

The Guide to
**Not-For-Profit
Governance**
2017

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The Guide to Not-For-Profit Governance 2017

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Not-For-Profit Practice Group

Not-For-Profit Governance and “Best Practices”

Not-for-profit organizations play a significant role in our society by undertaking and providing funding for projects that benefit the greater good. They provide services and grants in a wide variety of areas that are of importance to the community, including supporting hospitals, educational institutions, museums and organizations dedicated to assisting those in need. A not-for-profit organization may not be formed for financial gain and generally cannot provide profits or excessive benefits for its owners, insiders, donors or others outside the charitable class or objective for which the not-for-profit organization is formed and intended to serve. The mission of a not-for-profit organization sets forth the purpose for which the organization was formed and granted special legal not-for-profit status. This mission drives the activities carried out by the organization; the board of directors is responsible for governing the not-for-profit to carry out this mission. The assets of a not-for-profit organization are intended to benefit the public good and are restricted by law toward that use alone. Thus, given the prohibition against use of not-for-profit assets for anything other than the intended charitable objective, the founders, members, directors and managers of a not-for-profit will have less control over a not-for-profit corporation than if they established a for-profit corporation and had conventional rights of equity owners or for-profit directors or management.

Effective governance, with its corollaries, transparency and accountability, leads to increased public trust in the organization and a greater willingness by the public to donate funds and services. Effective governance also provides protection from regulatory intrusion.

This outline (i) summarizes steps a not-for-profit organization may wish to consider taking to ensure that it is accountable, transparent and effectively governed by an active and engaged board and (ii) serves as an introduction to the other documents included in this volume.

Boards of for-profit organizations have worked to restore public confidence and increase investment in the wake of a number of highly public governance failures. The steps taken by boards of for-profit organizations – including those required by reforms embodied in the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”), the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, and related rules and regulations – have led to increased board engagement. Not-for-profit corporations incorporated under New York law are also subject to new governance and oversight rules set forth in the Non-Profit Revitalization Act of 2013 (as amended, the “Revitalization Act”), which amends the New York Not-For-Profit Corporation Law. Most provisions of the Revitalization Act became effective on July 1, 2014. For a discussion of these amendments, see **Tab 2**. Boards of not-for-profit organizations may wish to adapt certain measures that have become “best practices,” even where to do so may not be required by law.

A summary of statutory and case law applicable to not-for-profit organizations in the State of New York, as well as liabilities imposed by the Internal Revenue Service (the “IRS”), are set forth at **Tab 3**.

I. ROLE OF THE BOARD AND FIDUCIARY DUTIES – AN OVERVIEW

The role of the board of directors of a not-for-profit organization is similar to the role of a for-profit board. In both cases, the organizations are tasked with providing oversight of the organization – essentially, managing other people’s money – and in both cases they are judged by their success in doing so. Yet, there is a very key difference: in the for-profit context, shareholders are able to hold corporate directors and officers accountable, whereas in the not-for-profit context there is no private mechanism by which the organization can be held accountable when it fails to act in furtherance of its mission. Although governmental entities (such as the relevant State Attorney General and the IRS) play an important role in policing and monitoring not-for-profit activities, there is no private right of action available against officers and directors to ensure accountability. The not-for-profit board is required to fill this void, by ensuring that the organization acts in accordance with its mission through meaningful oversight of operations and policy guidance in a way that assures integrity and effective management but without leading to board involvement in the organization’s day-to-day activities.

The basic duties of directors of not-for-profit and for-profit organizations are virtually the same, even though the organizations are typically governed by different laws and have different constituent relationships. Directors of not-for-profit organizations are required to discharge their duties in accordance with the following basic fiduciary duties, which are discussed in more detail at **Tab 3**:

- **Duty of care:** Act in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances;
- **Duty of loyalty:** Act in good faith in a manner the director reasonably believes to be in the best interests of the organization; and
- **Duty of obedience:** Act within the organization’s purposes and ensure that the mission is pursued.

Breaches of fiduciary duty are enforced by the Attorney General. Enforcement actions can result in significant personal liability for directors, which can be minimized through indemnification and/or directors’ and officers’ insurance. For a discussion of indemnification and insurance, and examples of enforcement actions, see **Tab 3** and **Tab 16**.

II. BASIC FUNCTIONS OF A NOT-FOR-PROFIT BOARD

The board of a not-for-profit organization is responsible for directing the affairs of the organization in accordance with its mission. In practice, the board delegates responsibility for managing the day-to-day activities of the organization to managers; however, fiduciary duties cannot be delegated and, therefore, the board retains oversight responsibility for matters that have been delegated. Board service should not be viewed as just an honor – the oversight responsibilities of directors are real, and failure to discharge these legal duties can have unwelcome consequences for the organization and its board members.

The primary functions of the not-for-profit board typically include the following:

- Selecting, monitoring, evaluating, compensating and – if necessary – replacing the Executive Director/Chief Executive Officer (the “CEO”), and developing and approving succession plans with respect to senior executives of the organization;

- Defining and reevaluating from time-to-time the long-term strategy by which the organization fulfills its mission and monitoring the performance of the organization in implementing the strategy;
- Reviewing and approving material capital allocations and expenditures, and major transactions;
- Approving budgets, financial plans and financial statements; monitoring and ensuring the integrity of the organization's financial reporting processes, internal control systems and audit; hiring the independent auditor (if any) and assuring itself of the auditor's independence;
- Balancing constituency interests in a manner that is consistent with the mission;
- Understanding the organization's risk profile and reviewing and overseeing the organization's management of risks;
- Ensuring compliance with all applicable laws, regulations, policies and ethical standards of the organization (including laws and regulations enforced by the IRS, as well as the organization's conflict of interest and other policies);
- Assisting in obtaining resources through making personally meaningful financial contributions, fundraising and/or grant-writing; and
- Establishing the composition of the board and its committees, and determining governance practices.

The demands of not-for-profit board service are heavy – board responsibilities are wide-ranging and board service is part-time (and usually voluntary). The board of a not-for-profit organization should consider implementing board processes and structures that can assist directors to more efficiently and effectively fulfill these responsibilities; however, in doing so, the board should bear in mind that board practices should address the unique needs and circumstances of the particular not-for-profit organization – one size does not fit all.

In addition to implementing any governance mechanisms that may be mandated by law, the board should look for governance “best practices” that embody pragmatic solutions that will work given the particular needs and circumstances of the organization, including organizational structure, size, activities, life-cycle stage and funding mechanisms. The goal of “best practice” is to promote active oversight and objective and informed judgment by the board. An effective board provides oversight over the activities of the managers to whom the board has delegated authority. This is necessary to promote the accountable functioning of the organization, including the responsible use of assets that have been entrusted to the organization by others. Board effectiveness can be enhanced by considering the following guiding principles that are common to effective not-for-profit boards.

III. COMMON GUIDING PRINCIPLES FOR EFFECTIVE BOARDS

3.1 Mission

Board accountability begins with the charitable, educational or social mission of the not-for-profit organization. The mission is the reason why the organization exists and has been granted legal status as a not-for-profit by the State and/or tax-exempt status by the IRS. The mission should be the not-for-profit organization's “polestar” in that it provides a measure of success and guides the organization's conduct. (This can be compared to the for-profit world “polestar” of maximizing shareholder value through the efficient production of goods and services.)

The board is charged with ensuring that managers further the mission, without wasting assets or engaging in self-dealing. Therefore, as a starting point, the board needs to:

- Understand the entity’s mission, as stated in its governing documents;
- Develop, with management, a strategy for carrying out that mission; and
- Monitor and assess management’s efforts to carry out that strategy in line with the mission.

3.2 Clear Delineation of Responsibility and Authority

All directors need to understand the role of the board as an entity, as well as their individual duties as fiduciaries and the distinct role of management. The role of the board is one of oversight – directors “direct” – while the role of management is to carry out the day-to-day activities of the organization – managers “manage.” Often members of a not-for-profit board cross the line between oversight and management by becoming overly engaged in the operating activities of the entity, such as the day-to-day work required to fulfill programmatic goals. Board involvement in operating activities can lead to tensions between the board and management/staff. Boards should consider the extent to which their involvement in operating – as opposed to strategic – activities benefits or hinders the ability of management to perform.

The board may wish to consider defining the respective roles of the board and management with respect to strategic and operational activities in a formal “delegation of authority” that addresses the specific matters reserved to the CEO and those reserved to the board. For example, the board typically delegates the execution of policies and strategic objectives to management. Creating a formal delegation of authority can also help the board identify and communicate expectations about what issues are worthy of board consideration and in what time frame decisions are expected to be made.

3.3 Monitoring and Measuring Performance

Active board oversight requires that management performance be evaluated against the specific operational goals that the board has determined will further the agreed strategy in line with the organization’s mission. The board should then define with management the specific benchmarks (both long-term and short-term) that would indicate successful performance and monitor results achieved by management against those benchmarks. If performance goals are not being met, the board should consider where adjustment may be necessary. For example, improving performance may call for adjusting the strategy and replacing management where necessary. Management changes are inevitable and the board should ensure that a succession plan for key executives is in place.

The board should utilize its evaluation of management performance in designing and implementing an executive compensation scheme that will compensate executives fairly and includes appropriate incentives for performance. Although not typical, in some cases it may be appropriate to compensate directors for their service on the board of the not-for-profit organization. Not-for-profit organizations that are required to file Form 990s with the IRS are required to make various disclosures with respect to the process for determining and the amount of compensation of executive officers, key employees, directors and trustees – see *Tab 5*.

3.4 “Following the Money”

Overseeing the finances of the not-for-profit organization is a critical part of the board’s role. Fulfilling this oversight responsibility begins with ensuring that the organization has an effective Chief Financial Officer or

equivalent (such as a bookkeeper or outside accounting firm). Recruiting such a person can be challenging, particularly as not-for-profit salaries are generally lower than in the for-profit sector. The board should establish open lines of communication with the CFO to facilitate the exchange of information. The board should work with the CFO in developing and approving budgets and financial plans, and should test management assumptions that may be embedded within budgetary analysis. The board is also responsible for monitoring and ensuring the integrity of the organization's financial reporting processes (including recordkeeping), internal control systems and audit, and should hire an independent auditor if required by law or as appropriate. New York not-for-profits should note that the Revitalization Act has raised the gross revenue thresholds above which an entity requires an audit or review by an independent certified public accountant – see **Tab 4**.

3.5 Determining Board Focus and Information Needs

The board's ability to govern effectively depends on how it focuses its time and attention and the information it has available to it. The board should take charge of its own agenda by identifying, articulating, prioritizing and scheduling the issues that the board will address. Usually, board attention – and therefore the board's agenda – is best focused on “following the money,” setting strategic direction and long-term goals, monitoring management's progress and results to achieve those goals, and ensuring satisfactory compliance with ethical standards, organizational policies and the law.

Board meetings should be structured to make the best use of board time. Meetings should be scheduled well in advance – for example, via an annualized schedule to address foreseeable issues – with additional meetings called when board review with respect to other issues is required. Board meetings should balance management presentations with discussion among directors and with management. Appropriate reports and analyses furnished in advance facilitate discussion at the meeting.

An effective board requires accurate, relevant and timely information relating to the organization and the context in which it operates. The board should identify what information it needs and work with management to ensure that it obtains such information. Information should be distributed in advance of meetings to enable directors to review the material and reflect on it.

In addition, the board of a not-for-profit organization might find it helpful to adopt governance guidelines it applies in fulfilling its responsibilities, including board functions and processes, as well as the organization's expectations of directors. Such guidelines should be specific and tailored to the needs and circumstances of the particular not-for-profit organization. Various factors unique to each not-for-profit organization, including, without limitation, organizational structure, activities, life-cycle stage, funding mechanisms and applicable legal requirements, may affect the provisions that should be addressed. The board sets the tone by adopting a governing style that emphasizes: adherence to codes and principles of conduct and ethics; strategic leadership rather than a focus on administrative detail; prospective focus on achieving mission based on current and anticipated facts; anticipation and preparedness rather than reactivity; collegiality, with respect for diverse viewpoints, and not divisiveness; and consensus building, as opposed to “majority rule.”

3.6 Board Size and Composition

Size and composition influence the ability of a board to be effective. Most decision-making groups function best with between seven and ten members. Not-for-profit boards are often much larger, due to their fundraising nature. If downsizing is not practical, a very large board may wish to consider whether there are ways to facilitate efficient decision-making through the use of committees; for example by creating an executive committee or advisory board that has authority to make decisions on behalf of the board where appropriate. Note that not-for-

profit organizations that are required to file Form 990s with the IRS are required to disclose the composition and scope of an executive committee or similar committee with broad authority to act on behalf of the board – see **Tab 5**.

Board candidates should be selected with a set of criteria in mind that are specific to the needs of the particular not-for-profit organization. The board (through a nominating committee, if there is one) should engage in a review of the composition of the board as a whole periodically, including the balance of independence, business specialization, technical skills, diversity, fundraising ability and/or willingness to make personally meaningful gifts, geographic representation and other desired qualities that directors bring to the board (such as integrity and sound judgment) – bearing in mind that a board is more than the sum of its parts and that the right mix of competencies will change as the organization evolves and its circumstances change – and refresh the board where necessary.

It has been observed that board member disengagement harms the organization in a number of ways, and that selection and identification of potential board members should involve a process of looking past a short-term ability to secure funds, and should look to the long-term positive or negative impact on the organization that the particular candidate will have. The board should be comprised of directors who are committed to the organization’s mission. Directors should ensure that they are interested in and understand the activities of the organization, the environment in which it exists and the challenges and risks it faces. They should learn about the structure of the organization by reviewing its governing documents, policies and minutes of board and committee meetings from the past year, as well as any literature produced as part of the organization’s programs. Directors should seek out information from management where required to gain this understanding.

3.7 Board Independence

The board should be comprised and organized in a manner that encourages directors to be engaged and to form and express objective judgments about certain issues, such as:

- Evaluation of management performance and compensation, and succession planning;
- Approving the organization’s financial objectives and major plans, strategies and actions;
- Oversight of audit, accounting, financial reporting and risk management;
- Review and approval of conflicts of interest and related party transactions; and
- Determination of board composition and governance processes.

The board should include a number of persons who lack material business relationships to the entity and also lack material business and family relationships to senior management and key constituents. Unless the board already performs such governance activities, the Revitalization Act requires New York not-for-profits to form an audit committee comprised of “independent directors” (as defined in the Revitalization Act), or identify independent directors to oversee the audit (if any), approve certain transactions and oversee the conflict of interest policy and the whistleblower policy (if any). Only independent directors of New York not-for-profits are permitted to participate in any board or committee deliberations or voting relating to such matters – see **Tab 6**. As discussed in more detail in **Tab 6**, a director of a New York not-for-profit may only be considered “independent” if:

- The director was an employee or a “key person” of the organization or a related organization or affiliate during the past three years;
- The director does not have a relative who is, or has been within the last three years, a “key person” of the organization or an affiliate of the organization;
- The director did not receive and does not have a relative who received total direct compensation exceeding \$10,000 in any of the past three tax years from the organization or related organizations or affiliates for services provided in the director's capacity as an advisor, consultant or independent contractor other than any reasonable compensation for service as a director;
- The director is not a current employee of and does not have a substantial financial interest in, and does not have a relative who is an officer of or has a substantial financial interest in, any entity that has made payments to, or received payments (not including charitable contributions) from, the corporation or an affiliate thereof for property or services in an amount that, in any of the last three fiscal years, has exceeded (a) the lesser of \$10,000 or 2% of such other entity's consolidated gross revenue if such other entity's consolidated gross revenue was less than \$500,000, (b) \$25,000 if such other entity's consolidated gross revenue was \$500,000 or more but less than \$10 million and (c) \$100,000 if such other entity's consolidated gross revenue was \$10 million or more;
- The director is not, and does not have a relative who is, a current owner, director, officer or employee of the organization's outside auditor, or has worked on the organization's audit at any time during the last three years; and
- Neither the director, nor any relative of the director, was involved in a loan, grant, excess benefit transaction, or a business transaction involving an interested person that is reportable on Schedule L of Form 990, with the organization (whether directly or indirectly through affiliation with another organization) during the most recent tax year.

