

Right From the Start
Responsibilities of Directors and Officers of
Not-for-Profit Corporations

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New York State Attorney General Andrew M. Cuomo is pleased to offer this booklet to assist current and future boards of directors and officers of New York not-for-profit corporations (and, by analogy, trustees of New York charitable trusts) to understand and carry out their fiduciary responsibilities to the organizations they serve.

Charitable organizations contribute substantially to our society. They educate our children, care for the sick, 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.

Please read this booklet carefully. It contains general information concerning fiduciary oversight of charitable assets. The Attorney General publishes another booklet, *Internal Controls and Financial Accountability for Not-for-Profit Boards*, which contains more detailed information on managing a charitable organization and overseeing its assets. That booklet and other publications of interest to board members may be found at:

<http://www.oag.state.ny.us/bureaus/charities/about.html>

This booklet is designed to provide guidance to fiduciaries of charitable assets. It is not a substitute for advice from a qualified lawyer, independent public accountant or other professional.

Whatever their mission or size, all organizations should have policies and procedures established

so that (1) boards and officers understand their fiduciary responsibilities, (2) assets are managed properly and (3) the charitable purposes of the organization 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 and the officers. The following guidelines are designed to assist board members in carrying out their responsibilities.

I. 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.

II. WHAT SHOULD A PROSPECTIVE BOARD MEMBER SHOULD KNOW BEFORE JOINING A BOARD?

Anyone considering membership on the board of a not-for-profit corporation should do 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 stated 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. Try to determine if the organization is managed by its board or its staff and, if the latter, how open is the relationship between board and staff. Talk to current and recent former board members to learn about what the board does and why any former board members recently left the board. In addition, make sure that the board and committee meetings are usually well-attended.

→ Review the organization's Internal Revenue Service Form 990 or 990 PF and audited financial statements for at least the last two (2) years as well as its current internal financial reports to see how the organization uses its assets and to evaluate its financial health. Is its auditor's report on its financial

statements unqualified? Has the auditor sent the organization a management letter? Has the Internal Revenue Service recently audited the organization? What does its report say? Ensure that it is in compliance with all conditions stated in its federal income tax determination letter.

→ 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. Evaluate whether the filings, audit reports and other compliance requirements appear to be completed on a timely basis. Find out whether there are any tax issues or concerns, or notices received from governmental authorities. Find out what other filings might be required. If the organization has paid employees, it must file the appropriate payroll tax forms and pay the appropriate taxes. The organization may also have sales tax and unrelated business income tax responsibilities.

→ Obtain an understanding of the internal control structure of the organization and the processes in place to monitor it. Determine whether there is a current accounting policies and procedures manual that is followed. Review the past two (2) years, management letters received from the public accountants and find out what has been done to remedy any problems identified. (For further information on internal controls and accountability, please see the Attorney General's Charities Bureau booklet - *Internal Controls and Financial Accountability for Not-for-Profit Boards*. That booklet and other publications of interest to charitable fiduciaries are available at www.oag.state.ny.us/charities/charities.html.

→ 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 the backgrounds of key management and understand the employee evaluation and compensation processes and due diligence procedures for material contracts entered into.

→ Make sure there is a conflict of interests and code of ethics policy in place and that it is updated annually.

→ Find out what committees the board has established and decide which (if any) to join. Make sure the committees appear to be sufficient (investment, budget, finance, audit, compensation, human resources, nominating, governance, etc.).

→ Determine who the organization's auditors are, what their reputation is and what their performance of the audit process has been.

→ 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.

→ Be sure to be 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. Learn what training (if any) is provided to the board. Joining a board without sufficient time to devote to its business is often at the root of troubles faced by many boards. A decision to decline an invitation to join a board because the invited individual is "over-extended" should be respected.

III. WHAT ARE THE DUTIES OF BOARDS OF DIRECTORS?

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

A. 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, responsible board members should, among other things, do the following:

- Attend all 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. Make sure her or his votes against a particular proposal are completely and accurately recorded. 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 and read them timely, suggesting 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 any literature produced as part of the organization's programs.

