Nonprofit Twists and Turns:

Governing Effectively and Avoiding Trouble

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Overview

1. Big Picture – Governance
2. Fiduciary Responsibilities
3. Potential Personal Liability
4. Bylaws, Membership, and Corporate Governance
5. Advancing the Mission!

Big Picture – Key Questions

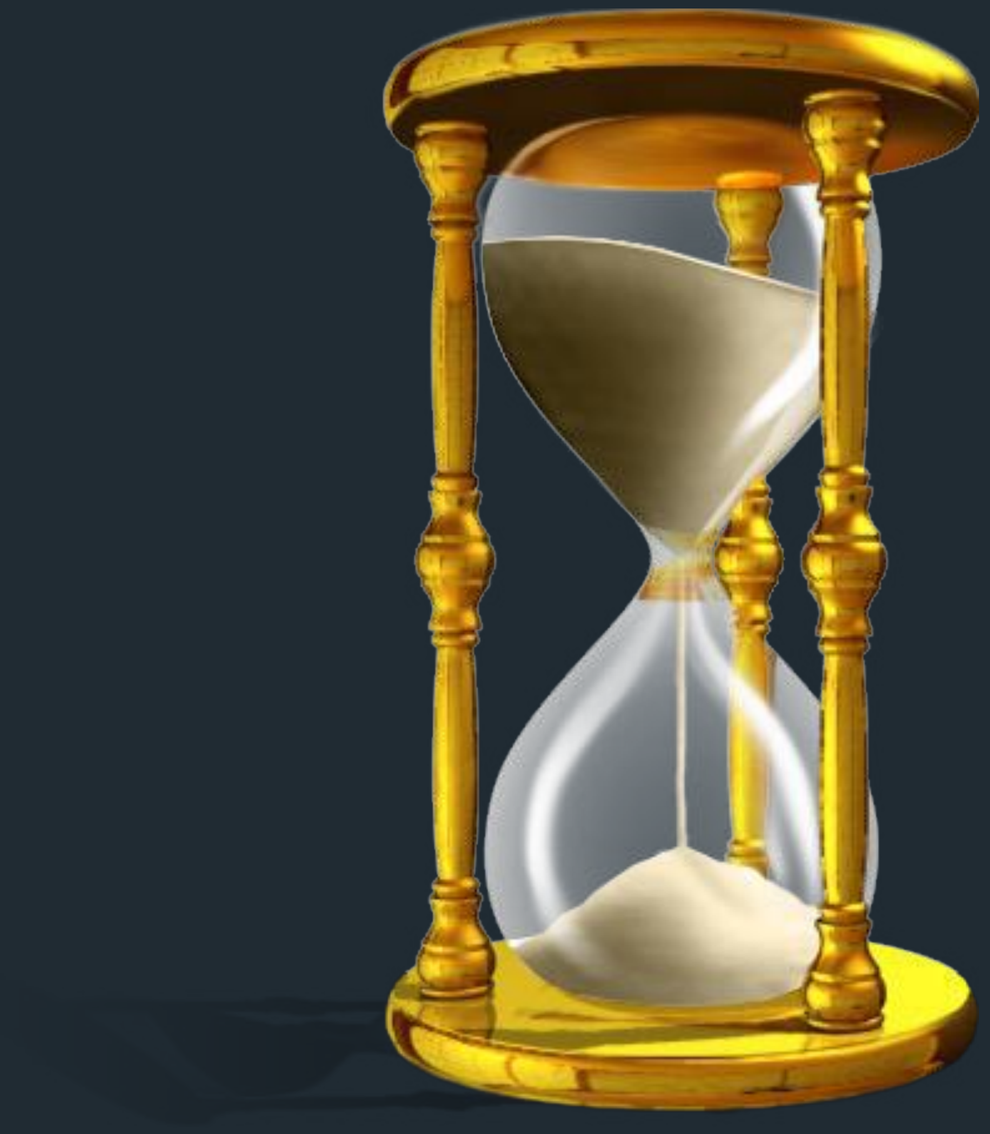
- Leaders - WHY ARE YOU HERE?
- Fiduciary Duties - care, loyalty, obedience
- Accountability
  - Government – IRS, Others?
  - Donors, grant-makers
  - MEMBERS, other program stakeholders
- Personal liability?