In addition, note that not-for-profit organizations that are required to file Form 990s with the IRS are required to disclose the number of directors who are considered “independent” in accordance with IRS tests, as well as whether any directors have family or business relationships with officers, directors, trustees or key employees of the organization – see **Tab 5**. The IRS tests for “independence” are different in some respects to the bright-line tests set forth in the Revitalization Act's definition of “independent director,” for example, the required “look-back” period is different (the most recent tax year under IRS tests, compared with the past three years under New York tests). As discussed in more detail in **Tab 6**, a director may only be considered “independent” in accordance with IRS tests if:

- The director was not compensated as an officer or other employee of the Organization or a related organization during the most recent tax year;
- The director did not receive total compensation exceeding \$10,000 in the most recent tax year from the Organization or related organizations for services provided in the director's capacity as an advisor, consultant or independent contractor other than any reasonable compensation for service as a director; and
- Neither the director, nor any relative of the director, was involved in a loan, grant, excess benefit transaction, or a business transaction involving an interested person that is reportable on Schedule L of Form 990, with the

Organization (whether directly or indirectly through affiliation with another organization) during the most recent tax year.

3.8 Board Leadership

An effective board leader is one who is capable of developing a strong but independent working relationship with management, and guiding the board to consensus after free and open discussion of viewpoints. An effective board leader is especially important for:

- Organizing the board agenda with input from management and helping to identify the board's information needs;
- Leading board discussions of management performance and compensation in sessions at which management is not present ("executive sessions"); and
- Encouraging frank but collegial discussions both at the board level and as between the board and management.

The Revitalization Act requires that no employee of a New York not-for-profit may serve as the chair of the board or hold any other title with similar responsibilities, effective January 1, 2017.

3.9 Policies and Guidelines

The board plays a key role in setting the tone of the organization by establishing policies and guidelines that set forth expectations for behavior within the organization and by assessing whether senior management is promoting an appropriate ethical culture within the organization. These policies should include the following:

- **Board Guidelines:** Board guidelines set forth expectations of directors, which may include board leadership, structures, composition, functions and processes, as well as requirements to make personally meaningful gifts and/or contribute to fundraising efforts.
- **Conflict of Interest Policy:** The conflict of interest policy assists directors, officers and others in the organization in identifying, evaluating and resolving conflicts of interest. A conflict of interest arises where a director, officer or other decision-maker has an outside interest or relationship that conflicts or may conflict with his or her ability to act strictly in the best interests of the organization. For example, a board member is said to be conflicted where the not-for-profit organization is considering a commercial transaction with another company in which the board member has a financial interest. The policy should define conflicts of interest and should require that the organization's officers, directors, trustees, and key employees disclose or annually update their interests that could give rise to conflicts of interest, usually by completing a questionnaire. The conflict of interest policy should also include practices for monitoring proposed or ongoing transactions and dealing with potential or actual conflicts, whether discovered before or after the transaction has occurred. The conflict of interest policy should specify the committee or other body that determines whether a conflict exists and the body that reviews actual conflicts (typically the audit committee or the full board). Persons with a conflict should be prohibited from participating in the deliberations and other decisions regarding the conflict. The Revitalization Act requires that all New York not-for-profits (a) adopt a conflict of interest policy applicable to directors, officers and key employees which meets the requirements of the Revitalization Act, and (b) follow specified procedures with respect to related party transactions – see **Tab 8**. In addition, note that not-for-profit organizations that are required to file Form 990s

with the IRS are required to disclose whether they have adopted a conflict of interest policy that meets certain requirements – see **Tab 5**.

- **Code of Business Conduct and Ethics:** This code applies to the board, management and employees and requires fulfillment of responsibilities in a manner that furthers the mission of the organization and complies with law, regulations, ethical standards and policies adopted by the organization – see **Tab 7**.
- **Whistleblower Policy:** The whistleblower policy should contain procedures to receive, investigate and take appropriate action regarding fraud or non-compliance with law or organizational policy, and to protect whistleblowers against retaliation. The policy should encourage directors, employees and volunteers to come forward with credible information regarding illegal practices or violations of organizational policies, law, regulations and/or ethical standards, and specify that the organization will protect the individual from retaliation, and identify those staff, board members or outside parties to whom such information can be reported. Such procedures are encouraged to be implemented by not-for-profit organizations so as to ensure compliance with applicable provisions of Sarbanes-Oxley, which make it a criminal offense, punishable by fines and/or up to 10 years of prison, for anyone, including not-for-profit organizations, to “knowingly, with the intent to retaliate” take any action harmful to an employee for providing information relating to the commission or possible commission of a federal offense. The Revitalization Act requires that New York not-for-profits with 20 or more employees and annual revenues above \$1 million adopt a whistleblower policy that includes procedures for reporting and investigating violations or suspected violations of law or corporate policies, and anti-retaliation provisions – see **Tab 9**. In addition, note that not-for-profit organizations that are required to file Form 990s with the IRS are required to disclose whether they have adopted whistleblowing procedures that meet certain requirements – see **Tab 5**.
- **Document Retention and Destruction Policy:** The document retention and destruction policy ensures that documents are retained pursuant to applicable laws and that documents that may be relevant to legal proceedings or governmental investigations are not destroyed. Such procedures are encouraged to be implemented by not-for-profit organizations so as to reduce the risk that documents will be inappropriately destroyed and to ensure compliance with applicable provisions of Sarbanes-Oxley which mandate penalties for obstruction of justice caused by the destruction of documents that are, or are anticipated to become, subject to any kind of official proceeding or federal agency investigation. The policy should identify the record retention responsibilities of staff, volunteers and board members for maintaining and documenting the storage and destruction of the organization’s documents and records. Note that not-for-profit organizations that are required to file Form 990s with the IRS are required to disclose whether they have adopted a document retention and destruction policy that meets certain requirements – see **Tab 5**.
- **Other Policies:** If the organization participates in significant grant programs or joint ventures, it should adopt policies governing those activities as well.

3.10 Committee Structure & Operations

Appropriate structure and use of board committees can enhance the efficiency and effectiveness of the board. Board committees may be particularly useful with respect to board responsibilities that may involve a conflict of interest for management; such committees should – where possible – be comprised of directors who are independent from management and should be provided for in the organization’s bylaws. New York not-for-profits should note that unless the board already performs such governance activities, the Revitalization Act requires New York not-for-profits to have an audit committee comprised of “independent directors” (as defined in the Revitalization Act), or identify independent directors to oversee the audit (if any), approve certain transactions

and oversee the conflict of interest policy and the whistleblower policy (if any). Only independent directors of New York not-for-profits are permitted to participate in any board or committee deliberations or voting relating to such matters – see *Tabs 5-14*.

Key board committees include:

- ***Audit Committee:*** This committee is responsible for hiring and assuring the independence of the independent auditor (if any), and providing oversight of (a) the audit, review or compilation of financial statements, (b) internal controls and related processes designed to assure the reliability of financial data, and (c) risk management processes. The Revitalization Act requires that, in the case of any New York not-for-profit required to file an independent certified public accountant’s audit report with the Attorney General, either the full board or an audit committee comprised entirely of independent directors (with only independent directors participating in deliberations and voting) is required to (i) provide oversight of the organization’s accounting and financial reporting, and the audit of the organization’s financial statements, (ii) annually retain the independent auditor, (iii) review the results of the audit and any related management letter with the independent auditor, and (iv) perform additional audit oversight responsibilities where the not-for-profit is expected to have annual revenues in excess of \$1 million – see *Tab 10*. In addition, note that not-for-profit organizations that are required to file Form 990s with the IRS are required to disclose whether they have an audit committee that meets certain requirements – see *Tab 5*.
- ***Compensation Committee:*** This committee is responsible for determining and reviewing the compensation of the CEO and other senior managers in accordance with objective, documented and comparable information, and for ensuring that compensation is tied to the achievement of predetermined performance goals that are keyed to mission-related accomplishments. New York not-for-profits should note that the Revitalization Act prohibits any person from being present at or otherwise participating in any board or committee deliberation or vote concerning such person’s compensation, although such person may present background information or answer questions prior to the commencement of the relevant deliberations or voting – see *Tab 12*. In addition, note that not-for-profit organizations that are required to file Form 990s with the IRS are required to disclose whether their process for determining compensation of certain persons included, among other things, review and approval by independent persons – see *Tab 5*.
- ***Nominating and Governance Committee:*** This committee is responsible for nominating board candidates, ensuring that the size, leadership and composition of the board are appropriate, and overseeing governance structures and policies – see *Tab 11*.

However, whether a not-for-profit organization would find it useful to establish a particular committee will depend on the needs and circumstances of the organization. For example, an organization with significant financial resources or complex financial arrangements may benefit significantly by establishing an audit committee. In contrast, a small organization with simple financial structures may decide that it would be efficient and effective to entrust responsibility for ensuring the integrity of financial reporting to the entire board. (In either case, some members of the board should be financially literate and at least one director should be sophisticated concerning financial reporting and accounting.)

Committee charters help set forth the responsibilities of each committee and clarify whether decisional authority is delegated to the committee or whether the committee is to undertake the background work and make recommendations to the board for board approval.

As discussed above, not-for-profits with large boards may find it useful to organize an executive committee to take on a number of tasks that might otherwise fall to the full board, but can be achieved more efficiently in a smaller group. Additionally, boards of not-for-profit organizations often have a large number of committees that focus on operational or program aspects; for example, strategic planning, finance, fundraising and public relations. Care should be taken that Board committees do not unduly proliferate and result in the board becoming over-engaged in operational matters and hampering management's ability to perform effectively.

3.11 Board Self-Evaluation

The board should regularly evaluate its performance and seek to continually improve (see *Tab 15*). The board of a not-for-profit organization may wish to consider evaluating its effectiveness against BoardSource's "Twelve Principles of Governance that Power Exceptional Boards" (2005):

1	Constructive Partnership	Exceptional boards govern in constructive partnership with the chief executive, recognizing that the effectiveness of the board and chief executive are interdependent.
2	Mission Driven	Exceptional boards shape and uphold the mission, articulate a compelling vision, and ensure the congruence between decisions and core values.
3	Strategic Thinking	Exceptional boards allocate time to what matters most and continuously engage in strategic thinking to hone the organization's direction.
4	Culture of Inquiry	Exceptional boards institutionalize a culture of inquiry, mutual respect, and constructive debate that leads to sound and shared decision making.
5	Independent-mindedness	Exceptional boards are independent-minded. When making decisions, board members put the interests of the organization above all else.
6	Ethos of Transparency	Exceptional boards promote an ethos of transparency by ensuring that donors, stakeholders, and interested members of the public have access to appropriate and accurate information regarding finances, operations, and results.
7	Compliance with Integrity	Exceptional boards promote strong ethical values and disciplined compliance by establishing appropriate mechanisms for active oversight.
8	Sustaining Resources	Exceptional boards link bold visions and ambitious plans to financial support, expertise, and networks of influence.
9	Results-Oriented	Exceptional boards are results-oriented. They measure the organization's advancement towards mission and evaluate the performance of major programs and services.
10	Intentional Board Practices	Exceptional boards intentionally structure themselves to fulfill essential governance duties and to support organizational priorities.
11	Continuous Learning	Exceptional boards embrace the qualities of a continuous learning organization, evaluating their own performance and assessing the value they add to the organization.
12	Revitalization	Exceptional boards energize themselves through planned turnover, thoughtful recruitment, and inclusiveness.

3.12 Other Governance Practices

- **Minutes and Records:** Boards and their committees should ensure that minutes of their meetings, and actions taken by written consent, are contemporaneously documented. Minutes/records should detail or summarize the deliberative process undertaken by the board and committees as they address organizational issues in the proper discharge of their fiduciary duties; in this way, the minutes/records serve not only as important reminders as to what has been decided and why, but also serve as evidence as to how the board and committees fulfilled their fiduciary duties. State law may impose requirements in relation to minutes/records. In addition, note that not-for-profit organizations that are required to file Form 990s with the IRS are required to disclose whether the organization contemporaneously documents the meetings held by the board and any committee authorized to act on behalf of the board.
- **Financial Statements:** Directors are stewards of a not-for-profit organization's financial and other resources. The board should ensure that financial resources are used to further charitable purposes and that the organization's funds are appropriately accounted for by regularly receiving and reviewing up-to-date financial statements and any auditor's letters or finance and audit committee reports. Smaller organizations may prepare financial statements without any involvement of outside accountants or auditors. Others use outside accountants to prepare compiled or reviewed financial statements, while others obtain audited financial statements. State law may impose audit requirements on certain charities. Many organizations that receive funds from the U.S. Government are required to undergo one or more audits as set forth in the Single Audit Act and OMB Circular A-133. However, even if an audit is not required, a charity with substantial assets or revenue should consider obtaining an audit of its financial statements by an independent auditor. A summary of the requirements of Form 990, which is required to be filed with the IRS by certain not-for-profit organizations, is set forth at **Tab 5**.

* * * * *

IV. RELATED MATERIALS

Outline of Director Duties and Liabilities at **Tab 3**.

Annual Reporting Requirements and Public Information at **Tab 4**.

IRS Form 990 Memorandum at **Tab 5**.

Sample Board Guidelines at **Tab 6**.

Sample Code of Conduct and Ethics at **Tab 7**.

Sample Conflict of Interest and Related Party Transaction Policy at **Tab 8**.

Sample Whistleblower Policy at **Tab 9**.

Sample Committee Charters at **Tabs 10-14**.

Board Self Evaluation at **Tab 15**.

Issues and Concerns for Directors of Troubled Not-For-Profit Organizations at ***Tab 16***.

Warning signs of Distress at ***Tab 17***.

Comparison of Liquidation Options at ***Tab 18***.

Checklist for Directors of Troubled Nonprofits at ***Tab 19***.

Not-for-Profit Alert

New Governance Rules for New York Not-for-Profit Corporations – It's Time to Prepare

By Gabriel Gershowitz

Not-for-profit corporations incorporated under New York law will soon be subject to new governance and oversight rules, the highlights of which are summarized in this alert.¹ Subject to certain exceptions, most of the provisions will become effective on July 1, 2014. As discussed in more detail below, New York not-for-profit corporations should review and prepare to modify, if necessary, their governance structure, oversight functions, policies, and day-to-day operations to ensure compliance with the upcoming changes to New York law. Most of the provisions of the new law summarized below apply to not-for-profit corporations incorporated under New York law (regardless of whether they are tax-exempt under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the Code)); however, provisions described in the “Independent Audit Oversight” paragraph below relating to financial audits and reporting also apply to not-for-profit organizations incorporated elsewhere but registered in New York for charitable solicitation purposes. Certain provisions of the new law also apply to charitable trusts that are subject to the New York Estates, Powers and Trusts Law.

The Non-Profit Revitalization Act (the Act), which was passed by the New York State legislature this past summer and signed into law by the Governor in December 2013,² effects material changes to various laws in New York applicable to not-for-profit corporations. It represents the first major overhaul of the state’s Not-for-Profit Corporation Law (the N-PCL) in over 40 years. The Act focuses primarily on: (i) internal governance and oversight reforms; (ii) processes and procedures relating to specified corporate transactions, such as a merger, consolidation, or transfer or sale of all or substantially all of a not-for-profit organization’s assets; and (iii) elimination of certain statutory and administrative requirements considered to be outdated and/or unnecessarily burdensome and confusing. Set forth below is a chart summarizing the applicability of the Act, followed by summaries of its key provisions. At the end of this alert, we include recommendations on “what to do now.”