→ Make sure that monthly financial charts of accounts and financial reports prepared for management are available to the board or finance and audit committees, and that they are clear and communicate proper information for 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.

→ Insure that the organization has addressed the sufficiency of its written internal financial controls and written policies that safeguard, promote and protect the organization's assets and that they are updated regularly. Obtain an employees, officers and directors fidelity bond to protect the organization from embezzlement. Have a policy regarding disclosure and identification of fraud (whether or not material). Make sure a policy for records retention and whistleblower protection is in place. Create 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 and then evaluating their performance.

B. Duty of Loyalty

The board should have a written "conflicts of interest" policy so that all members are aware of the type of transactions that may prohibit them from joining the board. Some such policies prohibit board members from engaging in any transaction that may result in even the appearance of a conflict of interest. They should provide for written disclosure of anticipated or actual conflicts.

Directors and officers 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, always be disclosed in advance of joining a board and when they arise. Board members should avoid transactions in which they or their family members benefit personally. If such transactions are unavoidable, disclose them fully and completely to the board.

In order to exercise this *duty of loyalty* directors must be careful to examine transactions that involve board members or officers. The board must not approve any transaction that is not fair and reasonable, and a conflicted board member may not participate in the board vote. There should be an established code of ethics in place that is updated annually as well.

Transactions involving conflicts should be fully documented in the board's minutes, and conflicts policies and disclosure statements should be discussed with the organization's auditors and attorneys.

C. Duty of Obedience

A board has a *duty of obedience* to insure that the organization complies with applicable laws and

regulations and its internal governance documents and policies, including:

→ Dedicating the organization's resources to its mission.

→ Insuring that the organization carries out its purposes and does not engage in unauthorized activities.

→ Complying with all appropriate laws, including registering with the Attorney General's Charities Bureau in New York State, complying with registration and reporting laws and other applicable laws of all states in which it conducts activities and/or solicits contributions, filing required financial reports with the Attorney General, the State Worker's Compensation Board, the State Department of Taxation and Finance and the Internal Revenue Service, 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 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.

IV. IDENTIFY, UNDERSTAND AND UPDATE THE ORGANIZATION'S MISSION AND INTERNAL POLICIES

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, are described in the organization's certificate of incorporation and/or by-laws or other constituent document.

If an organization's purposes are not already clearly stated in one of its organizational documents, one of

the first activities of the board should be to draft a clear statement of the organization's mission (which should correspond to its stated purpose to the IRS) and to ensure that everyone involved with the organization, directors and officers, employees, volunteers, fund raisers, and professionals, is fully familiar with and understands the 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, they will not be able to perform their respective tasks appropriately. The mission should be periodically re-assessed and evaluated and amended as needed.

Employees and volunteers should be aware of the organization's internal controls that impact their area of responsibility. At the time of adoption or revisions of internal controls, all directors, officers, employees and volunteers should be made aware of the organization's internal controls, given a copy of the policy and procedures manual, and trained to understand what is expected of them in carrying out their duties and in advising the organization's management and/or the board of directors of violations of the policy. New employees and volunteers should be trained before they assume their responsibilities.

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.

BoardSource, Inc. makes it possible to conduct such a review on line or on paper. The self evaluation is available at <http://boardsource.org/landingpage.asp?ID=34>.

V. MONITOR FUNDRAISING CONDUCTED ON BEHALF OF THE ORGANIZATION

Many organizations contract with professionals to raise funds on their behalf. Since the fund raiser represents the organization to the public, the selection of a fund raiser is extremely important. Establishing and following procedures for selection of a fund raiser can avoid future problems. Such procedures should include:

→ Obtaining bids from several fund raisers 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 fund raisers being considered are registered and have filed all required contracts and financial reports.

→ Asking the Charities Bureau for copies of the fund raiser's contracts with other charities to determine the services performed for and the fees charged to those charities.

→ Consulting *Pennies for Charity*, the Attorney General's annual report on telemarketing by professional fund raisers, to see how much income was received by the charities listed in the report.