Board Governance

- Directors
- Officers
- Key Employees – e.g., CEO (also officers, directors – per bylaws?)
- Fiduciary Roles

Fiduciary Responsibility

- "Entrusted with"
- A fiduciary is a person to whom property or power is entrusted for the benefit of another. Alternate – "of, based on, or in the nature of trust and confidence, as in public affairs."



Public Policy - Independence

- Basic public policy – Independence of nonprofit board is KEY:

  "Corporate responsibility and sound corporate governance depend upon the active and informed participation of *independent directors* and advisers who act vigorously in the best interest of the corporation and are empowered to exercise their responsibilities effectively."

- Task Force on Corporate Responsibility, ABA Report, 62-63 (2003)

Oversight vs. Management

Goals for an independent nonprofit board:

- Maintain substantial degree of board independence from management and other problematic relationships
- Avoid ineffective or dysfunctional governance
- Structure is key (overall independence vs. episodic conflicts)

What Does Oversight Look Like?

Historically

"A collegial relationship that is supportive as well as watchful…challenging yet positive, arm's length but not adversary."

ALI, Principles of Corporate Governance: Analysis and Recommendations 89 (1994)

What Does Oversight Look Like?

Best practices call for rejecting 'culture of passivity' re senior executive, and instead adopting "a new culture stressing constructive skepticism" in pursuit of oversight (not "climate of confrontation," but rather directors playing a more active, independent role).

M. Peregrine, "Independence" and the Nonprofit Board: A General Counsel's Guide, Journal of Health Law (Fall 2006) (citing ABA Task Force at 27-29)

Who, Me?
Directors' and Officers' Personal Liability

- State Nonprofit Corporation Laws
- Volunteer Protection Acts
- Indemnification
- D & O Insurance

Remember potential ORGANIZATIONAL liability too (or vice versa)

Pause - Questions?

Duty of Care

"The Buck Stops Here"

(a/k/a Active oversight through board participation)

- Legal Standard – being "reasonably informed"
- The Importance of Showing Up
- Reading is Fundamental
- When/what to delegate?

Duty of Care

- Is just showing up good enough?
- What matters can (and should) the board delegate?
- Documentation is key; how you can help lead the way.
- Financial and risk management
- Workers – a nonprofit's greatest asset and worst liability

Illinois Trusts and Trustees Act

- Each trustee has the "duty to invest and manage the trust assets as a prudent investor would considering the purposes, terms, distribution requirements, and other circumstances of the trust." (760 ILCS 5/5(a)(1).
- Can delegate!
- Need "reasonable care, skill, and caution."

Delegation within Duty of Care

From Revised Model Nonprofit Corporation Act:

- *A director fulfills his or her duty of care by acting "in good faith; (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) in a manner the director reasonably believes to be in the best interest of the corporation," which allows him or her to "rely on information, opinions, reports or statements, including financial statements and other financial data, if prepared or presented by: (1) one or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the matters presented; (2) legal counsel, public accountants or other persons as to the matters the director reasonably believes are within the person's professional or expert competence; [and] (3) a committee of the board of which the director is not a member, as to matters within its jurisdiction, if the director reasonably believes the committee merits confidence."*

Duty of Care – Case Example

- E.D. doesn’t provide financials for two years
- Directors don’t insist on financials
- E.D. doesn’t remit payroll income tax withholding for several quarters
- IRS issues ”Notice of Intent to Levy” to directors – for their personal bank accounts.

- NOW WHAT?

Duty of Care

- Corporate Documents
- Supervision of charitable services
- Internal financial controls
- Management of financial assets
- Employment practices
- Whistleblower

Duty of Care – More Examples

- Organization doesn't follow bylaws – outdated (e.g., number of directors, how directors are nominated and approved, committee structure
- Directors are aware of problem employee - sexual innuendo, offensive comments

Now what?