Not-for-Profit Corporations to Which the Act Applies³

Type of Entity

Scope of Applicability

New York not-for-profits:

■ Not-for-profit corporations incorporated in the State of New York (referred to in this chart as “NY NFPs”)	Entire Act except where noted below
■ NY NFPs that are not registered in NY for charitable solicitation purposes	Not required to comply with any provisions discussed under “Independent Audit Oversight” below
■ NY NFPs that have \$500,000 or less annual gross revenue	Not required to comply with any provisions discussed under “Independent Audit Oversight” below
■ NY NFPs that have annual revenue of \$1 million or less	Not required to comply with certain provisions discussed under “Independent Audit Oversight” below
■ NY NFPs that have fewer than 20 employees and annual revenue of \$1 million or less	Not required to comply with any provisions discussed under “Whistleblower Policy” below

Not-for-profits incorporated outside of New York:

■ Registered in NY for charitable solicitation purposes and with gross revenues in excess of the thresholds described in “Raising Thresholds Requiring an Independent Audit or Accountant Review”	Required to comply with provisions discussed under “Independent Audit Oversight” below
■ Authorized to conduct or conducts activities in NY	Generally not required to comply; however, Act provisions related to mergers are applicable

Gross Revenue & Support Threshold Applicability

Requirement	Until June 30, 2014	July 1, 2014 until June 30, 2017	July 1, 2017 until June 30, 2021	Beginning July 1, 2021
Audit report	In excess of \$250,000	In excess of \$500,000	In excess of \$750,000	In excess of \$1 million
Review report	\$100,000 to \$250,000	\$250,000 to \$500,000	\$250,000 to \$750,000	\$250,000 to \$1 million

Internal Governance and Oversight Reforms

The Act amends corporate governance requirements applicable to New York not-for-profit corporations in the following notable ways:

- **Non-Employee Chair.** No employee of the not-for-profit may serve as chair of the board or hold any other title with similar responsibilities. This requirement becomes effective January 1, 2015. The Act provides no “grandfather” rule.
- **Raising Thresholds Requiring an Independent Audit or Accountant Review.** The Act amends the New York Executive Law to raise the gross revenue and support thresholds that trigger the requirements that not-for-profits that are registered in New York for charitable solicitation purposes obtain and file with the New York Attorney General an independent certified public accountant audit report or review report, as set forth above. In addition, charitable organizations which use paid fund-raisers will no longer be required to obtain an audit report unless they meet the gross revenue and support thresholds.
- **Independent Audit Oversight.** The Act requires that, in the case of any not-for-profits required to file an independent certified public accountant’s audit report with the Attorney General (as discussed above), either the full board or an audit committee comprised entirely of independent directors (with only independent directors participating in deliberations and voting) is required to:
 - oversee the accounting and financial reporting of the organization and the audit of the organization’s financial statements;
 - annually retain the independent auditor;
 - review the results of the audit and any related management letter with the independent auditor; and
 - in the case of a New York not-for-profit expected to have annual revenues in excess of \$1 million:
 - review with the independent auditor the scope and planning of the audit prior to its commencement;
 - upon completion of the audit, discuss with the independent auditor material risks and weaknesses in internal controls identified by the auditor, any restrictions on the scope of the auditor’s activities or access to requested information, any significant disagreements between the auditor and management, and the adequacy of the corporation’s accounting and financial reporting processes; and
 - annually consider the performance and independence of the independent auditor.
- **Independent Directors.** Unless the board already performs such governance activities, New York not-for-profits will need to form an audit committee composed of “independent” directors or identify “independent directors” to oversee the audit (if any), approve certain transactions, and oversee the conflict of interest policy and the whistleblower policy (if any). Note that only independent directors may participate in any board or committee deliberations or voting relating to such matters. The Act does not prescribe a minimum number of audit committee members although the N-PCL generally requires that committees of the board have at least three members. The Act defines “independent director” as a director who meets the following “bright-line” tests:
 - is not, and has not been within the last three years, an employee of the corporation or an affiliate of the corporation, and does not have a “relative” who is, or has been within the last three years, a “key employee” of the corporation or an affiliate of the corporation;
 - has not received, and does not have a relative who has received, in any of the last three fiscal years, more than \$10,000 in direct compensation from the corporation or an affiliate of the corporation, other than reasonable compensation for service as a director; and
 - is not an employee of or does not have a substantial financial interest in, and does not

have a relative who is an officer of or has a substantial financial interest in, any entity that has made payments to, or received payments (not including charitable contributions) from, the corporation or an affiliate thereof for property or services in an amount that, in any of the last three fiscal years, exceeds the lesser of \$25,000 or two percent of such other entity's consolidated gross revenues.⁴

- **Mandatory Related Party Transaction Procedures and Ability of Attorney General to Unwind.** Prior to undertaking a transaction with a “related party,”⁵ the board of a New York not-for-profit must first determine if the proposed transaction is fair, reasonable, and in the corporation's best interest. This requirement applies to *all* related party transactions – there is no *de minimis* threshold. In addition, for “charitable organizations” (described below under “Eliminating Organization Types”), where a related party has a “substantial financial interest” in a proposed transaction, the board (or authorized committee) must follow certain procedural requirements, including the consideration of alternative transactions to the extent available, majority board or committee approval, and contemporaneous documentation of the board's considerations and decision.⁶ Notably, the Act enhances the power of the Attorney General to bring an action to enjoin, void, or rescind related party transactions that have been entered into without complying with applicable procedural requirements, as well as to remove directors or officers, order payment of double the amount of certain improperly obtained benefits, or seek restitution.
- **Conflict of Interest Policy.** All New York not-for-profit corporations – regardless of size – will be required to adopt a conflict of interest policy applicable to directors, officers, and key employees. While some not-for-profits have previously adopted a conflict of interest policy, disclosure of which is required by IRS Form 990, the Act expressly mandates the adoption of such policy.⁷ The Act requires that such policy, among other things: (i) define the circumstances that constitute a conflict; (ii) include procedures

for disclosing, addressing, and documenting related party transactions (discussed above); (iii) prohibit a conflicted person from participating in deliberations or voting or influencing the vote; and (iv) require directors to disclose to the corporation (upon joining the board and annually thereafter) any entities with which they are affiliated and with which the corporation has a relationship, and any corporate transactions possibly giving rise to a conflict for the director. The board or audit committee (or other independent board committee) must oversee the adoption and implementation of and compliance with the policy, and only independent directors may participate in any board or committee deliberations or vote on matters relating to the policy.

- **Whistleblower Policy.** New York not-for-profits that have 20 or more employees and annual revenue above \$1 million must adopt a whistleblower policy that includes procedures for reporting and investigating violations or suspected violations of law or corporate policies, and anti-retaliation provisions. In addition, the policy must designate a specific employee, officer, or director to administer the policy and report to the audit committee or the full board. The board or audit committee (or other independent board committee) must oversee the adoption and implementation of and compliance with the policy, and only independent directors may participate in any board or committee deliberations or vote on matters relating to the policy. Some not-for-profits have previously adopted whistleblower policies in response to applicable provisions of the Sarbanes-Oxley Act prohibiting retaliation against whistleblowers. IRS Form 990 also requires disclosure of any whistleblower policy.

Streamlined Corporate Transactions

The Act streamlines the state law hurdles associated with certain corporate transactions, including:

- **Eliminating Two-Step Approval for Certain Transactions.** Under existing law, a merger, dissolution, and certain other transactions (including, in the case of certain not-for-profits,

amending the charter by changing, eliminating, or adding a purpose or power) require both Attorney General and Supreme Court approval. Pursuant to the Act, certain transactions will no longer require both types of approvals – rather, they will only require Attorney General approval. However, court approval (i) will still be required if the corporation is insolvent or would become insolvent as a result of the transaction or if the Attorney General concludes that court approval is appropriate and (ii) will still be available to the organization if the Attorney General does not approve the transaction.

■ **Majority Vote for Routine Real Estate**

Transactions. The Act requires only a majority of the board or authorized committee to approve routine real estate transactions (such as the purchase, sale, mortgage, or lease of real property that does not constitute, after giving effect to the transaction, all or substantially all of the assets of the not-for-profit). However, a real estate transaction that constitutes an acquisition (after giving effect to the transaction) or disposition of all or substantially all of the assets of the not-for-profit still requires the approval of two-thirds of the entire board (or a majority of the entire board if there are 21 or more directors).

Simplified Formation and Day-to Day Operations

The Act includes features designed to simplify and reduce statutory and administrative requirements considered to be burdensome, including:

- **Permitting Electronic Meetings, Consent, and Communications.** The Act expressly permits electronic technology for certain meetings, notices, waivers, proxies, and other communications, and allows boards or committees to take action by written consent in electronic form. In certain cases, the Act permits website posting in lieu of newspaper publications.
- **Eliminating Organization “Types.”** Ending a statutory construct that has caused decades of confusion and undue burden for the not-for-profit community, the Act replaces the “letter types” of

not-for-profits (“A” through “D”) with two basic categories: charitable and non-charitable. A “charitable corporation” means any corporation formed or deemed to be formed for charitable purposes. “Charitable purposes” are defined to mean purposes contained in the certificate of incorporation that are charitable, educational, religious, scientific, literary, cultural, or for the prevention of cruelty to children or animals. A “non-charitable corporation” means any not-for-profit corporation other than a charitable corporation, including but not limited to one formed for any one or more of the following non-pecuniary purposes: civic, patriotic, political, social, fraternal, athletic, agricultural, horticultural, or related to animal husbandry or for the purpose of operating a professional, commercial, industrial, trade, or service association. Type A not-for-profits incorporated before July 1, 2014, will be deemed “non-charitable,” Type B and C not-for-profits incorporated before July 1, 2014, will be deemed “charitable,” and Type D corporations formed before July 1, 2014, will be deemed “charitable” or “non-charitable,” depending on the purposes as reflected in their existing charters.

- **Eliminating State Education Department Consent for Certain Entities.** The Act eliminates the requirement that certain not-for-profits obtain advance approval of the New York State Education Department for formation. Currently, not-for-profits involved in any type of education – such as “educating the public at large regarding social issues” – are required to obtain pre-approval from the State Education Department or the regents of the state university system. Under the Act, State Department approval will only be required for a school, library, museum, or historical society; note that the approval of the regents of the state university system is required for a college or university. Other not-for-profits whose charters include a purpose for which a corporation might be chartered by the regents of the state university system will be required only to provide the Commissioner of Education with a certified copy of the certificate of incorporation within 30 business days after formation.

- **Permitting Correction of Typographical or Similar Non-Material Errors in Certificates or Instruments.** The Act allows certificates and other instruments relating to not-for-profits that contain typographical or non-material errors to be corrected by e-mailing the New York Department of State.

What To Do Now?

- Review the organization's board leadership structure and succession plan to ensure that, by January 1, 2015, at the latest, the chair will not be an employee of the organization
- Determine which directors will qualify as "independent" in accordance with the Act's independence standards and, if necessary, plan to elect or appoint independent directors who will be responsible for providing oversight of the organization's conflict of interest policy, whistleblower policy (if any), audit oversight (where applicable), and other matters as prescribed by the Act
- Confirm whether it is anticipated that the organization's gross revenues and support are such that the organization's financial statements will be required to be audited or reviewed by an independent certified public accountant in light of the revised thresholds
- Review the organization's governing documents, policies, and procedures, including:
 - By-laws
 - Consider specifying that the chair of the board and/or any other individual holding a title with similar responsibilities must not be an employee and that the organization is required to adopt and comply with a conflict of interest policy and whistleblower policy (if applicable)
 - Audit committee charter (if any)
 - For organizations that are required to or otherwise file audited financial statements, determine whether the board or independent audit committee

will be responsible for oversight of the organization's accounting and financial reporting processes and the audit of its financial statements

- Conflict of interest policy and whistleblower policy
 - Any amendments to either of these policies should be approved by the board or independent audit committee
 - Consider incorporating into the conflict of interest policy the Act's disclosure and approval requirements with respect to related party transactions
- Board guidelines and code of conduct
 - Make any conforming changes as needed

1. Groups intending to engage in activity for not-for-profit purposes tend to do so through the structure of a not-for-profit corporation or an unincorporated association. Other types of entities such as trusts or LLCs may also be used, although they are much less common (and note that New York does not have an LLC statute expressly permitting the formation of a not-for-profit LLC). This alert focuses primarily on not-for-profit corporations, but readers should be aware that there are alternative structures that may be utilized.
2. The Governor's Approval Memorandum filed on December 19, 2013, states that the bill as passed by the state legislature contains certain technical defects and barriers to implementation that the legislature has agreed to remedy via additional legislation. The Governor's signing of the bill is on the basis of such additional legislation. On January 8, 2014, New York State Senator Ranzenhofer introduced Bill S6249, which, according to the state legislature's website, represents discussions between the Governor, the Attorney General, the Senate, and the Assembly intended to implement the necessary "minor technical changes" to the Act noted in the Governor's Approval Memorandum. As of this writing, Bill S6249 was referred to and has been approved by the Senate Rules Committee and is expected to be voted on by the full Senate in the near future, although no companion legislation has yet been introduced in the Assembly. Please click on the following link to access the full text of the Act, Bill A8072-2013: http://assembly.state.ny.us/leg/?default_fld&bn=A08072&term=2013&Summary=Y&Text=Y.
3. Certain provisions of the Act also apply to certain wholly charitable trusts.

4. While, the terms “related party” and “independent director” are also relevant for the purposes of compliance with the tax laws, it should be noted that tax laws and the Act differ in their definitions of these terms.
5. A “related party” is defined by the Act as: (i) any director, officer, or key employee of the corporation or any of its affiliates; (ii) any relative of any director, officer, or key employee of the corporation or its affiliates; or (iii) any entity in which an individual described in clause (i) or (ii) has a 35 percent or greater ownership or beneficial interest or, in the case of a partnership or professional corporation, a direct or indirect ownership interest in excess of five percent. The Act defines a “related party transaction” as any transaction, agreement, or other arrangement in which a “related party” has a financial interest and in which the corporation or any of its affiliates is a participant. An “affiliate” of a corporation is defined as any entity controlled by, in control of, or under common control with such corporation. A “key employee” is defined as any person who is in a position to exercise substantial influence over the affairs of the corporation.
6. For a number of years, the Code has imposed analogous rules setting parameters around “related party” transactions. The so-called “intermediate sanctions” provisions of Code Section 4958 establish specific guidelines, similar (but not identical) to the procedures required under the Act, that serve to protect the not-for-profit organization from violating the prohibition against private inurement and thereby incurring penalties. Notably, the Code’s guidelines in this area are not mandatory, but merely establish a “safe harbor,” whereas the Act requires that a not-for-profit take specific steps prior to participating in a related party transaction.
7. IRS Form 990 (the annual tax return filed by most not-for-profit organizations) requires disclosure of whether the organization has a conflict of interest policy. The tax law (and IRS Form 990) does not require that an organization have a conflicts policy; however, the IRS believes that the absence of a conflicts policy is a factor suggesting substandard corporate governance, which (the IRS maintains) may lead to violation of tax law principles applicable to exempt organizations, and therefore warrants heightened scrutiny.

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Not-For-Profit Practice Group

Duties and Liabilities of Directors of Not-For-Profit Organizations¹

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I. BACKGROUND FOR NOT-FOR-PROFIT ORGANIZATIONS

A tax-exempt not-for-profit organization is defined by its inability to distribute its profits to those who control it or to its directors² or officers.³ A not-for-profit corporation is organized “exclusively for a purpose or purposes, not for pecuniary profit or financial gain,” and “no part of the assets, income or profit of which is distributable to, or inures to the benefit of, its members, directors or officers except to the extent permitted under this statute.”⁴ The distinguishing characteristic is not a lack of profits, but the prohibition on pecuniary gain, and it is that prohibition – rather than statutory type of the not-for-profit corporation⁵ – that informs many of the liabilities and duties of its directors and officers.⁶

1.1 Role and Purpose of the Board of Directors in Not-For-Profit Corporations

Not-for-profit organizations are governed by a board of directors that has management powers.⁷ The board typically delegates responsibility for the day-to-day management of the organization to a management team appointed by the board. In addition, the New York Not-For-Profit Corporation Law (as amended by the Non-Profit Revitalization Act of 2013 (as amended, the “Revitalization Act”), the “NPCL”) §701 allows incorporators to diminish the management powers of the board through a provision in the certificate of incorporation that vests management of the corporation in one or more persons other than the board. Nonetheless, the board remains liable for breaches of its duties, even if the board does not retain management powers.⁸ This is important because:

- Most not-for-profit directors are volunteers and, as such, may incorrectly assume that they have few legal responsibilities or potential liabilities; and
- Not-for-profit directors often operate on a part-time schedule and do not devote much time to their directorships.

1.2 Enforcement of Duties and Liabilities

The NPCL identifies the following persons as potential enforcers of director and officer duties and liabilities:

- The Attorney General;⁹
- The corporation itself;¹⁰ or
- On behalf of the corporation: any director or officer;¹¹ a receiver, trustee in bankruptcy or judgment creditor;¹² or a member of the corporation, in limited derivative cases.¹³

The foregoing can be contrasted with the enforcement regime facing for-profit corporations, which have shareholders or owners capable of enforcing director and officer duties and liabilities.¹⁴ In addition, the Internal Revenue Service (“IRS”) and “cooperative prosecution” are political enforcers of not-for-profit directors and officers.

A. The Attorney General

In recent years, in the not-for-profit arena, the Attorney General has been the primary enforcement agent.¹⁵ In addition to being empowered to seek the dissolution of the corporation in certain instances¹⁶, the Attorney General may sue not-for-profit directors and officers for their misconduct or breaches of fiduciary duty under several statutory provisions:¹⁷

- NPCL § 112 (power to initiate an action or special proceedings against directors or officers);
- NPCL § 715 (power to enjoin, void or rescind a related party transaction, and/or seek restitution, an account of profits, director and officer removal and other penalties);
- NPCL § 719 (liability of directors in certain cases); and
- NPCL § 720 (power to initiate suits against directors and officers seeking certain types of relief).