→ Asking the fund raiser for references. A reputable fund raiser should be happy to provide a potential client with the names, addresses and telephone numbers of some of its clients.

→ Contacting some of the fund raiser's other clients to see if those nonprofits were satisfied with the services received.

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

→ Reviewing all written solicitations and scripts used by the fund raiser, making sure that solicitation material appropriately describes the organization and its activities, includes the name of the organization as registered with the Attorney General and advises 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 professional fund raiser and any of its representatives ("professional solicitors") disclose the name of the specific professional solicitor and the employing professional fund raiser and state that the solicitor is being paid to raise funds.

VI. MAKE USE OF AVAILABLE RESOURCES

In carrying out their responsibilities, board members should realize that they need not do it alone. There are many resources available to assist not-for-profit organizations in fulfilling their fiduciary duties.

Following are some of those resources:¹

The Attorney General's Web site - <http://www.oag.state.ny.us/bureaus/charities/about.html> - posts all forms and instructions for registration and annual filing with the Charities Bureau, links to other web sites that provide resources for not-for-profit boards and publications of interest to not-for-profit organizations.

If the material on the Attorney General's web site does not answer your particular question, you may make an inquiry to the Charities Bureau by phone or email.

For questions about not-for-profit organizations, contact:

charities.bureau@oag.state.ny.us or (212) 416-8401

For questions about fundraising professionals, contact:

charities.fundraising@oag.state.ny.us or (518) 486-9797

NASCOnet.org - www.nasconet.org - This site is maintained by the National Association of State Charity Officials (NASCO). NASCO members are employees of state agencies that regulate not-for-profit organizations and their fund raisers. The site provides information concerning the registration and reporting requirements applicable to not-for-profits that conduct activities and/or raise funds in the various states.

¹ In addition to the resources listed in this booklet, many more resources are available on the Internet and in communities around the state. Inclusion of any particular entity should not be construed as an endorsement of that entity or the services it renders.

The Internal Revenue Service - www.irs.gov - posts all of its forms and instructions and many brochures drafted to assist not-for-profit boards in completing their annual financial filings with the IRS and in carrying out their other responsibilities. If you can't find the information that you want on the IRS web site, call its toll-free number - 1-877-829-5500 - set up especially for those who have questions about tax-exemption and tax-exempt organizations.

GovernanceMatters! - <http://www.governancematters.org> - GovernanceMatters! is an organization whose purpose is to encourage and promote good governance in the nonprofit sector. Its web site posts information on good governance, links to other sites of interest to not-for-profit boards and information about courses and conferences for nonprofit board members.

Alliance for Nonprofit Management - www.allianceonline.org - The Alliance for Nonprofit Management is a professional association of individuals and organizations whose mission is improve the management and governance capacity of nonprofits. Its web site includes information about resources available to not-for-profit organizations.

American Institute of Certified Public Accountants (AICPA) - www.aicpa.org - The AICPA's web site has extensive information on accounting standards and procedures. It is a valuable source of a wide variety of information on accounting issues for board members.

Better Business Bureau (BBB) - www.newyork.bbb.org - The BBB's New York Philanthropic Advisory Service publishes standards for not-for-profit organizations that are used in its evaluations of charities and which are posted on its web site. The standards address issues such as governance, financial accounting, program efficiency and public disclosure. The web site also contains guidelines for implementation of the standards.

Board Café - www.compasspoint.org - Board Café is an electronic newsletter for members of

nonprofit boards of directors. Board Café offers a menu of ideas, information, opinion, news, and resources to help board members in carrying out the responsibilities of their board service.

BoardSource, Inc. - www.boardsource.org - has a wide range of material designed to assist board members in carrying out their duties. Its nine pamphlet “Governance Series”, beginning with *Ten Basic Responsibilities of Nonprofit Boards*, is a source of basic information for board members and includes other suggested resources.

