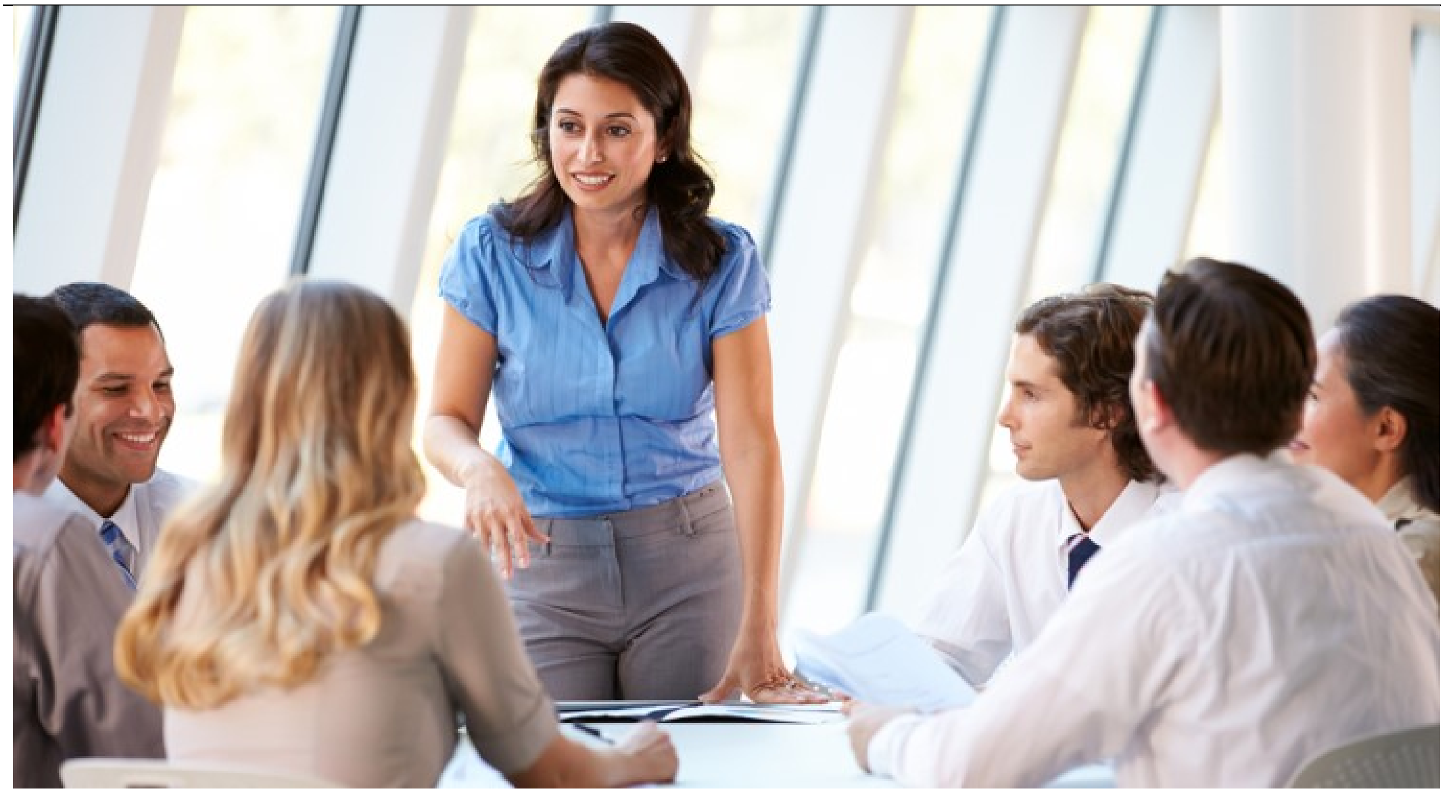
Nonprofit Knowledge: Board Fiduciary Duties

Compliance and Ethics



Board members of nonprofit organizations are subject to the same common law fiduciary duties that apply to board members of other types of corporations. In addition, nonprofit board members often have duties that are specified by statute and have responsibilities as set forth on their organization's form 990.