In addition, the Attorney General has authority under the NPCL to regulate fundamental changes and to play a role in overseeing major developments and transactions at a not-for-profit corporation which require approval of the Attorney General or the supreme court of the State of New York, such as:

- Amendments to certificates of incorporation that change an organization's purpose;¹⁸
- Sale, lease, exchange or other disposition of all or substantially all the assets of the organization;¹⁹
- Mergers and consolidations; and²⁰
- Dissolution.²¹

This oversight can lead to an investigation of whether directors and officers have satisfactorily discharged their duties in deciding to dispose of some or all of the organization's assets.

- *Manhattan Eye, Ear & Throat Hospital and Memorial Sloan Kettering Cancer Center et al. v. Eliot Spitzer*. "Since as a type B, i.e., charitable, corporation, Manhattan Eye, Ear & Throat Hospital ("MEETH") does not have shareholders, the Attorney General, acting as *parens patriae*, is statutorily involved whenever such a charity seeks to dispose of all, or substantially all, of its assets, as MEETH resolved to do."²²

B. The IRS

The IRS has an important role to play in policing not-for-profit organizations and their directors and officers, using intermediate sanctions or revocation of tax-exempt status as a means of encouraging not-for-profit directors and officers to fulfill their fiduciary duties.²³

- *Kamehameha Schools* (an educational not-for-profit corporation whose board violated its duties). The IRS, instead of simply imposing sanctions, cooperated with the Hawaii Attorney General in formulating an agreement²⁴ with Kamehameha mandating implementation of a new governance regime and on the payment of a fine imposed by the Hawaii Attorney General.²⁵

C. Cooperative Prosecution

A not-for-profit organization whose directors are accused of violating their duties may face cooperative prosecution by several entities, including the Attorney General, the IRS, and any other regulatory body that has oversight of the corporation. For example:

- *Kamehameha Schools* – the IRS deferred to the Hawaii Attorney General in deciding what sanctions to apply.²⁶
- *Committee to Save Adelphi v. Diamandopoulos, et al.*²⁷ – the Board of Regents of the State of New York and the New York Attorney General instituted simultaneous actions. Although the Board of Regents and the New York Attorney General did not act in concert, we expect to see more cooperation among various regulators in the future.

1.3 Liability of Directors and Officers to Third Parties

The liabilities of directors and officers to third parties are governed by NPCL § 720-a.

- *Standard.* Gross negligence or intentional conduct.
 - A person serving without compensation as a director or officer of a not-for-profit entity shall not be liable to persons other than the not-for-profit entity, on the sole basis of the director's conduct in the execution of his or her office, unless such conduct, with respect to the person asserting liability, constituted gross negligence or was intended to cause the resulting harm to the person asserting such liability.²⁸
 - As a result of such a rigorous standard, directors and officers are rarely liable to third parties based on their corporate actions.

II. DUTIES OF NOT-FOR-PROFIT DIRECTORS AND OFFICERS

Directors and officers are fiduciaries of the not-for-profit organizations they serve.²⁹ The NPCL and the courts have defined three broad duties: the duties of care, loyalty and obedience.

2.1 The Duty of Care

The duty of care applicable to not-for-profit directors and officers is set forth in NPCL § 717:

Directors and officers shall discharge the duties of their respective positions in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.³⁰

Further, an action may be brought against one or more directors or officers to compel the defendant to account for his or her conduct for the neglect of, or failure to perform, or other violation of his or her duties in the management and disposition of corporate assets committed to his or her charge.³¹

The duty of care is closely modeled on the New York Business Corporation Law (“BCL”) for-profit model,³² and the legal expectation and legislative presumption is that courts will apply the standards uniformly.³³ In general, most commentators have found that, at a minimum, the duty of care requires directors to:

- Prepare for and regularly attend board and committee meetings;
- Exercise independent and informed judgment on all corporate decisions; and
- Take appropriate steps to be informed.³⁴

The American Bar Association's Corporate Director's Guidebook provides that:

A director's duty of care primarily relates to the responsibility to become and remain reasonably informed in making decisions and overseeing the corporation's business. [D]irectors satisfy their duty of care when they act with the care that a person in a like position would reasonably believe appropriate under similar circumstances. This "reasonable belief" incorporates a director's personal belief, but it also must be based upon a rational analysis of the situation as understandable to others. The phrase "like position" means that a director's actions must incorporate the basic attributes of common sense, practical wisdom and informed judgment generally associated with the position of corporate director. The phrase "under similar circumstances" recognizes that the nature and extent of the preparation for and deliberations leading up to decision-making, and the level of oversight, vary depending on the corporation's circumstances and the nature of the decision to be made.³⁵

A. Application of the Duty of Care

The director's duty of care applies both to his or her decision-making function and to his or her oversight function.³⁶

- Decision-making depends on the facts and circumstances at a certain point in time.
- The director's oversight function, by contrast, involves "ongoing oversight of the activities and affairs of the corporation."³⁷

Within the for-profit context, "[i]t is the directors' duty to make necessary inquiries" where "suspicions are aroused or should be aroused."³⁸ However, "directors are not required to ferret out wrongdoing absent a specific warning or other obvious "red flag."³⁹ Therefore, a director is not liable unless he or she failed "to devote attention to ongoing oversight of the activities and affairs of the corporation . . . when particular facts and circumstances of significant concern materialize that would alert a reasonably attentive director to the need."⁴⁰

This standard appears to apply to not-for-profit corporations as well. In the following cases, there was sufficient evidence to find that directors may be liable for breaches of the fiduciary duty of care because they failed to address significant violations or irregularities in the governance of their organizations:

- *United States v. William Aramony et al.*⁴¹ See below for further discussion.
- *Vacco v. Diamandopoulos.*⁴² See below for further discussion.

B. Applications of the Duty of Care to Investment Decisions

Not-for-profit organizations are likely to face increased scrutiny by the Attorney General and the IRS into investment performance and investment decisions and general compliance with the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") rules, codified by New York as the New York Prudent Management of Institutional Funds Act ("NYPMIFA").⁴³ These rules impose a statutory duty of care, expenditure rules for endowments and rules required for delegation of investment management. In the exercise of its investment

authority, the administration of assets received for specific purposes and the delegation of investment management decisions, the board should consider the following:

- *Reasonable Costs.* A not-for-profit organization should incur only those investment fees and costs which are appropriate and reasonable in relation to its assets, purposes and the skills available to it.⁴⁴
- *Investment Factors.* The board should consider the following factors when managing and investing funds: (a) general economic conditions; (b) the possible effect of inflation or deflation; (c) expected tax consequences, if any, of investment decisions or strategies; (d) the role that each investment or course of action plays within the overall investment portfolio of the fund; (e) the expected total return from income and the appreciation of investments; (f) other resources of the organization; (g) the needs of the organization to make distributions and to preserve capital; and (h) an asset's special relationship or special value, if any, to the purposes of the organization.⁴⁵
- *Investment Strategy and Policy.* Investment decisions should not be made in isolation but in the context of an overall investment strategy having risk and return objectives reasonably suited to the organization.⁴⁶ Not-for-profit organizations should have a written investment policy setting forth guidelines on investments and delegation of management and investment functions in accordance with applicable law.⁴⁷ A not-for-profit organization should make reasonable efforts to verify facts relevant to the management and investment of its fund.⁴⁸
- *Diversification.* Not-for-profit organizations should diversify their investments unless the organization prudently determines that the purposes of its investments are better served without diversification because of special circumstances.⁴⁹ Decisions to not diversify should be reviewed at least annually.⁵⁰
- *Timing of Investment Decisions.* Not-for-profit organizations should carry out decisions concerning the retention or disposition of property or to rebalance a portfolio promptly, unless there is a good reason not to.⁵¹
- *Delegation of Management and Investment Functions.* Not-for-profit organizations should: (a) carefully carry out decisions concerning the selection, retention or termination of investment advisors, including assessing any conflicts of interest or other factors affecting their independence; (b) carefully monitor an investment advisors performance and compliance; and (c) provide that each contract delegating authority to an investment advisor should be terminable upon no more than 60 days' notice.⁵²

C. Good Faith Reliance on Information under the Duty of Care

NPCL § 717(b): "In discharging their duties, directors and officers, when acting in good faith, may rely on information, opinions, reports or statements including financial statements and other financial data, in each case prepared or presented by:⁵³

- One or more officers or employees of the corporation, whom the director believes to be reliable and competent in the matters presented;⁵⁴
- Counsel, public accountants or other persons as to matters that the directors or officers believe to be within such person's professional or expert competence;⁵⁵ or
- A committee of the board upon which they do not serve, duly designated in accordance with a provision of the certificate of incorporation or the bylaws, as to matters within its designated authority, which committee

the directors or officers believe to merit confidence, so long as in so relying they shall be acting in good faith and with [the requisite] degree of care.”⁵⁶

“Persons shall not be considered to be acting in good faith if they have knowledge concerning the matter in question that would cause such reliance to be unwarranted. Persons who so perform their duties shall have no liability by reason of being or having been directors or officers of the corporation.”⁵⁷

Competence vs. Confidence

For reliance to be defensible it must be placed upon experts who are competent in their fields; competence generally implies expertise.⁵⁸

When relying on an “expert” opinion, diligence requires that the board investigate the expert’s qualifications and ascertain his or her competence. The director must review the material and follow up with any questions presented by that material. “If all a director knows about a report is the conclusion, he is not acting in good faith or with the required diligence.”⁵⁹ Moreover, “like position refers to the individual director, his or her specific function, expertise and length of service. An insider with greater knowledge may be held to a higher standard than a director who was recently appointed or has no affiliation with the organization.”⁶⁰

Conversely, in the case of a committee composed of the organization’s board members, a reasonable belief by the other directors who are not members of the committee that the committee members will act in good faith and in a disinterested manner is sufficient to satisfy the due care standard.⁶¹

D. The Business Judgment Rule

The business judgment rule protects director decision-making by limiting the scope of judicial review. The business judgment rule creates a presumption that the decision being challenged was made by “disinterested and independent directors on an informed basis and with a good faith belief that the decision will serve the best interests of the corporation.”⁶² If the party challenging the decision does not overcome the presumption, then the business judgment rule prohibits the court from examining the merits of the underlying business decision.⁶³ The business judgment rule has never been codified in New York, and therefore is not found in the BCL or the NPCL. However, New York’s highest court has accepted its use in for-profit cases⁶⁴ and in the not-for-profit arena.⁶⁵

- *Consumer Union of U.S., Inc.* (challenging legislation allowing for the conversion of defendant from a not-for-profit to a for-profit corporation, and directing that certain organization assets be used for various public health and charitable purposes). Plaintiffs alleged that the board breached its fiduciary duties by deciding to convert and by encouraging politician-legislators to decide how its assets should be used after conversion. Noting that the legislation supersedes all inconsistent common-law and statutory duties, the court made the point that even if this was not the case, “the business judgment rule...bars plaintiff’s claim.”⁶⁶
- *William J. Higgins v. NYSE* (challenging the proposed merger of the NYSE and Archipelago). Plaintiff alleged breaches of the fiduciary duty of loyalty, due care and good faith by the NYSE’s board and CEO.⁶⁷ The court in *Higgins* cited *Consumer Union* as authority for the applicability of the business judgment rule to decisions made by boards of not-for-profit organizations.⁶⁸
- *Eliot Spitzer, as Attorney General of the State of New York v. Schussel et al.*, (alleging a breach of fiduciary duty by defendant directors for a number of self-dealing transactions). The Court recognized the business judgment rule but held that where there is a “showing that a breach of fiduciary duty occurred, including

evidence of bad faith and self-dealing, or decision affected by inherent conflicts of interest, judiciary inquiry is triggered.”⁶⁹

New York courts have also applied the business judgment rule in cases involving residential cooperative boards, religious corporations and educational institutions regulated by the New York State Board of Regents.⁷⁰

- *40 West 67th Street, Respondent, v. Pullman; Levandusky v. One Fifth Avenue Apartment Corp.* (boards of residential cooperatives).⁷¹

E. NPCL § 719: Liability of Directors in Certain Cases

NPCL § 719 discusses certain situations relating to financial decision-making/fiscal management in which directors who vote for or concur in the action can be “jointly and severally liable to the corporation for the benefit of its creditors or members or the ultimate beneficiaries of its activities, to the extent of any injury suffered by such persons, respectively, as a result of such action, or, if there be no creditors or members or ultimate beneficiaries so injured, to the corporation, to the extent of any injury suffered by the corporation as a result of such action.”⁷²

- **Cash or Property Distributions.** Any distribution of the corporation’s cash or property to members, directors or officers, other than a distribution permitted under NPCL § 515 (such as the payment of reasonable compensation), may create liability.⁷³ Dividends are prohibited, but certain distributions of cash or property are authorized.⁷⁴
- **Security Redemptions.** Any redemption of capital certificates, such as bonds or security interests, member’s capital contributions, or subvention certificates, may give rise to liability unless statutory prescriptions are followed.⁷⁵
- **Interest Payments.** Payment of fixed or contingent periodic sums to the holders of subvention certificates or of interest to the holders or beneficiaries of bonds to the extent such payment is contrary to NPCL §§ 504 or 506.⁷⁶
- **Dissolution and Distribution of Assets.** Dissolution must be accomplished according to statute. A failure to pay for all known liabilities of the corporation could create liability. Dissolution is covered in NPCL Article 10 and Article 11.
- **Corporate Loans.** Corporate loans to directors and officers are illegal in most cases.⁷⁷ They are discussed in more detail below.

If a director is present at a board or committee meeting where an action is taken and such action does not comply with the statutes listed above, *concurrence is assumed unless dissent is recorded* in the minutes of the meeting or otherwise delivered in writing. If a director is not present at the relevant meeting, he is assumed to concur unless dissent is delivered or sent by registered mail or filed in the minutes of the proceedings, within a reasonable time after learning of such action.⁷⁸ In addition, a director against whom a claim is successfully made is entitled to contribution from other concurring directors.⁷⁹

F. Loans to Directors

- NPCL § 716 prohibits loans from a not-for-profit corporation to its directors or officers, or to any corporation or firm in which one or more of the non-profit's directors or officers hold a substantial financial interest.⁸⁰
- A loan that violates § 716 is considered a violation of the director's duty to the corporation.⁸¹
- Exceptions:
 - Loans through the purchase of bonds, debentures or similar obligations of the type customarily sold in public offerings or through ordinary deposit of funds in a bank.⁸²
 - Loans between two charitable organizations.⁸³ However, directors should inform themselves of and must properly resolve and document any potential conflicts of interest, such as a director who serves on both boards.
 - Loans to non-officer employees of not-for-profits.⁸⁴

2.2 The Duty of Loyalty

“The duty of loyalty requires directors to exercise their powers in good faith and in the best interests of the corporation, rather in their own interests or the interest of another entity or person.”⁸⁵

Good faith has been equated with “rules of conscientious fairness, morality and honesty in purpose”⁸⁶ and requires “the exercise of an honest judgment and an honest and unbiased consideration of any fact or circumstances affecting the general interest of the corporation.”⁸⁷ The good faith standard mandates an objective review of facts and circumstances in an effort to ascertain the defendant's state of mind before making a deliberation of whether the defendant's actions were taken in good faith.⁸⁸

In effect, “the duty of loyalty is thus transgressed when a corporate fiduciary . . . uses his or her corporate office . . . to promote, advance or effectuate a transaction between the corporation and such person (or an entity in which the fiduciary has a substantial economic interest, directly or indirectly) and that transaction is not substantively fair to the corporation.”⁸⁹

Further, an action may be brought against one or more directors or officers to compel the defendant to account for his or her official conduct for the acquisition by himself, transfer to others, loss or waste of corporate assets due to any neglect of, or failure to perform, or other violation of his or her duties.⁹⁰

The following are classic examples of situations that implicate the duty of loyalty:

- A director appearing on both sides of a transaction;
- A director receiving a personal benefit from a transaction;⁹¹ or
- A director usurping or appropriating a financial opportunity for his or her own personal gain.

