? Who makes IRS Form 990 (informational tax returns) available to the public? Does that person keep the board updated and informed?

- Does the board monitor **restricted activities** that may jeopardize the non-exempt status (unrelated business activities, lobbying etc?) and is the staff aware of these restrictions?

- Do the **bylaws** conform with current mission statement and activities of the organization? Are director liability and indemnification provisions up to date? Is the current number of directors and officers in accordance with bylaws? Are board meetings conducted in accordance with bylaws and records kept? Are officer positions and duties accurately described?

- Is there a single and consistent **mission statement** in all of the corporate documents as well as public and marketing materials? Does it still fit? Do all directors and staff know what it is?

- What **policies** do we have in place, (conflict of interest, document retention, etc.) and who monitors awareness and compliance?

- Does the Board have **committees** and what are their roles/powers?

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Chapter 2: Duty of Care – Active and Informed Decision-Making

“the amount of care that an ordinarily prudent person would exercise in a like position and under similar circumstances” when making a decision

- Be Reasonably Informed
- Participate in Decision
- Exercise Independent Judgment and Act in Good Faith and in Furtherance of Mission

BEFORE you approve an action or make a decision, ASK YOURSELF: Do I have enough information? Did I attend the meeting? Did I ask questions and independently evaluate the information provided to me? THEN make the decision in good faith and what you believe to be in the best interest of the organization and in furtherance of your organization’s MISSION

DOCUMENT!

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- **Be Reasonably Informed and Participate in Decisions**

  - **Know the Basics About Your Organization as Discussed in Chapter 1**
  - **Monitor your Organization's Activities Against Those Basics**
  - **Schedule Regular Meetings of the Board and its Committees**
    - → Receive reports and data from staff, accountants etc. BEFORE meetings and review (e.g. financial reports, fundraising activities) – no surprises at the meeting!
    - → Limit sporadic information flow between meetings
    - → Do not allow selective distribution of information to single board members (exception: committees and single task authorization)
    - → Have a policy of removal for directors who miss a certain percentage of meetings

Example: Sale of Old Daycare Facility

The daycare center will soon move into its new facility and the Board has authorized and directed the Executive Director to engage a real estate broker and put the old facility up for sale. The Executive Director receives an offer and calls a special telephonic board meeting in accordance with the bylaws.

Before you accept the offer, ask for information and a copy of the offer (ideally, the Executive Director will have provided you with everything for your review before the meeting). Who is the buyer, how do we know the price is fair, do we take on any risks by signing this contract, can we sell the building and use the proceeds without violation our exempt status?

Document the decision the Board makes and the considerations of the Board in reaching that decision in a resolution or by unanimous written consent – seek assistance of counsel if you have any questions about drafting good minutes

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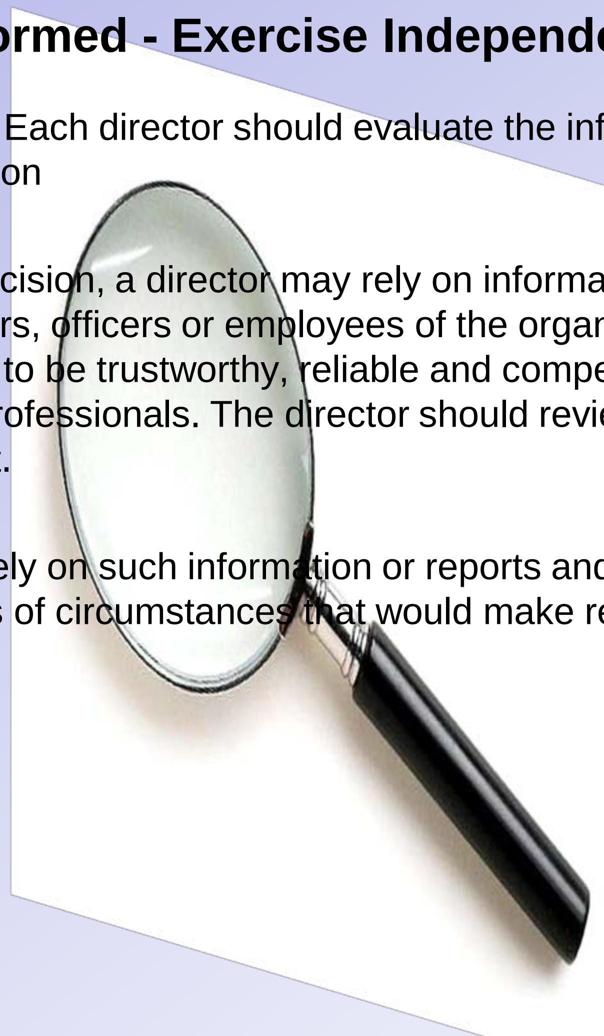
- **Once You Are Informed - Exercise Independent Judgment**
  - What do you think? Each director should evaluate the information received and come to his/her own conclusion
  - In making his/her decision, a director may rely on information and reports prepared by his/her fellow board members, officers or employees of the organization, as well as outside sources it reasonably believes to be trustworthy, reliable and competent, such as accountants, legal counsel and other professionals. The director should review and evaluate such information before acting upon it.
  - A director may not rely on such information or reports and will not be acting in good faith where he/she knows of circumstances that would make reliance upon such information unreasonable.