It's important for board members to understand and comply with their fiduciary duties, not only to protect the organizations they serve, but also because doing so insulates the board members from potential liability. Below is an overview of these responsibilities.

Fiduciary duties

Although fiduciary duties are based in common law, they have been woven into questions on Internal Revenue Service (IRS) 990 tax-exempt organization information return and on state charitable solicitation registration filings.

The three basic duties of a nonprofit board are the duty of care, duty of loyalty, and duty of obedience. When an individual takes on the role of a board member, he or she is bound by these duties.

Duty of care

The board of directors must give the same care and concern to their board responsibilities as any prudent and ordinary person would.

Generally, to meet the duty of care, board members must:

- Exercise ordinary and reasonable care in the performance of their duties, exhibiting honesty and good faith;
- Act in a manner that he or she believes to be in the best interests of the organization, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances; and
- Be obligated to protect the confidential information of the organization.

The duty of care is reflected in the “business judgment rule," which protects a board member from personal liability for actions made in poor judgment, as long as there is a reasonable basis to indicate that the action was undertaken with due care and in good faith.

Duty of loyalty

The board directors must place the interests of the organization ahead of their own interests at all times.

The duty of loyalty is generally a duty of faithfulness to the organization. A board member cannot put his or her personal interests before those of the organization when making decisions affecting the association.

Duty of obedience

The board of directors must make sure that the nonprofit is abiding by all applicable laws and regulations and doesn’t engage in illegal or unauthorized activities.

The duty of obedience requires that a board member act in accordance with the organization’s mission, governing documents (e.g., articles of incorporation, bylaws, and policies), as well as all applicable laws and regulations.

Compliance with duties

The New York Attorney General's office provides examples of how to meet these duties:

Duty of care

- Attend board meetings and participate in discussions.
- Read prepared materials before the meeting.
- Read the minutes of the meetings and make sure the votes are properly recorded.
- Participate in risk assessment and strategic planning.

Duty of loyalty

The board should have a written conflict of interest policy so that members are aware of the type of transactions that might prohibit them from joining the board.

- Board members must disclose actual or perceived conflicts of interest prior to joining the board and when they arise.
- The board should carefully examine transactions that involve board members and officers.

Duty of obedience

- Ensure that the organization carries out its purposes and does not engage in unauthorized activities.
- Comply with applicable laws and all required filing obligations (e.g., IRS, state charitable solicitation registrations, etc).
- Provide copies of the organization's tax-exemption application, IRS 990, and financial reports filed with the New York Attorney General's office to members of the public who ask for them.

Illinois is an example of a state that has codified the expectations of board members, officers, and others who owe such fiduciary duties to charities as follows:

1. To avoid self-dealing and conflicts of interest;
2. To avoid wasting charitable assets;
3. To avoid incurring penalties, fines, and unnecessary taxes;
4. To adhere and conform the charitable organization to its charitable purpose;
5. To not make non-program loans, gifts, or advances to any person;
6. To use the trust in conformity with its purposes for the best interest of the beneficiaries;
7. To timely file registration and financial reports required by this Act; and
8. To comply and to cause the charitable organization to comply with this Act.

IRS and the duties

In addition, these fiduciary duties are reflected in IRS oversight of tax-exempt organizations. The IRS form 990 asks about governing boards, minute-taking, conflicts of interest and private inurement.

It also asks about transparency and accountability, such as sharing financial information with the public and with state agencies.

Board member misconduct

Board members who do not meet their fiduciary duties can be subject to fines, penalties, prison time, or lawsuits. However, if they act in good faith and in accordance with their fiduciary duties, board members are usually indemnified by organizations and are covered by organizations' director and officers' insurance liability policies.

If they do not act in accordance with these duties generally, board members are not able to seek indemnification or insurance protection by the organizations they serve, and can be held personally responsible for their misconduct.

Conclusion

It's good practice to regularly train and remind board members of the fiduciary duties they owe to the organizations they serve. This ensures that they understand the risks and benefits of board service, the importance of attending meetings, and the relevant issues needed to make decisions that are in the best interest of the organization.