Although there is no specific mention of this duty in the NPCL beyond § 717(a)'s exhortation to discharge duties in good faith, the duty of loyalty has been recognized by New York courts.⁹²

- *American Baptist Churches of Metropolitan New York v. Galloway* (by creating a competing company to exploit, for personal gain, corporate opportunity created for the not-for-profit, the defendant director breached his duty of loyalty).⁹³

A. NPCL § 715 – Related Party Transactions

The Revitalization Act has revised NPCL § 715 to address “related party transactions.”⁹⁴ Under the Revitalization Act, the board of a New York not-for-profit (or an authorized board committee (the “Committee”)) must determine that a related party transaction is fair, reasonable and in the corporation’s best interest at the time of such determination. Further, any director, officer or “key person”⁹⁵ who has an interest in a related party transaction must disclose in good faith to the board, or the Committee, the material facts concerning their interest. In addition, for transactions involving a charitable organization in which a related party has a “substantial financial interest” (which is not defined in the NPCL), boards or Committees must follow certain procedural requirements, including consideration of alternative transactions to the extent available, majority board or committee approval and contemporaneous documentation of the board or Committee’s considerations and decision. Interested officers and directors may not participate in deliberations or voting relating to the transaction at issue; however, they may be requested to present information concerning the transaction at a board or committee meeting prior to the commencement of deliberations or voting relating thereto.⁹⁶ A 2015 amendment to the Revitalization Act clarified that directors who are present at a meeting but not present at the time of a vote due to a conflict of interest or related party transaction are deemed to be present at the time of the vote for quorum purposes. A 2016 amendment to the Revitalization Act revised the definition of “related party transaction” to allow a transaction with a related party to proceed without board review if the transaction is (i) of limited monetary value; (ii) would not usually be reviewed by the board in the ordinary course of business and is available to others on the same or similar terms; or (iii) provides a charitable benefit to a member of a charitable class where the benefit is available to others on similar terms.

B. NPCL § 715-a – Conflict of Interest Policy

The Revitalization Act also requires that all New York not-for-profit corporations – regardless of size – have a conflict of interest policy applicable to directors, officers, and key persons. While some not-for-profits may have previously adopted a conflict of interest policy, disclosure of which is required by IRS Form 990, the Revitalization Act expressly mandates the adoption of such policy.⁹⁷ The Revitalization Act requires that such policy, among other things:

- Define the circumstances that constitute a conflict;⁹⁸

- Include procedures for disclosing conflicts or possible conflicts to the board or to a committee of the board, and procedures for the board or committee to determine whether a conflict exists;⁹⁹
- Prohibit a conflicted person from participating in deliberations or voting or improperly influencing the vote on the matter giving the rise to the conflict;¹⁰⁰
- Include procedures for disclosing, addressing and documenting related party transactions;¹⁰¹ and
- Require directors to disclose to the corporation (upon joining the board and annually thereafter) any entities with which they are affiliated and with which the corporation has a relationship, and any corporate transactions possibly giving rise to a conflict for the director.¹⁰² The board must oversee the adoption and implementation of and compliance with the policy, and only independent directors may participate in any board deliberations or vote on matters relating to the policy.

C. Compensation of Directors and Officers

NPCL § 202(a)(12) sets the standard for appropriate compensation for officers and directors.

“Each corporation, subject to any limitations provided in this chapter or any other statute or its certificate of incorporation, shall have power in furtherance of its corporate purposes . . . [t]o elect or appoint officers, employees and other agents of the corporation, define their duties, fix their reasonable compensation and the reasonable compensation of directors . . . [s]uch compensation shall be *commensurate* with services performed.” (emphasis added)¹⁰³

NPCL § 515(b) further provides that a “corporation may pay compensation in a reasonable amount to members, directors, or officers for services rendered.”

Commentators and courts have focused on the “commensurate” language in the statute. Given the not-for-profit ethos of charitable organizations, “[t]he clear implication is that legislators are less tolerant of excessive executive compensation in the nonprofit arena than they are in the business community.”¹⁰⁴ Therefore, it is important for boards to exercise diligence in reviewing and approving compensation programs.

Furthermore, the IRS recently imposed stricter disclosure requirements on executive pay. Any organization filing a Form 990 must list all of its current officers, directors, and trustees, regardless of whether any compensation was paid to such individuals. The organization must also list up to 20 current employees who satisfy the definition of “key person” (persons other than directors or officers who hold positions to exercise substantial influence over the organization¹⁰⁵), and its five current highest-compensated employees with reportable compensation of at least \$100,000 from the organization and related organizations who are not officers, directors, trustees, or key persons of the organization.¹⁰⁶ See also the discussion relating to excess benefit transactions, below.

In addition, the IRS recently added a requirement to Form 990 to require disclosure relating to embezzlement and fraud. Specifically, Form 990 requires that the organization report if it became “aware during the year of a significant diversion of the organization’s assets.” The IRS considers a diversion to be “significant” if the gross value of all diversions exceeds the lesser of \$250,000 or 5% of the organization’s receipts or assets for its tax year or as of the end of the tax year, respectively.¹⁰⁷

D. Key Cases: Adelphi and United Way

*Committee to Save Adelphi v. Diamandopoulos*¹⁰⁸

The board of trustees of Adelphi University breached its duty of care in fixing the salary and additional compensation of the University President, Dr. George Diamandopoulos, from 1987 to 1995. Specifically, Diamandopoulos received raises of approximately \$30,000 per year starting from \$95,000 in 1985, so that by 1996 his base salary was \$330,750. In addition to the base salary, Diamandopoulos received a life insurance policy of \$1.25 million, an annual \$60,000 contribution to Diamandopoulos' pension fund, a contribution to a sabbatical year salary at one sixth of his base salary which was approximately \$55,000, an option to buy an apartment in New York City for \$905,000 (a 17% discount from the price at which Adelphi acquired it ten months earlier), free rent worth \$36,000 at a house near Adelphi, operating costs for the two residences at approximately \$100,000, and other perks. By 1996, the estimated total compensation when all of these factors were taken into account was \$837,113.

Except for one year, the full board of trustees did not review or approve the President's compensation. The salary and additional compensation was set by a three-member ad-hoc committee, without explanation of Diamandopoulos' contributions or an evaluation of how his performance rated against the academic goals of the University, and the committee did not consider salaries of presidents at comparable institutions.

The Board of Regents concluded that Diamandopoulos' salary was not commensurate with the work he performed for Adelphi University, as mandated by NPCL § 202(a)(12). The Board of Regents found that the trustees breached their duty of care by failing to take the necessary steps to inform themselves of the compensation decisions, and for awarding Diamandopoulos compensation between 1993 and 1996 that was greater than the value of the services he performed. The Regents removed eighteen of nineteen trustees for breaching their fiduciary duty of care. Finally, the Board of Regents found that Diamandopoulos breached his duty of loyalty by accepting the excessive payments.

Committee to Save Adelphi also provides an example of self-dealing. One trustee, Ernesta Procope, received personal benefits from University insurance contracts. Procope owned and operated E.G. Bowman, Inc., a licensed broker of insurance policies. In 1986, the University's insurer threatened to cancel its coverage. The board of trustees formed a committee, chaired by Procope on account of her expertise in the insurance industry, which was charged with finding a new insurer for Adelphi. Rather than conducting an arms-length search for a new insurer, Procope installed E.G. Bowman as the insurance broker for the University. Diamandopoulos personally authorized the use of Procope's company, and explained to the board of trustees that its services were free of charge when in fact, Diamandopoulos arranged for E.G. Bowman to receive fees of \$1,227,949 in 1987. These terms were never disclosed to the board of trustees and thus the guidelines set forth in NPCL § 715 for implementation of interested director transactions that were then in effect were not followed. Finally, this arrangement occurred while Procope was on the committee responsible for setting Diamandopoulos' compensation.¹⁰⁹ Although the arrangement that E.G. Bowman brokered may have been fair, the fact that Procope purposefully used her directorship for personal gain, and did not put the University's needs first by searching for the best available option, created a breach of the duty of loyalty for which she was found liable.

The Board of Regents found that both Diamandopoulos and Procope violated the duties of care and loyalty on several accounts. In the criminal counterpart to the Board of Regents decision, the Attorney General in the State of New York sued the removed trustees for damages relating to their breaches of the duties of care and loyalty.¹¹⁰ There was no cooperation between the Attorney General and the Board of Regents in sanctioning the former trustees or the University. However, the New York Supreme Court did incorporate the Board of Regent's

investigation, findings, and judgment in its decision. The Attorney General sought damages from the trustees who benefited from the improper payments and interested transactions, as well as from those who allowed the payments. The ousted trustees settled the criminal action by paying \$1.23 million to the University and assuming \$400,000 in legal fees, and Diamandopoulos paid approximately \$750,000 in damages to the University.¹¹¹

*The United Way and William Aramony*¹¹²

William Aramony, the CEO of the United Way of America, and other United Way officials, were found to have engaged in self-dealing, and to have breached their fiduciary duties of care and loyalty. Aramony used company funds for chauffeur service, to buy personal gifts, take vacations and monthly flights to Florida, and to pay his girlfriend a salary despite that fact that she worked only one or two days a month. Aramony arranged these payments through Thomas Merlo, the CFO hired by Aramony, by paying him large bonuses. These bonuses were not based on work performed; rather, they were vehicles through which the executives were able to appropriate company funds for private use. In one instance, Merlo received a bonus of \$300,000, and subsequently allocated \$89,000 to Aramony's girlfriend.¹¹³ In addition, Aramony bought a condominium in Florida with United Way funds for \$125,000, funded through Steven Paulachak, another Aramony appointee in control of a subsidiary of United Way, ostensibly for use for company functions, but which was in fact for personal use.

The CFO purchased annuity funds in the name of the United Way then, using his position, caused them to be transferred to himself as annuitant. In two such schemes, he was able to defraud the United Way out of approximately \$500,000.

The Chief Executive of PUI, a subsidiary of United Way, transferred PUI funds to Aramony, facilitated Aramony's use of corporate funds for private matters, and filed fraudulent tax returns to cover up these transactions.

The court found that all three officials had violated their duties of care and loyalty, and had engaged in a "virtual roadmap for what to avoid in not-for-profit governance."¹¹⁴ Additionally, the court found that the United Way board of directors breached its fiduciary duty of care by not staying sufficiently apprised of the organization's affairs, noting the following in its decision:

- There were only two board meetings per year and to prepare for those meetings, board members reviewed briefing books created by Aramony that did not contain substantial financial or strategic analysis of the organization or of any of its planned initiatives;
- Directors did not seek to investigate the company's practices or to insist on greater disclosure by management; and
- The board of directors did not investigate whether certain spin-offs were necessary or even financially viable and beneficial.

Concurrent with the convictions above, the board's conduct became the subject of an investigation by the New York Attorney General and was resolved in an out-of-court settlement pursuant to which the board was required to institute oversight procedures and to become more informed about the workings of the business.¹¹⁵

2.3 The Duty of Obedience

The duty of obedience concerns a director's obligation to ensure that the mission of the corporation is upheld and perpetuated. This duty is not stated explicitly in the NPCL, and is not codified in any statute relating to not-for-profit organizations, but does find support in NPCL §§ 201-202, and 402(a)(2), which require a not-for-profit organization to have a purpose in order to incorporate. The duty of obedience would be at issue in the following circumstances:

- Diversion of corporate resources away from the stated purpose, no matter how worthy the use, is not legally justifiable and exposes the director to liability for breaching the duty of obedience.¹¹⁶
- In the context of a merger or sale of all or substantially all of its assets, the organization must present a verified position to the Attorney General or the requisite supreme or county court setting forth "[t]hat the consideration and the terms of the sale, lease, exchange or other disposition of the assets of the corporation are fair and reasonable to the corporation, *and that the purposes of the corporation*, or the interests of its members will be promoted thereby." (emphasis added)¹¹⁷
 - *Manhattan Eye, Ear and Throat Hospital v. Spitzer*. The trustees of the hospital sought court approval to sell the hospital facilities and the land to a cancer hospital and real estate developer. As part of this sale, the hospital would close certain programs that were mandated by its corporate purpose. Noting that the board failed or refused to consider other sale alternatives that would have allowed the hospital to continue as a specialty hospital in its chosen fields, the court found the board breached its duty of obedience, holding that "the proposed use of the assets involves a new and fundamentally different corporate purpose."¹¹⁸
 - *Agudist Council of Greater New York v. Imperial Sales Company*¹¹⁹ (a synagogue's sale of its property housing a senior center was invalidated because preservation of a service for seniors was an explicit organizational purpose).
 - However, *In the Matter of the Application of Sculpture Center, Inc.*, the New York Supreme Court allowed the sale of a building belonging to the Friends of the Sculpture Center, as the proceeds were only to be used to buy a larger building in a different location, thus preserving the organization's purpose.¹²⁰

III. LIABILITIES IMPOSED BY THE IRS: INTERMEDIATE SANCTIONS

3.1 Background

IRC § 501(c)(3) proscribes any private inurement or benefit as a condition of tax-exempt status.

- Private inurement and benefit occurs when an officer or director profits financially or receives an improper advantage from the corporation's actions or existence.¹²¹

On January 23, 2002, IRC § 4958 was enacted, creating intermediate sanctions, a mechanism short of revocation of exempt status to punish those who benefit or inure at the expense of their organizations. However, the imposition of intermediate sanctions does not preclude a revocation of tax-exempt status if the IRS deems it necessary.¹²²

3.2 Excess Benefit Transactions

IRC § 4958 defines violations that inure or cause benefit to certain “disqualified persons” as “excess benefit transactions,” and imposes a two-tiered excise tax on individuals who profit from those transactions.

- An “excess benefit transaction” is a transaction in which an economic benefit is provided by an applicable tax-exempt organization, directly or indirectly, to a “disqualified person”, where the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) that is received.¹²³

The following may be seen as excess benefit transactions:

- Certain sales of property;
- Unreasonable compensation;¹²⁴
- Direct and indirect compensation or enrichment (through a controlled intermediary);¹²⁵ and
- Certain gifts by sponsors or other entities in a transaction to directors or officers.

3.3 Definition of Disqualified Persons

The IRC definition of “disqualified persons” includes:

- A person who was, at any time during the five-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization;
- A member of the family of such an individual; and
- A person who controls at least 35% of the transacting or benefiting entity.¹²⁶

Treasury Regulation 53.4958-3(c) defines “substantial influence” to mean:

- Any member of the organization’s governing body, presidents, CEOs, treasurers, CFOs and any other individual regardless of title who either “has ultimate responsibility for implementing the decisions of the governing body or for supervising the management” or “has ultimate responsibility for managing the finances of the organization;”¹²⁷ or
- Certain other persons can have “substantial influence,” depending on specific facts and circumstances, such as whether the person is a founder or a significant contributor to the organization.¹²⁸

3.4 Taxes on Disqualified Persons and Managers Who Engage in Excess Benefit Transactions

A “disqualified person” who engages in an excess benefit transaction is liable for excise taxes under IRC § 4958 as follows:

- An initial tax of 25% of the excess benefit; and

- If the excess benefit is not returned within a reasonable time, then the IRS may levy an additional tax of 200% of the excess benefit on the offending individual.¹²⁹

Additionally, a manager who does not fall within the disqualified person definition can still be taxed, albeit at a lower rate, if that manager is deemed to have knowingly participated in an excess benefit transaction.¹³⁰ A manager may be deemed to have “knowingly participated” if the manager had actual knowledge that the transaction would be an excess benefit transaction and either affirmatively approved the transaction or did not oppose the transaction.¹³¹ A manager who knowingly participates in an excess benefit transaction and where such participation was willful and/or not the result of reasonable cause (such as reliance upon a written opinion of counsel) will be taxed at 10% of the excess benefit.¹³²

Exceptions to the Disqualified Persons Rule

- ***The “First Bite” Exception.*** IRC § 4958 does not apply to payments that are made pursuant to fixed, objective terms specified in a contract before the person was in a position to exercise substantial influence.¹³³ Once the person has achieved substantial influence, any future payments are reviewable.¹³⁴
- ***Reliance on a Professional Opinion Exception.*** A manager’s participation in a prohibited transaction will ordinarily not be considered “knowing” if, after “full disclosure of the factual situation to an appropriate professional, the organization manager relies on a reasoned written opinion of that professional with respect to elements of the transaction within the professional’s expertise.”¹³⁵ “Appropriate professionals” would include legal counsel (including in-house legal counsel) or certified public accountants or certified public accounting firms with expertise regarding the relevant tax matters.¹³⁶
- ***“Safe Harbor” Rebuttable Presumption.*** The organization, by taking certain steps, can create a rebuttable presumption that certain compensation agreements or property transfers were reasonable.¹³⁷
- ***Advance Decision.*** The board or a committee composed entirely of individuals who do not have a conflict of interest with respect to the transaction must make an advance decision regarding the transaction.¹³⁸
- ***Comparability Data.*** The decision-making body must obtain and rely upon appropriate comparability data in making its decision.¹³⁹ Appropriate data may include:¹⁴⁰
 - Appraisals;
 - Other offers;
 - Availability of similar services in the geographic area of the organization; and
 - Comparable compensation schemes.