Example: Hiring of Executive Director

Your organization needs a new Executive Director. Your chairman of the board has the perfect candidate whom he/she thinks will take the organization to the next level. He/she has known the candidate for years and urges you to just trust him/her on this one. The candidate will require a salary of $150,000, but in her current job is making twice that and you are assured that she is well worth the money.

Should you approve the hire relying solely on your chairman’s opinion that the candidate is “just great” and this will be the best thing the organization ever did?

After you ask some questions about the candidate and one of the members does some research on the salary range for this kind of position, it turns out that this candidate has no previous experience running an organization like yours and the typical salary for others in similar positions is $70,000.

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Chapter 2: Duty of Loyalty – Best Interest of the Organization at All Times

- **Conflict of Interest**
  - Act with the organization's interest in mind, not your own. Be aware of situations where you or another director may have a personal interest in a decision to be made by the Board, which interest could cloud your undivided loyalty to the organization. <u>Recognize, disclose and abstain</u> from the decision-making process when you have a personal interest, for example in a proposed transaction with the organization.

- **Corporate Opportunity**
  - Do not take an opportunity for yourself that otherwise would have belonged to the organization. If you learn of an opportunity that is of interest to you, but that may also be of interest to the organization, offer it to the organization first. Only take it, if the Board has declined such opportunity.

- **Confidentiality – Keep It**

Conflict of Interest

Entering into a transaction in which a director has a personal interest is not an offense per se. The law recognizes that conflicts will arise and prescribes a certain matter to deal with them, which, if followed and documented correctly, in most instances will shield the interested and non-interested directors from liability.

- **Recognize -** Fill out annual director questionnaires and review conflict policies.
- **Disclose -** Let the other directors know immediately so they can take action.
- **Abstain** - Do not participate in the decision-making process and do not vote on the matter in which you have an interest. Excuse yourself from the room.
- **Document –** Record and describe disclosure and approval process in the board minutes.

If procedures are followed and the transaction is approved in good faith and a well informed decision is made by the non-interested directors, a court will most likely not second guess the decision made. If the process is not followed and the transaction is challenged, the burden of proof for showing that the transaction was fair and at arm’s length is on the board.

Note that transactions with related parties may have to be reported to the IRS.

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Example: Overpriced Building Purchase

Your organization acquires a building from ABC Company for $1 million dollars, without researching the fair market value or hiring a real estate broker to run comparables. After the fact, the board finds out that the husband of the Board Chair is one of the owners of ABC Company and that the building's fair market value is only $900,000.

Duty of Care: Not informed decision-making.

Duty of Loyalty: Undisclosed Conflict of Interest by the Board Chair – if transaction is challenged, directors have to show that it was fair.

Taxes: In Related party transactions, the IRS may impose and excise tax on the Board Chair and the directors who approved transaction.

Example: Sale of Daycare Facility – Modified

This time, not the Executive Director is in charge of the sale of the old facility, but two board members, one of whom is a real estate broker, as a committee of the Board.

The Board, after receiving and evaluating numerous offers from listing brokers to list the property, gave the listing of the old facility to their board member/real estate broker, because his contract terms were more favorable than the others and he offered a reduced commission. This decision was made without the real estate broker/board member and well documented in the minutes for the meeting.

The organization is in need of cash to continue to serve its mission and decided to price the facility just slightly below market value for a quick sale.

After three months the organization has not received a single offer on the facility. To help out the organization, but also realizing that he is getting a great deal, a board member offers to buy the facility for slightly less than asking price.