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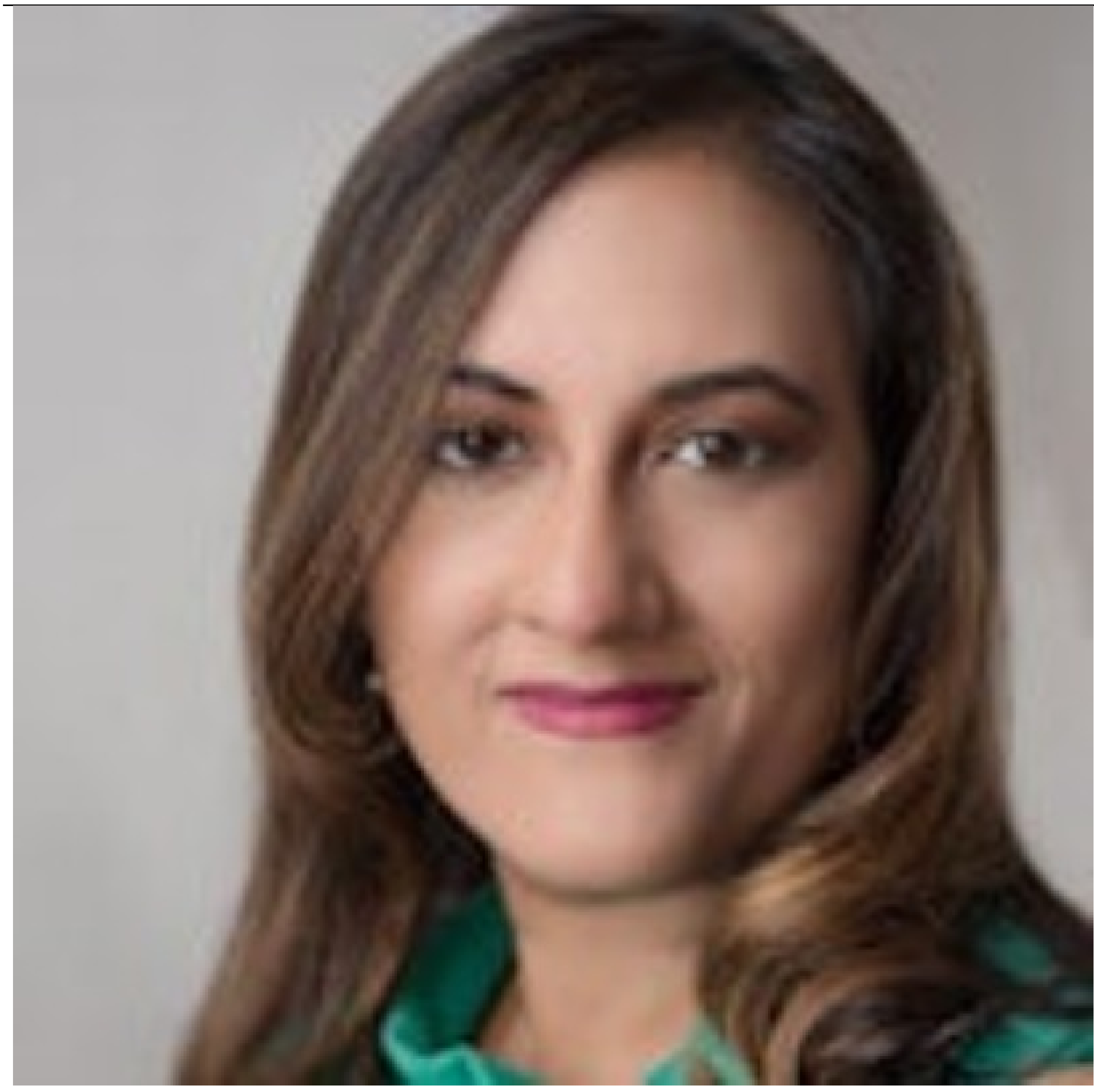

Member

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