- **Disinterested Participation.** Disqualified persons cannot participate in the discussion or the vote, but may be present to answer questions (although they may not be present during any debate or vote).¹⁴¹
- **Document the Decision.** The board or committee must document the basis for its decision within 60 days of the action taken, or before their next meeting.¹⁴² Documentation must include:
 - Terms of the transaction and date approved;
 - Members of the board or committee present when the transaction was approved, and those who voted on it;
 - Comparability data relied upon and how it was obtained;
 - Actions taken with respect to consideration of the transaction by a board or committee member who has a conflict of interest with respect to the transaction; and
 - The basis for determining the compensation or payment if the board or committee determines that what is reasonable or fair market value is higher or lower than the range of comparable data obtained.¹⁴³

However, if the organization reimburses excise taxes, pays personal expenses, offers to engage in transactions not at fair market value, or pays insurance premiums for excise tax liability for the individual, such payments are generally considered excess benefits unless they are included in the person's compensation package, which, in turn, is subject to the reasonableness requirement.¹⁴⁴

3.5 Example of Application of Intermediate Sanctions

Kamehameha Schools

The settlement imposed intermediate sanctions of only \$40,000 per trustee even though the IRS had originally sought \$6.5 million.¹⁴⁵ However, contingent on that settlement was the agreement that the organization would pay a \$25 million fine to the state of Hawaii. Additionally, by the terms of the settlement, it was agreed that the implicated trustees would resign and that the organization would follow operational parameters presented in the Closing Agreement in order to retain its exempt status.¹⁴⁶

IV. INDEMNIFICATION AND INSURANCE FOR NOT-FOR-PROFIT DIRECTORS AND OFFICERS

4.1 Indemnification

NPCL §§ 721-726 provide the statutory framework for indemnification where directors act:

- In good faith;
- For a purpose that he or she reasonably believed to be in, or, in the case of service of any other corporation not opposed to, the best interests of the corporation; and

- In criminal actions or proceedings had no reasonable cause to believe that his or her conduct was unlawful.¹⁴⁷

Directors and officers *must* be indemnified if they have succeeded in defending a civil or criminal action or proceeding.¹⁴⁸ The NPCL allows a not-for-profit corporation to provide indemnification rights and requirements beyond those mandated by statute in the certificate of incorporation or in the bylaws as long as the additional indemnification provisions are not contrary to the indemnification requirements of the NPCL.¹⁴⁹

A corporation is prohibited from indemnifying a director where it has been established by an adverse final judgment that his or her acts “were committed in bad faith or were the result of active and deliberate dishonesty and were material to the cause of action so adjudicated, or that he personally gained in fact a financial profit or other advantage to which he was not legally entitled.”¹⁵⁰

4.2 Insurance

Indemnification provisions in the bylaws or certificate of incorporation provide protection only if, and to the extent, the organization has the financial capability to make indemnification payments. Many organizations purchase indemnity insurance to reassure potential directors that their costs will be covered in case of a claim.¹⁵¹ According to the NPCL¹⁵² a not-for-profit corporation can obtain insurance to:

- Reimburse itself for any indemnification costs;
- Indemnify directors and officers for permissible costs; and
- Indemnify directors and officers for those costs that may not be allowed under the indemnification provisions,¹⁵³ provided that such a contract includes the required deductible and co-insurance payments.¹⁵⁴

V. VOLUNTEER PROTECTION ACT OF 1997¹⁵⁵

The Volunteer Protection Act is a federal statute that provides liability protection for volunteers of not-for-profit organizations for acts or omission on behalf of the organization if:

- The volunteer was acting within the scope of the volunteer’s responsibilities at the time of the act or omission;
- If appropriate or required, the volunteer was properly licensed, certified, or authorized by the appropriate authorities for the activities or practice in the State in which the harm occurred;
- The harm was not caused by willful or criminal misconduct, gross negligence, reckless misconduct, or a conscious, flagrant indifference to the rights or safety of the individual harmed; and
- The harm was not caused by the operating of a vehicle for which the State requires the operator or owner to possess a license or maintain insurance.¹⁵⁶

This Act preempts State law to the extent that such laws are inconsistent. However, State laws conditioning limited liability for volunteers cannot be inconsistent with this Act. For example, State law may require not-for-profit organizations to adhere to risk management procedures or to maintain insurance or other financially secure financial sources for recovery by individuals who suffer harm as a result of actions taken by a volunteer.

New York has abolished charitable immunity for not-for-profit corporations because it is contrary to the public policy of the state and because insurance made full compensation possible without any significant diminution of a

charitable organization's funds.¹⁵⁷ New York does, however, continue to provide certain limited volunteer protection for volunteer fire fighters,¹⁵⁸ volunteers of national ski patrol¹⁵⁹ and the trustees of and certain other people associated with the City University of New York.¹⁶⁰

ENDNOTES

¹ This memorandum contains a limited general discussion of duties and liabilities of directors of New York not-for-profit corporations. Not-for-profit organizations that are organized in other states are subject to different applicable law. Furthermore, the federal income tax law discussion contained in Section III regarding the intermediate sanctions regime is relevant only to tax-exempt organizations that are either public charities or social welfare organizations, and is not intended to cover the many tax-related issues that confront not-for-profit organizations. For a more complete discussion of the fundamental tax law considerations applicable to not-for-profit organizations, please refer to Section III.

² References herein to “directors” should be construed as including “trustees” as well.

³ IRC § 501(c)(3).

⁴ NPCL § 102(a)(5).

⁵ NPCL § 201. There are different types of not-for-profit corporations. Prior to its amendment by the Revitalization Act, which became effective July 1, 2014, the NPCL divided not-for-profit corporations into Type A, B, C or D. **Type A** classified corporations formed for non-business purposes including, but not limited to: civic, patriotic, political, social, fraternal, athletic, agricultural, horticultural, animal husbandry, and for a professional, commercial, trade or service organization. **Type B** classified corporations formed for non-business purposes including but not limited to: charitable, educational, religious, scientific, literary, cultural or for the prevention of cruelty to children or animals. **Type C** classified corporations formed for a lawful business purpose to achieve a lawful public or quasi-public objective. **Type D** classified corporations formed under other corporate law of the state. Under the Revitalization Act, New York not-for-profit corporations are no longer categorized as a letter-type corporation, but are rather classified as a charitable or non-charitable corporation. Under the Revitalization Act, “charitable corporation” is defined to mean “any corporation formed, or . . . deemed to be formed, for charitable purposes.” NPCL § 102(a)(3-a). “Non-charitable corporation” is defined to mean “any [not-for-profit corporation] other than a charitable corporation, including but not limited to one formed for any one or more of the following non-pecuniary purposes: civic, patriotic, political, social, fraternal, athletic, agricultural, horticultural, or animal husbandry, or for the purpose of operating a professional, commercial, industrial, trade or service association.” NPCL § 102(a)(9-a). For New York not-for-profit incorporations incorporated before July 1, 2014, Type A not-for-profits are deemed non-charitable, Type B and C not-for-profits are deemed charitable and Type D corporations are deemed either charitable or non-charitable, depending on the purposes as reflected in their existing charters. *See* NPCL § 201.

⁶ Victoria B. Bjorklund, James J. Fishman and Daniel L. Kurtz, *New York Nonprofit Law and Practice: With Tax Analysis* (2d ed. May 2013), §§ 11.01, 11.03.

⁷ *Id.* at § 10.01.

⁸ NPCL § 701(b), and Bjorklund, §6.05.

⁹ NPCL § 720(b).

¹⁰ NPCL § 720(b)

¹¹ NPCL § 720(b)(1).

¹² NPCL § 720(b)(2).

¹³ NPCL § 720(b)(3). In certain cases a member may bring a derivative suit under NPCL § 623.

¹⁴ *In the Matter of Herbert H. Lehman College Foundation, Inc. v. Ricardo R. Fernandez et al.* (“Lehman”), 292 A.D.2d 227, 228 (Sup. Ct. N.Y. 2002) (“directors of a not-for-profit corporation do not act on behalf of shareholders who control the corporation’s certificate of incorporation, and its board. They act on behalf of beneficiaries who have no direct voice in governing the corporation and must depend on the State to represent and protect their interests.”).

¹⁵ Three major cases in which the Attorney General has taken action as the enforcement agent are: *The People of the State of New York, by Eliot Spitzer v. Richard A. Grasso, Kenneth G. Langone, and the New York Stock Exchange* (“Grasso”), 816 N.Y.S.2d 863 (Sup. Ct. N.Y. 2006) (motion to discuss four of the six claims denied), rev’d, 836 N.Y.S.2d 40 (N.Y. App. Div. 1st Dep’t May, 8, 2007) (noting that the New York State Attorney General lacked legal authority specifically with respect to nonstatutory causes of action); *Vacco, as Attorney General of the State of New York v. Peter Diamandopoulos et al.*, 715 N.Y.S.2d 269 (1998), Index No. 401253/97 (Sup. Ct. N.Y. Cty., March 24, 1997 complaint); and *Manhattan Eye, Ear & Throat Hospital and Memorial Sloan Kettering Cancer Center et al. v. Eliot Spitzer, as Attorney General of the State of New York* (“MEETH”), 715 N.Y.S.2d 575, 1999. These cases are discussed in detail in Section II. More recently, the Attorney General succeeded in permanently barring a director of a not-for-profit corporation from serving in any capacity for a charitable entity after the New York supreme court sufficiently found, among other things, that the director had breached his fiduciary duty to a charitable organization under NPCL § 717, where the director was found to have used charity assets for his personal expenditures. See *Schneiderman ex rel. People v. Lower Esopus River Watch, Inc.*, 975 N.Y.S.2d 360 (Table) (Sup. Ct. N.Y. 2013).

¹⁶ Elizabeth M. Guggenheimer, *Fiduciary Duties of Directors and Officers of Not-for-Profit Organizations: An Overview for Volunteer Attorneys*, Lawyers Alliance for New York, March 2000, at 14.

¹⁷ Guggenheimer, *supra* note 16, at 14. See also § 145:775 Proceedings by Attorney General, Carmody-Wait 2d New York Practice with Forms, March 2016.

¹⁸ NPCL § 804. See *Lehman*, *supra* note 13 (“By thus diluting the influence of the College and its president on the governance of the Foundation, in effect transforming the Foundation into an independent entity unaccountable to the College, the bylaw amendments changed the Foundation’s powers and purpose as enumerated in its certificate of incorporation. There can be no doubt that any like amendment to the certificate would require judicial approval on notice to the Attorney General.”).

¹⁹ NPCL §§ 510, 511.

²⁰ NPCL § 907.

²¹ NPCL Articles 10 and 11.

²² *MEETH*, *supra* note 15, citing NPCL § 511.

²³ Michael A. Shea, *Closing Agreement Shows IRS Position on the ‘Straight and Narrow’ of Organization Management*, 12 Journal of Taxation of Exempt Organizations 24, July/August 2000. See also IRC § 4958.

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Committee to Save Adelphi v. Diamandopoulos* (Board of Regents of the University of the State of New York Decision Feb. 5, 1997).

²⁸ NPCL § 720-a.

²⁹ *Scheuer Family Foundation, Inc. v. 61 Associates*, 179 A.D.2d 65 (1st Dept. 1992).

³⁰ NPCL § 717(a).

³¹ NPCL § 720(a)(1)(A).

³² BCL § 717(a).

³³ Bjorklund, *supra* note 6, §6.02(5).

³⁴ American Bar Association, Nonprofit Organizations Committee, *Guidebook for Directors of Nonprofit Corporations*, (the “Nonprofit Guidebook”) at 26-30 (3d. ed. 2012).

³⁵ American Bar Association, Committee on Corporate Laws, *Corporate Director’s Guidebook*, Sixth Edition, at 19 (6th ed.2011).

³⁶ Dennis J. Block, Nancy E. Barton & Stephen A. Radin, *The Business Judgment Rule: Fiduciary Duties of Corporate Directors*, at 2 *quoting* Model Bus. Corp. Act Annotated § 8.30(a), (b) (6th ed. 2009).

³⁷ Model Nonprofit Corp. Act § 8.31(a)(2)(4) (2008).

³⁸ *Hoye v. Meek*, 795 F.2d 893, 896 (10th Cir. 1986).

³⁹ Block, *supra* note 36, at 127.

⁴⁰ Model Nonprofit Corp. Act § 8.31(a)(2)(4), as amended.

⁴¹ *United States v. William Aramony, et al.*, 88 F.3d 1369 (1996).

⁴² *Vacco v. Diamandopoulos*, *supra* note 15. Vacco was the New York Attorney General who brought the criminal component to the Board of Regents case against the trustees of Adelphi University.

⁴³ UPMIFA has been codified in New York at NPCL §§ 550-558 (“NYPMIFA”). Also see NPCL §§ 512-514, 522 regarding investment authority, delegation of investment management and use of restricted funds. For additional information on NYPMIFA see “A Practical Guide to the New York Prudent Management of Institutional Funds Act” available at http://www.charitiesnys.com/nypmifa_new.html. UPMIFA has been codified in Delaware at 12 Del. Code §§ 4701 - 4710.

⁴⁴ NPCL § 552(c)(1); 12 Del. Code § 4703(c)(1).

⁴⁵ NPCL § 552(e)(1); 12 Del. Code § 4703(c)(2)(b)(1).

⁴⁶ NPCL § 552(e)(2); 12 Del. Code § 4703(c)(2)(b)(2).

⁴⁷ NPCL § 552(f) (this requirement to have a written investment policy is a requirement of NYPMIFA that is not in the UPMIFA).

⁴⁸ NPCL § 552(c)(2).

⁴⁹ NPCL § 552(e)(4); 12 Del. Code § 4703(c)(2)(b)(4).

⁵⁰ NPCL § 552(e)(4) (this requirement to review decisions to not diversify is a requirement of NYPMIFA that is not in the UPMIFA).

⁵¹ NPCL § 552(e)(5); 12 Del. Code § 4703(c)(2)(b)(5).

⁵² NPCL §§ 514 and 554 (the requirement that contracts be terminable upon no more than 60 days' notice is a requirement of NYPMIFA that is not in the UPMIFA); 12 Del. Code § 4705.

⁵³ NPCL § 717(b).

⁵⁴ NPCL § 717(b)(1).

⁵⁵ NPCL § 717(b)(2).

⁵⁶ NPCL § 717(b)(3).

⁵⁷ NPCL § 717.

⁵⁸ Bjorklund, §6.02(2)(b), *supra* note 6, §6.02(5).

⁵⁹ *Id.*, quoting *Davidowitz v. Edelman*, 583 N.Y.S.2d 340 (Sup. Ct., Kings Cty. 1992).

⁶⁰ Bjorklund, *supra* note 6, §6.02(2)(b).

⁶¹ *Davidowitz v. Edelman*, *supra* note 59, at 857 (finding that “the committee did not fulfill the requirements of a thorough and reasonable inquiry” and that “the committee [did not] possess the required disinterested independence”).

⁶² Block, *supra* note 36.

⁶³ *Id.*, quoting *Federal Deposit Ins. Corp. v. Stahl*, 89 F.3d 1510, 1517 (11th Cir. 1996).

⁶⁴ Bjorklund, *supra* note 6, §6.02(3)(a). In *Auerbach v. Bennett*, the Court of Appeals applied the federal standard encapsulated above to New York business corporations. *Auerbach v. Bennett*, 393 N.E.2d 994 (1979).

⁶⁵ See *Consumer Union of U.S., Inc. et al. v. The State of New York, Empire HealthChoice, Inc. et al.*, 840 N.E.2d 68 (2005).

⁶⁶ *Id.* at 360, 118.

⁶⁷ *William J. Higgins v. New York Stock Exchange*, 806 N.Y.S. 2d 339 (Sup. Ct. N.Y. 2005).

⁶⁸ *Id.* at 357.

⁶⁹ *Spitzer v. Schussel*, 2007 WL 3133222, 8 (N.Y. App. Div. Sept. 11, 2007).

⁷⁰ *Morris v. Scribner*, 69 N.Y.2d 418 (1987); *Committee to Save Adelphi v. Diamandopoulos*, (Board of Regents of the University of the State of New York Decision Feb. 5, 1997).

⁷¹ *40 West 67th Street, Respondent v. Pullman*, 790 N.E.2d 1174 (2003) citing *Levandusky v. One Fifth Avenue Apartment Corp.*, 553 N.E.2d 1317 (1990).

⁷² NPCL § 719(a).

⁷³ NPCL § 719(a)(1).

⁷⁴ NPCL § 515. Certain distributions would be allowed to members in the case of corporate dissolution or liquidation.

⁷⁵ NPCL § 719(a)(2). *See* NPCL §§ 502, 504 and 506.

⁷⁶ NPCL § 719(a)(3). *See* NPCL §§ 504 and 506.

⁷⁷ NPCL § 719(a)(5). *See* NPCL § 716.

⁷⁸ NPCL § 719(b).