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Example: Several Board Positions

X is well known in the community and was asked by three organizations to be on their respective boards. He accepted all three positions. Two of the organizations ask him to serve as the chair of the fundraising committee. X is aware that both organizations are asking some of the same institutions for donations and are competing for a distinct pool of money.

Example: Lease of Facility from Board Member

The organization is growing and needs to expand its facility. One of the board members just had a tenant move out of a building that seems perfect and the board approves that the organization lease the space from the board member.

Example: Marketing Materials – Giving Jobs to Friends of the Board

You have a big event coming up and your printer just went out of business. You must find someone to print your marketing and event materials immediately. One of your board members has a good friend who is in the business and after calling in a “favor” the friend agrees to take the sizeable job. Prices are not discussed and no other bids are solicited, because there is just no time.

Corporate Opportunity

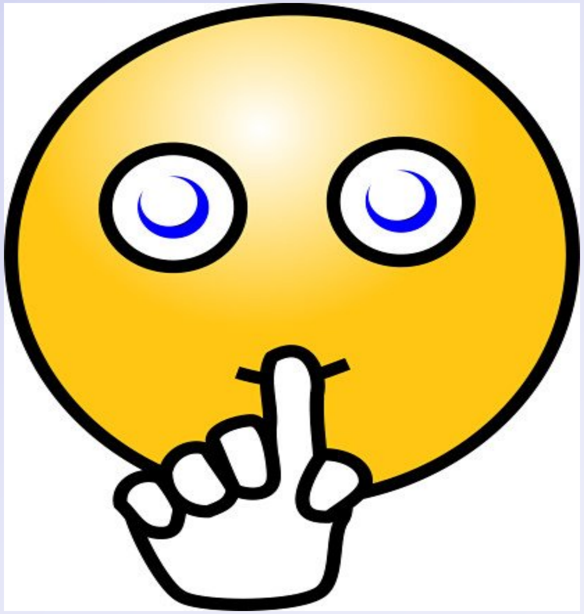
Before a director engages in a transaction that he should reasonably know to be of interest to the organization, he should disclose the transaction and offer it to the organization first. He should only engage in the transaction after the board declines the opportunity (document!).

Example: Lease of Facility – Modified

The Executive Director of the daycare center informs the board that the organization is outgrowing its current space and needs to move. The Board appoints a committee consisting of board members X and Y to find new space to lease or potentially buy. Board member X owns a tutoring school for high school students and has been looking for space to move to for six months now. Her business is going great and is busting out of its seems. One afternoon, board member X gets a call from a friend who heard that board member X is in charge of looking for new space for the daycare center. The friend knows of a great place. After inspecting the place, board member X decides that the daycare center would probably not want it because it is slightly over the set budget, but the space is so phenomenal that she decides to rent it for her own tutoring business.

Confidentially

A director should not disclose information about the organization and its business activities unless that information is already known to the public.



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Chapter 2: Duty of Obedience

The duty of Obedience is a special duty applicable to directors of nonprofits. It requires that directors **are at all times faithful to the mission of the organization** and that their actions are always consistent with the mission. Directors' actions must comply with the mission statement, the governing documents of the organization (Articles and Bylaws) and all tax exemption filings and requirements. Directors must not commit acts that under those documents or under the law are beyond the scope of the organization's powers.

- **Chapter 1: Know your non-profit documents, mission and restriction on activities that could endanger your tax exempt status.**

Chapter 3: Liability of and Protection for Directors

- **Who can bring an action against a Director for violation of his/her fiduciary duties?**
  - Members/Directors - Derivative Action/Damages
  - Attorney General - Oversees organization on behalf of donating public to carry out mission and use funds wisely
  - IRS - Sanctions/Loss of Exemption
- **Indemnification Obligations of the Corporation**
  - State law/Bylaws
- **Insurance**

BE INFORMED – SPEND TIME – CARE

- Read and be familiar with and periodically review your organization's Articles and Bylaws
- Be an active and critical board member, attend regular board meetings, ask questions and keep good minutes
- Understand the nonprofit basics and what is necessary to preserve your tax-exempt status
- Monitor your operations against the content of your articles, bylaws, tax-exempt restrictions, your policies and your MISSION
- Implement internal financial controls

ACT IN THE BEST INTEREST OF THE ORGANIZATION - NOT YOURS - BE LOYAL

- Know a conflict of interest when you see one; implement and follow strict procedures; disclose, abstain and document!
- No private inurnment or taking away an opportunity that belongs to the organization

For More Information:

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