Council of Community Services of New York (CCSNYS) - www.ccsnys.org - CCSNYS is a statewide association of over 1,000 charitable nonprofit organizations. CCSNYS conducts programs designed to strengthen the nonprofit sector, provide information to donors and contribute to community-based planning. CCSNYS provides technical assistance, training, information and group purchasing options for nonprofits. It also provides information to and conducts and coordinates advocacy on behalf of the New York nonprofit sector. Its web site contains information concerning membership in CCSNYS and resources for nonprofit organizations.

Council on Foundations - www.cof.org - The Council on Foundations is a membership organization of more than 2,000 grant making foundations and giving programs worldwide. It provides leadership expertise, legal services and networking opportunities, among other services, to its members and to the general public. Its web site contains information of interest to not-for-profit boards.

The Foundation Center - fdncenter.org - The Foundation Center's mission is to strengthen the nonprofit sector by advancing knowledge about U.S. philanthropy. It collects, organizes and communicates information on U.S. philanthropy, conducts and facilitates research on trends in the field, provides education and training on the grant seeking process and promotes public access to information and services through its web site and print and electronic publications and five library/learning centers.

GuideStar - www.guidestar.org - GuideStar is a national database of that posts financial reports and other information on over 850,000 tax-exempt U.S. charitable organizations on its web site. It is a source of information about the operations and finances of nonprofit organizations.

Independent Sector (IS) - www.independentsector.org - is a national coalition of nonprofit organizations of all sizes as well as Fortune 500 corporations with commitments to community involvement. IS advocates on behalf of and provides educational services to the nonprofit sector.

Lawyers Alliance of New York (LANY) - www.lany.org - LANY is a not-for-profit corporation whose staff attorneys and 650 volunteer lawyers from private firms and corporations provide *pro bono* legal services to nonprofit organizations. LANY's publications provide guidance for organizations in drafting by-laws, applying for tax exempt status, securing fiscal management and other aspects of nonprofit governance.

The Minnesota Council on NonProfits (MCN) - MCN is a membership association of over 1300 Minnesota nonprofit organizations that shares information, services and research to educate its members and the community. The "Info Central" section of its web site - www.mncn.org/infocentral.htm - contains information of interest to not-for-profit organizations regardless of their state of formation or location.

The New York State Society of CPAs (NYSSCPAs) - www.nysscpa.org - NYSSCPA is a membership association of certified public accountants. It has resources available to answer technical inquiries, offer training in financial and tax areas and provides referrals for audit and tax services.

The Nonprofit Coordinating Committee of New York (NPCC) - www.npccny.org - NPCC is a nonprofit membership corporation with over 1,200 New York City tax exempt organizations as members. Its goal is to protect and help the city's nonprofit sector by offering management services to its members. It also monitors governmental actions on the city, state and federal level to promote the needs of nonprofit organizations. It holds workshops and roundtables on managerial and organizational issues. Many of NPCC's publications are posted to its Information Databank.

Support Center for Nonprofit Management (Support Center) - <http://www.supportctr.org> - The mission of the Support Center is to strengthen the capacity of nonprofit and public interest organizations to fulfill their missions. It provides management training and consulting and disseminates information and resources to local and national organizations, foundations and government agencies. The Support Center works directly with Board Leaders, Executive Directors and their staff to assist them in solving problems and maximizing their opportunities to carry out successful programs. The Support Center's web site contains information for nonprofit organizations and links to other web sites of interest of interest to those who manage nonprofit organizations.

The Urban Institute - www.urban.org - The Urban Institute is a nonprofit nonpartisan policy research and educational organization established to examine the social, economic, and governance problems facing the nation. It provides information and analysis to public and private decision makers to help them address these challenges. It maintains extensive databases of information on the not-for-profit sector.

Volunteer Consulting Group (VCG) - www.boardnetUSA.org - VCG is a nonprofit organization whose mission is to strengthen the governing and management capability of nonprofit boards of directors by bringing qualified leadership into service as board members. VCG assists boards in defining their board recruitment objectives and then conducting a targeted search for business, professional and community leaders with the desired expertise, diversity of perspective and resources. VCG's web site is a resource designed to enable potential board members--and nonprofit boards needing leadership--to find each other.

Revised - January 2007