⁷⁹ NPCL § 719(c).

⁸⁰ NPCL § 716.

⁸¹ NPCL § 716.

⁸² NPCL § 716.

⁸³ NPCL § 716.

⁸⁴ Bjorklund, §6.03(3).

⁸⁵ Nonprofit Guidebook, *supra* note 34 at 43 (2012).

⁸⁶ *Kavanaugh v. Kavanaugh Knitting Co.*, 123 N.E. 148, 193 (1919).

⁸⁷ *Kavanaugh*, 123 N.E. 148, 197.

⁸⁸ Bjorklund, *supra* note 6, at §6.02(2)(b).

⁸⁹ Block, *supra* note 36, at 263, quoting *Solash v. Telex Corp.*, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,608 at 97,727 (Del. Ch. Jan. 19, 1988).

⁹⁰ NPCL § 720(a)(1)(B).

⁹¹ *Cinerama Inc. v. Technicolor Inc.*, 663 A.2d 1134, 1146 (Del. Ch. 1994) (“if a trustee sold the asset to benefit her own self-interest . . . she [will] be required to return a trust beneficiary to the position she would have been in but for the sale”), *aff’d*, 663 A.2d 1156 (Del. 1995).

⁹² *E.g.*, *Guth v. Loft, Inc.*, 5 A.2d 503, 511 (Del. 1939).

⁹³ *American Baptist Churches et al. v. Eric Galloway et al.*, 271 A.D.2d 92, 710 N.Y.S.2d 12 (N.Y. App. Div. (2000)).

⁹⁴ A “related party” is defined to mean (i) any director, officer or key person of the corporation or any affiliate of the corporation; (ii) any relative of any individual described in the foregoing clause (i); or (iii) any entity in which any individual described in the foregoing clauses (i) and (ii) has a 35% or greater ownership or beneficial interest or, in the case of a partnership or professional corporation, a direct or indirect ownership interest in excess of 5%. A “related party transaction” is defined to mean any transaction, agreement or other arrangement in which a “related party” (defined above) has a financial interest and in which the corporation or any affiliate of the corporation is a participant, except that a transaction shall not be a

related party transaction if: (i) the transaction or the related party's financial interest in the transaction is de minimis, (ii) the transaction would not customarily be reviewed by the board, or boards of similar organizations, in the ordinary course of business and is available to others on the same or similar terms, or (iii) the transaction constitutes a benefit provided to a related party solely as a member of a class of the beneficiaries that the trust intends to benefit as part of the accomplishment of its mission which benefit is available to all similarly situated members of the same class on the same terms. An "affiliate" of a corporation is defined to mean any entity controlled by, or in control of, such corporation. *See* note 95 for the definition of "key person." *See* NPCL § 102(a)(19), (23)-(25).

⁹⁵ *See* NPCL § 102(a)(25). A "key person" is defined to mean a person, other than a director or officer, whether or not an employee of the corporation, who: (i) has responsibilities, or exercises powers or influence over the corporation as a whole similar to the responsibilities, powers, or influence of directors and officers; (ii) manages the corporation, or a segment of the corporation that represents a substantial portion of the activities, assets, income or expenses of the corporation; or (iii) alone or with others controls or determines a substantial portion of the corporation's capital expenditures or operating budget.

⁹⁶ *See* NPCL § 715(g).

⁹⁷ NPCL § 715-a(a).

⁹⁸ NPCL § 715-a(b)(1).

⁹⁹ NPCL § 715-a(b)(2).

¹⁰⁰ NPCL § 715-a(b)(3)-(4).

¹⁰¹ NPCL § 715-a(b)(6).

¹⁰² NPCL § 715-a(c).

¹⁰³ NPCL § 202(a)(12).

¹⁰⁴ Frank White, Isidore Kantrowitz and Sol Slutsky, *White on New York Business Entities*, 14th ed., ¶ 202.04 (2014). *See* Grasso, *supra* note 15, at 30 (the Attorney General alleged that a majority of the Board did not effectively vote to approve Mr. Grasso's salary and additional compensation, as the Board was presented with allegedly inaccurate and incomplete information).

¹⁰⁵ *See supra* note 95.

¹⁰⁶ Form 990, Return of Organization Exempt from Income Tax, Part VII.

¹⁰⁷ *Id.* at Part VI, Section A, Line 5 and related instructions. *See also* Dan Keating and Rebecca Rolfe, *The Most Intriguing Check Box on a Nonprofit's Disclosure Form*, WASH. POST, Oct. 26, 2013.

¹⁰⁸ *Committee to Save Adelphi v. Diamandopoulos*, *supra* note 27.

¹⁰⁹ *Id.* at 25.

¹¹⁰ *Vacco v. Diamandopoulos*, *supra* note 15.

¹¹¹ David M. Halbfinger, *Lawsuits Over Ouster of Adelphi Chief Are Settled*, N.Y. Times, Nov. 18, 1998, at B1.

¹¹² *United States v. William Aramony*, *supra* note 41; *Aramony v. United Way of America*, 28 F. Supp. 2d 147 (S.D.N.Y. 1998), *aff'd, rev'd and remanded in part* 191 F.3d 140 (2d Cir. 1999); *United States v. Aramony*, 166 F.3d 655 (4th Cir. 1999), *cert. denied* 526 U.S. 1146 (1999). A large part of this case history revolves around Aramony's efforts to receive several million dollars from a Replacement Benefit Plan that did not contain a "bad boy" clause canceling the payments if Aramony was convicted of a crime. The breaches of his duties and the fines assessed were not at issue in the appeals.

¹¹³ *United States v. Aramony*, *supra* note 41, at 1374.

¹¹⁴ Pamela A. Mann, *Advising Nonprofit Organizations*, Practising Law Institute, at 28 (2014).

¹¹⁵ *Vacco v. Aramony*, N.Y.L.J., Aug. 7, 1998, p. 21 (Sup. Ct. N.Y. County July 13, 1998).

¹¹⁶ Bjorklund, *supra* note 6, §6.04(1).

¹¹⁷ NPCL § 511(a)(6). *See also* NPCL §511-a(b)(1), (c).

¹¹⁸ *MEETH*, *supra* note 15, at 154.

¹¹⁹ *Agudist Council of Greater New York v. Imperial Sales Company*, 158 A.D.2d 683, 551 N.Y.S.2d 955, 1990.

¹²⁰ *In the Matter of the Application of Sculpture Center, Inc.*, 2001 N.Y. Slip Op 40368U, 2001 N.Y. Misc. Lexis 1019.

¹²¹ Bruce R. Hopkins, *The Law of Tax-Exempt Organizations*, 485 (8th Ed. 2003).

¹²² Treas. Reg. § 53.4958-8(a).

¹²³ IRC § 4958(c)(1)(A).

¹²⁴ *See* Stephanie Strom, *I.R.S. Finds Tax Errors in Reports of Nonprofits*, N.Y. TIMES, Mar. 1, 2007, at A15. Having completed its two-year investigation of executive compensation at nonprofit organizations, the IRS imposed more than \$20 million in penalties on 40 individuals at 25 organizations which substantially overcompensated executives and more could be imposed still.

¹²⁵ Treas. Reg. § 53.4958-4(a)(2).

¹²⁶ IRC § 4958(f)(1).

¹²⁷ Treas. Reg. § 53.4958-3(c).

¹²⁸ Treas. Reg. § 53.4958-3(e)(2), (3). Section 501(c)(3) organizations and certain § 501(c)(4) organizations are not deemed "disqualified." Treas. Reg. § 53.4958-3(d).

¹²⁹ IRC § 4958(a), (b).

¹³⁰ IRC § 4958(a)(2).

¹³¹ Treas. Reg. §§ 53.4958-1(d)(4)(iii), 53.4958-1(d)(3).

¹³² IRC § 4958(a)(2).

¹³³ Treas. Reg. § 53.4958-4(a)(3).

¹³⁴ Treas. Reg. § 53.4958-4(a)(3)(vii) example 4.

¹³⁵ Treas. Reg. § 53.4958-1(d)(4)(iii).

¹³⁶ *Id.*

¹³⁷ Treas. Reg. § 53.4958-6.

¹³⁸ Treas. Reg. § 53.4958-6(a)(1).

¹³⁹ Treas. Reg. § 53.4958-6(a)(2). *See also*, Stephanie Strom, *I.R.S. Finds Tax Errors in Reports of Nonprofits*, N.Y. TIMES, Mar. 1, 2007, at A15. Having completed its two-year investigation of executive compensation at nonprofit organizations, the IRS imposed penalties at organizations that failed to use comparable figures or otherwise failed to justify executive pay levels. Mr. Miller, the commissioner in charge of the I.R.S. division overseeing tax-exempt entities, noted however “That shouldn't be read to mean that high compensation wasn't paid in the other cases...it means that in some cases where we found high compensation – and we did find it – the organization has done a good job of using comparables and establishing a procedure to determine it.”

¹⁴⁰ Treas. Reg. § 53.4958-6(c)(2).

¹⁴¹ Treas. Reg. § 53.4958-6(c)(1)(ii).

¹⁴² Treas. Reg. § 53.4958-6(c)(3)(ii).

¹⁴³ Treas. Reg. § 53.4958-6(c)(3)(i).

¹⁴⁴ Sarah J. Schmidt, *Avoiding the Snares of Intermediate Sanctions*, 14 Nonprofit World No. 6 at 18, November/December 1996.

¹⁴⁵ Evelyn Brody, *Troubling Lessons from the Bishop Estate Settlement For Administering the New Intermediate Sanctions Regime*, 32 Exempt Org. Tax Rev. 431, June 2001.

¹⁴⁶ Shea, *supra* note 23, at 19-21.

¹⁴⁷ NPCL § 722(a).

¹⁴⁸ NPCL §§ 723. *See* 722(a).

¹⁴⁹ NPCL § 721.

¹⁵⁰ NPCL § 721.

¹⁵¹ Bjorklund, §7.03(1).

¹⁵² NPCL § 726(a).

¹⁵³ For instance, fines and penalties where there has been an adverse judgment in a derivative action.

¹⁵⁴ NPCL § 726(a). An insurance policy issued directly to a director or officer (rather than to a corporation) is not subject to retention and co-insurance requirements.

¹⁵⁵ 42 USC 14501 *et seq.*

¹⁵⁶ 42 USC 14503.

¹⁵⁷ *Rakaric v. Croation Cultural Club “Cardinal Stepinac Organization”*, 76 A.D.2d 619, 631 (1980) (noting that “the doctrine of charitable immunity is ‘out of tune with the life about us, at variance with modern-day needs and with the concepts of justice and fair dealing’”).

¹⁵⁸ *See* NY Gen. Mun. Laws Sec. 205-b.

¹⁵⁹ *See* NY Unconsol. Laws Ch. 211-A, Sec. 1.

¹⁶⁰ *See* NY Educ. Laws Sec. 6205. Any member of the board of trustees of the City University of New York, among others, will be indemnified against any claim or suit arising from an act or omission occurring within the scope of his/her duties.

Not-For-Profit Practice Group

Annual Reporting Requirements and Public Information Regarding Not-For-Profit Organizations

Board members of not-for-profit organizations should be aware of the reporting obligations that apply to their entity, such as those mandated by the Internal Revenue Service (the “IRS”) and the New York State Attorney General. Board members should also be aware of the publicly available information regarding their organization pursuant to applicable law and regulations. Discussed below is a summary of certain annual reporting requirements and publicly available information regarding not-for-profit organizations. Additional reports and filings may be required, for example, when an organization amends its charter or bylaws. Note that each organization is unique and must determine which reporting or filing obligations are applicable to it.

I. CERTAIN ANNUAL REPORTING REQUIREMENTS

The following are descriptions of certain annual reporting requirements for not-for-profit organizations that are incorporated in the State of New York.

1.1 IRS Form 990

Form 990 is an annual reporting return that certain federally tax-exempt organizations must file with the IRS. It provides information on the filing organization’s mission, programs and finances, and governance, management and disclosure practices. With some exceptions, organizations that are required to file Form 990 include federally tax-exempt not-for-profit organizations that have gross receipts greater than or equal to \$200,000 and total assets greater than or equal to \$500,000 and all 501(c)(3) private foundations, regardless of income.¹ In general, organizations that are not required to file Form 990 include most faith-based organizations. Not-for-profit organizations (other than private foundations) with gross receipts less than \$200,000, or total assets less than \$500,000 are entitled to file a simplified form called Form 990-EZ, in lieu of Form 990. An exempt organization whose annual gross receipts are normally \$50,000 or less may instead file Form 990-N (“e-postcard”) which requires disclosure of only the most basic information about the organization.

The IRS maintains a list of exempt organizations, which is available online. The searchable Exempt Organization Select Check is available at <https://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Select-Check>. The searchable database allows users to limit searches to organizations that are eligible to receive tax-deductible charitable contributions, have had their tax-exempt status automatically revoked or have filed Form 990-N (“e-Postcard”). The downloadable “master file” list is available at <http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Business-Master-File-Extract-EO-BMF>.

Failure to file the applicable version of Form 990 for three consecutive years leads to an automatic revocation of an organization’s tax-exempt status. See the Instructions for the Form 990 for information on how to complete the Form 990 and what fees and attachments are required, available at <http://www.irs.gov/pub/irs-pdf/i990.pdf>. For more information on Form 990, see **Tab 5**.

1.2 New York State Annual Filing for Charitable Organizations: Form CHAR500

With some exceptions (dependent upon the amount and nature of solicitations), registered charitable or other not-for-profit organizations that have filed a Form CHAR410 (Registration Statement for Charitable Organizations), available at <http://www.charitiesnys.com/pdfs/char410.pdf>, are required to annually file a Form CHAR500 (Annual Filing for Charitable Organizations), available at http://www.charitiesnys.com/pdfs/CHAR500_2014.pdf, to the Charities Bureau of the New York State Attorney General. Registration is required of charitable and other not-for-profit organizations that (i) solicit contributions from New York State (including residents, foundations, corporations, government agencies and other entities) (pursuant to Article 7-A of the Executive Law) and/or (ii) are incorporated, are formed or otherwise conduct activity in New York State (pursuant to Section 8-1.4 of the Estates, Powers and Trusts Law). Depending on the organization's finances during the year, it may be required to submit a filing fee and attachments, such as an IRS Form 990 and an accountant's audit or review. See the Instructions for the Form CHAR500 for information on how to complete the Form CHAR 500 and what fees and attachments are required, available at http://www.charitiesnys.com/charindex_new.jsp#filing.

In addition, organizations registered in New York for charitable solicitation purposes must have their financial statements certain audited or reviewed by an independent certified public accountant, and must file the audit report or review report. The chart below reflects the gross revenue and support thresholds above which a New York not-for-profit will require an independent audit or accountant review:²

Requirement	Gross Revenue & Support Threshold Applicability		
	July 1, 2014 until June 30, 2017	July 1, 2017 until June 30, 2021	Beginning July 1, 2021
Audit report	In excess of \$500,000	In excess of \$750,000	In excess of \$1 million
Review report	\$250,000 to \$500,000	\$250,000 to \$750,000	\$250,000 to \$1 million

1.3 Charitable Solicitation Annual Report

New York not-for-profit organizations annually filing a Form CHAR500 should also be aware that New York, like all states, requires charitable solicitation registration and annual reporting. While the majority of states, including New York, accept the Unified Registration Statement for a not-for-profit organization's initial filing, annual reports should be submitted by filing a Form CHAR500.

II. PUBLIC INFORMATION REGARDING NOT-FOR-PROFIT ORGANIZATIONS

There are many organizations and publications which rank or rate not-for-profit organizations based on established standards, criteria or processes. Many of these organizations provide their findings, as well as IRS Form 990s filed by not-for-profit organizations, free-of-charge to the public. Below is a sample list of such organizations and publications.

2.1 Organizations

- American Institute of Philanthropy (AIP): AIP is a charity watchdog service whose purpose is to provide information on how efficiently a charity uses donations to fund its supported programs. "CharityWatch exposes nonprofit abuses and advocates for [donor] interests. . ." Its website provides information about the charities which it rates as well as its method for rating charities. <http://www.charitywatch.org>

- Better Business Bureau (BBB) Wise Giving Alliance (WGA): The WGA reports on nationally soliciting charitable organizations that are the subject of donor inquiries. “BBB WGA does not rank charities but rather seeks to assist donors in making informed judgments about those that solicit their support. Evaluations are done without charge to the charity and are posted for free public access on give.org.” <http://www.bbb.org/us/Wise-Giving/>
- Charity Navigator: Charity Navigator provides information on charities and evaluates the financial health of these charities. Charity Navigator aims “to advance a more efficient and responsive philanthropic marketplace, in which givers and the charities they support work in tandem to overcome our nation’s and the world’s most persistent challenges.” <http://www.charitynavigator.org>
- GuideStar. GuideStar gathers and publicizes information about nonprofit organizations. GuideStar aims to “to revolutionize philanthropy by providing information that advances transparency, enables users to make better decisions, and encourages charitable giving.” <http://www2.guidestar.org>

ENDNOTES

¹ Private Foundations file IRS Form 990-PF.