Duty of Care and Members' Rights

- 805 ILCS 105/107.75 - Books and records.
  (a) Each corporation shall keep correct and complete books and records of account and shall also keep minutes of the proceedings of its members, board of directors and committees having any of the authority of the board of directors; and shall keep at its registered office or principal office a record giving the names and addresses of its members entitled to vote. Any voting member shall have the right to examine, in person or by agent, at any reasonable time or times, the corporation's books and records of account and minutes, and to make extracts therefrom, but only for a proper purpose. In order to exercise this right, a voting member must make written demand upon the corporation, stating with particularity the records sought to be examined and the purpose therefor. If the corporation refuses examination, the voting member may file suit in the circuit . . . . If the purpose is to examine minutes, the burden of proof is upon the corporation to establish that the voting member does not have a proper purpose

Pause -
Questions?

Duty of Loyalty

KEY POINT: Directors, officers, trustees, and key employees are prohibited from using their position of trust for personal advantage, both financially and non-financially.

Q: How to address conflicts of interest?

- Permissible vs. Impermissible
- Best interest of organization?
- Recusal of conflicted director

Duty of Loyalty

Misuse of position of trust for personal advantage, at organization's expense

- Conflicts of interest
- Misuse of corporate information
- Misappropriation of corporate assets
- Key question – involvement with other organizations, "day job" – conflict?

Conflict of Interest Policy

The purpose of this Conflict of Interest Policy is to protect the Corporation and its tax-exempt status when the Corporation is contemplating entering into a transaction or arrangement that involves certain individuals that have a special relationship with the Corporation, either directly or through family or business relationships. The law imposes a fiduciary duty on the Corporation's directors, which carries with it a broad and unbending duty of loyalty to the Corporation. The directors have the responsibility of administering the Corporation's affairs honestly and prudently, and of exercising their best care, skill, and judgment for the Corporation's sole benefit. As such, they shall exercise the utmost good faith in all transactions involved in their duties, and they shall not use their positions with the Corporation or knowledge gained therefrom for improper private benefit. The interests of the Corporation must be the first priority in each director's decisions and actions. This Policy is intended to supplement but not replace applicable laws governing conflicts of interest for nonprofits.

Conflict of Interest/Duty of Loyalty Case Examples

- Stern vs. Lucy Webb Hayes Training School (1974)
- Mile-O-Mo Fishing Club (1965)
- RE Purchase by Board Director/Straw Man – Documentation is Key!

Duty of Obedience

The Board's Role:

- Know organization's mission
- Stay true to the mission
- Change mission carefully, strategically

Duty of Obedience – Case Example

Ms. Honey, the School Teacher

A Word on Founder's Syndrome

- The domineering board member
- The martyr board member
- The actual founder – e.g., entrepreneurial spirit
- What are the symptoms?
- What is the cure?

Connections to Other Organizations

- Charitable "arm" – Section 501(c)(3)
- PACs
- Businesses

BE CAREFUL, especially with overlapping leadership, confidentiality, and tax compliance!

Pause - Questions?

CAM-UNITY

Chicago's Business and Association Connection

Corporate Documents and Best Practices

Corporate Purpose

The Corporation is organized and operated exclusively for tax-exempt purposes in accordance with Section 501(c)(6) of the Internal Revenue Code of 1986. More specifically,. . . [to advance a line of business . . .]

Bylaws - Members

- Member qualification – who decides, per what criteria?
- Membership classes?
- Membership voting – on what? (directors?)
- Membership costs
- Membership benefits
- Membership meetings

Bylaws – Board of Directors

- Director number and range
- Ex officio?
- Director qualification
- Director terms
- Majority vote
- Meetings, quorum
- Removal – by members, other directors?

Bylaws – What Else?

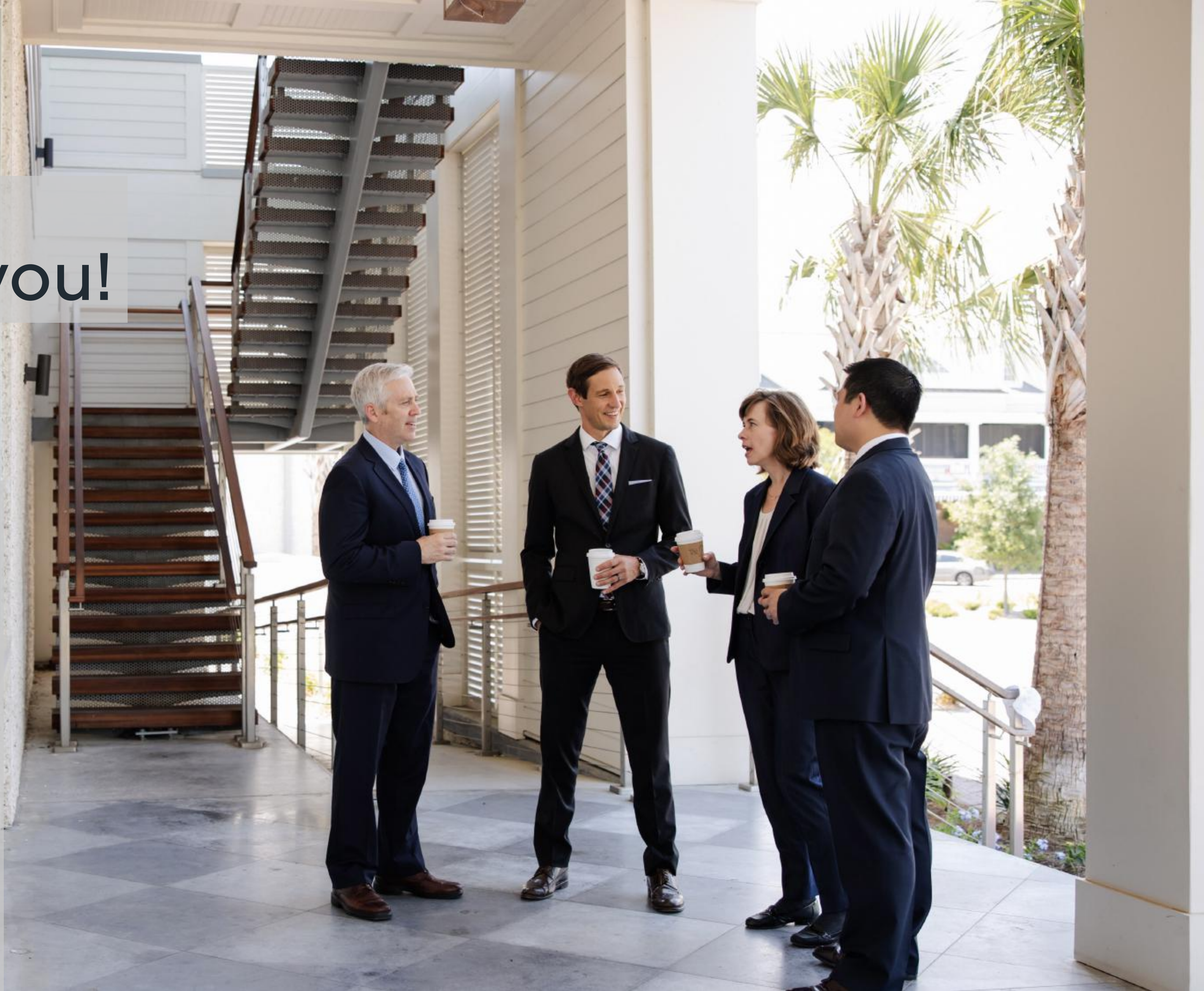
- Taking Board Action
- Officers
- Committees – With/without corporate authority?
- Financial policies
- Indemnification
- Merger/Amendment

Policies

- Conflict of Interest (with Annual Disclosure Statement
- Dispute Resolution – for members too
- Investment?
- Spending
- Record retention
- Data Privacy
- More!

Questions?

Thank you!



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