² See New York Attorney General's Charities Bureau Guidance Document 2014-1, "Guidance on Provisions of the Nonprofit Revitalization Act of 2013; Revised CPA Review and Audit Thresholds and Annual Filing Fees for 7A and DUAL Filers" (April 15, 2014), *available at* http://www.charitiesnys.com/pdfs/NYSGuidance2014_Audit%20Thresholds%20and%20Fee.pdf.

Not-For-Profit Practice Group

Fundamental Tax Law Considerations for the Not-For-Profit Organization

The following outlines significant tax-law considerations generally relevant to NFP organizations. Given the scope and the nuances of tax-law, it is not possible to, and the following is not an attempt to, answer questions that are specific to a particular organization or to a particular set of facts or circumstances. Thus, the following outline should serve merely as a starting point, a resource that can help to educate and alert an NFP board member or executive as to the very significant tax-law considerations that affect every aspect of the organization's conduct.

I. SAFEGUARDING AND SPENDING THE ASSETS OF AN NFP – AN OVERVIEW

1.1 Not-for-Profit is Not the Same as Tax-Exempt

1. State Not-For-Profit Corporation Law – The NFP entity is formed under, exists by reason of, and derives its organic legal rights and obligations from state law.
2. Most states have a special statute applicable to NFPs. In some jurisdictions, like Delaware, there is not a separate statutory framework specifically and exclusively applicable to NFPs; rather, general corporate law applies to the NFP corporation.
3. Meaning of “Not for Profit” – The defining state law feature of an NFP organization is that there exists no person who can, through ownership or control of the entity, derive a profit from the organization. “Not for profit” does not, however, mean that the organization is precluded by state corporate law from conducting an activity that generates a profit, even an activity designed to do so.
4. Meaning of “Tax Exempt” – Classification of an entity as “tax exempt” generally refers to the exclusion it enjoys from paying income and other taxes under US federal, state and local tax statutes. Often (but not always), tax-exempt organizations are those to which donations may be made on a tax-deductible basis.
5. Typically, the not-for-profit character of an organization is only one of many requirements for the organization to seek, attain and retain tax-exempt status under the various tax statutes.

1.2 Planning & Supervising NFP Activities & Operations – The NFP Board and Management Must Consider the Organization's Activities Through the Following Prism

1. Are we “on mission”? The guiding principle of every action (or inaction) taken by an NFP is its “mission” as enunciated in its governing documents.

2. “Mission” is not necessarily what a given board member (or even the entire board) or manager believes to be the organization’s goals; rather, “mission” is defined by the organization’s governing documents, subject to being amended or updated in accordance with the provisions within those governing documents.
3. What does our charter say? The organization’s conduct must at all times and in every way comport with the guidelines and limitations established under its organic documents.
4. What have we “promised” our donors? Often, if not always, donors to an NFP expect that the funds will be applied in a certain way. Sometimes specific promises are made as part of the fundraising effort, and sometimes no express promise is made other than the implicit assurance that the funds will be applied in accordance with the organizational mission. In many situations, the lines are not clearly drawn. In all cases, the NFP must be ever mindful of valid donor expectations as it deliberates application of organizational assets.
5. What did we tell the IRS when we sought tax exemption? The process by which the NFP seeks tax-exempt status is one in which many representations are made to the IRS (or other taxing authority) regarding virtually (if not actually) every aspect of the organization’s operations. To the extent that, at some later time, the NFP strays from the factual representations made to the taxing authority, it can place its tax-exempt status in jeopardy.
6. Will we jeopardize our exempt status or subject ourselves to tax law penalty? Merely remaining in strict or technical compliance with the representations made to the taxing authorities when first seeking exempt status is no guaranty of anything. Commercial (and other) activities conducted by an NFP can result in the organization losing its exempt status and also can expose both the organization and its members and officers to penalties under the tax law.

1.3 NFP Assets Must Be Safeguarded and Properly Spent

1. State Law – Generally under governing state law, the assets of an NFP are held in trust for the public.
 - It’s All About Mission – The NFPs assets are not in any way the property or domain of the major donor, the founder or the visionary; while these people often are given a say or even a controlling say in the application of NFP assets, those decisions must be guided by the overriding principle that the NFP assets are dedicated to the NFPs mission and held by the NFP in trust for the achievement of that mission.
2. Tax Law – The assets of the tax-exempt NFP must be applied in furtherance of its tax-exempt objectives. The tax law, in its insistence on and enforcement of this principle, provides (at least) three express prohibitions (discussed in greater detail in the succeeding portions of this outline) regarding the use and application of organizational assets:
 - no Private Inurement
 - no Private Benefit
 - no Excess Benefit Transactions

3. When do these tax-law constraints arise? Any act, decision or arrangement that involves the assets of the NFP implicates these tax law constraints. Thus, these constraints arise in just about every deliberation undertaken and every decision made by the NFP board and its management.

II. THE TAX-EXEMPT NFP – PRIVATE INUREMENT

2.1 Private Inurement – Statutory Construct

1. Section 501(c)(3) describes an organization “...organized and operated exclusively for ... charitable ... purposes, ... *no part of the net earnings of which inures to the benefit of any private shareholder or individual.*”
2. Thus, the tax statute absolutely prohibits so-called “private inurement,” the realization by certain people associated with the organization of any benefit as a result of their association.
3. Private inurement constraint applies to many types of tax-exempt entities, including:
 - Section 501(c)(3) Charities
 - Section 501(c)(4) Social Welfare Organizations
 - Section 501(c)(6) Trade Associations

2.2 Private Inurement vs. Private Benefit

1. Aside from the “private inurement” constraint, the tax law also includes an additional prohibition against the NFP affording a “private benefit.”
2. While the proscription against Private Inurement focuses on “insiders,” the proscription against Private Benefit is concerned with anyone (outside the charitable class). Thus, even if someone is not an “insider,” generally the tax-exempt NFP may not provide benefit to that person unless the provision of that benefit is consistent with and in furtherance of its exempt purpose.
 - Private Benefit a Product of Tax Regulations: The “private benefit” concept grows out of the regulatory interpretation and application of the statutory requirement that the organization be “organized and operated” for exclusively charitable purposes.
 - For purposes of the “private benefit” constraint, the tax law permits a certain level of “incidental” benefit.
3. Practical Difference Between Private Inurement and Private Benefit: Scrutiny and Sympathy – When a tax-exempt NFP provides a benefit to a person outside the charitable class, the taxing authority tends to afford greater latitude if that person is not an “insider.”

2.3 Private Inurement – Dealing With Insiders

1. Prohibition Covers Any Asset: Real, personal, tangible, intangible.
2. The Meaning of “Insider”: You know one when you see one.

- Someone who exercises control and/or has influence
 - Derive Meaning of “Insider” from Excess Benefit Transaction Rules – As discussed below, the tax law contains an entire subset of constraints, the so-called intermediate sanctions, that contain an elaborately defined “insider” concept; to what extent will that definition apply to or inform the meaning of “insider” for purposes of the “private inurement” constraint?
 - The First Contract: One Bite at the Apple – Although a senior executive or executive director, once hired, can be expected to be treated as an “insider” for purposes of this rule, before he/she is hired (assuming no other relationship) there should not be “insider” status. Thus, the first contract with the executive is made with a non-“insider”; watch out, however, when it comes time to amend or renew that first contract!
3. Any Amount of Benefit to “Insider” Prohibited.
- Practice vs. Theory – Technically, the tax law allows for no benefit, regardless of how little, to be afforded an “insider.” As a practical matter, however, the taxing authorities are, understandably, reluctant to revoke tax-exempt status from otherwise “good” organizations and, consequently, do not usually enforce this rule in such a stringent manner.

2.4 Private Inurement – Value For Value Permitted

1. The private inurement rule prohibits any value or benefit paid or afforded to an “insider.” This constraint, however, does not proscribe the tax-exempt organization from paying or providing value to an “insider” (or any person) if the NFP is getting full value in return.
2. Reasonable Compensation for Services – Thus, the private inurement prohibition does not proscribe compensation so long as it is reasonable and necessary for the services rendered in exchange.
3. Fair Price for Property – Similarly, a tax-exempt NFP may pay value to an insider in exchange for property, so long as the property received by the NFP is (at least) equal in value to the consideration paid.
4. Private Foundations Subject to Greater Constraints: The Self Dealing Rule – Although tax-exempt organizations generally are permitted to enter into commercially reasonable and fair transactions, whether in a compensatory or other setting, organizations classified under the tax law as “private foundations” are subject to a number of additional, more limiting constraints, including with respect to “self-dealing.” In the case of “private foundations,” the meaning of proscribed “self-dealing” is quite expansive and covers many situations that would otherwise be recognized as reasonable and, at “arm’s-length,” indeed even to certain arrangements clearly favorable for the organization.

2.5 Situations Giving Rise to Private Inurement (for “Insiders”) or Potential Inurement

1. The private inurement constraint must be considered in connection with every relationship or interaction between the tax-exempt NFP and any of its directors, officers or other “insiders.”

2. NFP boards and managers often fail to appreciate and focus on the many situations in which the private inurement constraint may apply. The following is an illustrative list of some of the many situations that have the potential to raise the private inurement issue:
 - Excessive Compensation
 - Low-Interest Loans
 - Free Use of Assets
 - Rent-Free Use of Premises
 - “Extra” Bonus, Severance, Reimbursements, Perquisites
 - Payment of Legal Fees
 - Portfolio Management and Other Consultant Fees
 - Fundraising Commissions
 - Promoting the Business/Reputation of “Insider”
 - Advancing “Insiders” Political/Social Agenda
 - “Overly Commercial” Activity
 - Commercial Joint Ventures

2.6 Avoiding Inurement – Best Practices

1. Board Must Set the “Tone” – Organizational culture and day-to-day conduct of “rank and file” is significantly affected by signals emanating from the Board. The Board should establish a culture of scrupulousness regarding the oversight and application of organizational assets.
2. Monitor Every Use of Organizational Funds/Assets.
3. “Test” All Transactions Against Mission/Exempt Purpose.
4. Adopt and Follow Written Procedures.
 - Board Guidelines/Policies
 - Conflicts Policy
5. Follow Process for Every Insider Transaction.
 - Obtain Comparables and Perform Diligent Analysis – Assure commercial terms of arrangements are at “arm’s-length” (or better for the NFP)

- Transaction and all its elements considered, deliberated and approved by an independent committee/body
- Contemporaneous Minutes – Written memorialization of the processes and deliberations undertaken by the independent committee
- Documentation – Written agreement incorporating every element of the agreement reached with an “insider”
- Transparency/Disclosure – Form 990

III. EXCESS BENEFIT TRANSACTIONS – THE INTERMEDIATE SANCTIONS

3.1 Tax Law Imposes Monetary Penalties on “Insiders” and Board Members/Managers Involved in an “Excess Benefit Transaction”

1. Applies to Section 501(c)(3) and Section 501(c)(4) Organizations
2. Organizations treated under the tax law as “private foundations” are not covered by these rules and are instead covered by a different (and long-standing) set of potential excise taxes

3.2 The Intermediate Sanctions Target a Specific Abuse: “Excess” Value Provided by the Tax-Exempt Organization to an “Insider”

1. Too much compensation
2. Too high a price for property (of any sort)
3. Direct or Indirect – These sanctions can apply to situations even where the web of relationships and/or arrangements is complex and fuzzy, if a benefit (even if indirectly) has been provided to an “insider”

3.3 These Sanctions Were Enacted in 1996 as a Response to the Inadequacy of the Then Available IRS Tools to Combat Abuses

1. As noted above, while the Private Inurement rule technically proscribes the tax-exempt NFP from affording any benefit to an “Insider,” for many practical reasons the taxing authority cannot strictly enforce the prohibition and revoke exempt status.
2. The Intermediate Sanctions supplement and overlap with Private Inurement rules.
 - IRS has two weapons: Revocation of exempt status and imposition of Intermediate Sanctions

3.4 Excess Benefit Transactions – The Penalties

1. Penalty Imposed on Recipient “Insider.”
 - Initially 25%, and increasing to 200% of uncured excess benefit

- Cure and abatement provisions are provided
- 2. Additional Penalty Imposed on Organization Decisionmaker.
 - 10% of excess benefit up to \$10,000 (per excess benefit transaction)
 - Applies to organization trustees, officers, directors and others
 - Imposed on organization managers who knowingly participated
 - Exception if participation not willful AND reasonable cause
 - “Participation” can be by action or inaction
 - Joint/several liability if more than one participating manager

3.5 Excess Benefit Transactions –Who Is an “Insider”?

1. “Disqualified Person” – “Any person who was in a position to exercise *substantial influence* over the affairs” of the organization.
 - Five-year lookback from date of transaction
2. Board Member, CEO, Managing Director, COO, CFO, Treasurer.
3. Family members; 35% controlled entities.
4. Facts/Circumstances Determination of “Substantial Influence.”
 - Relevant Factors:
 - Founder
 - Substantial contributor
 - Employee entitled to revenue-based compensation
 - Exception for employee below specified amount
 - Exception for New Hire Based on Fixed Compensation – Similar to the “first bite at the apple” described earlier in connection with “private inurement,” the tax law does not apply the “intermediate sanctions” to a first-time arrangement with an executive, even though the executive becomes or may become an “insider” as a result of the new arrangement. This exception is specifically defined, and organizations must beware if the arrangement provides any discretionary compensation, as well as if/when the arrangement is renewed or amended.

3.6 Excess Benefit Transactions – Rebuttable Presumption

1. If certain requirements are met, the tax law allows a rebuttable presumption that a contractual arrangement with an “insider” does not run afoul of these rules.
 - Contract terms must be pre-approved by independent committee
 - The decision on contract terms must be based on appropriate data/comparables
 - There must be contemporaneous written documentation of the decision process and the agreement
2. The presumption that the contractual arrangement will not be subject to the intermediate sanctions, where established, is rebuttable by the IRS.

IV. JOINT VENTURES WITH NON-EXEMPT PARTNERS ... WHEN DO THE TAX ISSUES ARISE?

4.1 What Is a “Joint Venture”?

1. Joint venture includes any arrangement by which the profit from an activity is shared between an exempt organization and a third party.
2. The prototypical Case is a partnership or joint venture with third party.

4.2 Tax Law Focuses on “Substance”: Even a “Simple” Contract Can Be a “Joint Venture”

- For example, a “royalty” arrangement pursuant to which the exempt organization shares the profits from an activity with a third party, or
- A compensatory arrangement in which a service provider shares in the profit derived from a given activity

4.3 NFP Motivations in Fashioning Profit Sharing Arrangements

- Attract employees
- Exploit and maximize NFP assets – *e.g.*, intellectual property
- Raise capital to support charitable activity
- Facilitate/enable charitable goals – *e.g.*, medical research

4.4 Joint Ventures with Non-Exempt Partners – The Stakes

1. Tax Exempt Status.
 - Activity Attribution – When an exempt organization has an interest in certain types of entities or businesses, the very activity conducted by the entity or business can be treated, under and

for purposes of the tax law, as conducted directly by the exempt organization. Depending on the nature and scope of the activity so attributed, the organization's exempt status can thereby be placed in jeopardy.

- Private Benefit – In a context where assets are deployed in a venture and some portion of the venture profit inures to the benefit of a third party, it is possible that the exempt organization will run afoul of the prohibition against private benefit (described above).
- 2. Unrelated Business Taxable Income (UBTI) – The exempt organization's portion of income or profit derived from a joint venture can be characterized as "unrelated business taxable income" and subject to tax.
- 3. Private Foundation Excise Taxes – Where a "private foundation" engages in a joint venture, it must also analyze the various prohibitions/excise taxes specifically applicable to it under the tax law, including those regarding:
 - Self-dealing
 - Excess business holdings
 - Jeopardy investments

4.5 Joint Ventures with Non-Exempt Partners – Protecting Tax-Exempt Status

1. Trap for Both the Unwary and the Wary? – The tax law relating to joint ventures between an exempt organization and any third party is, in many respects, confused, confusing and unsettled, and can be treacherous. The types of potential arrangements that could, at least in theory and often in practice, be cast as a "joint venture" are many and varied, and not always very obvious.
2. Situations to Beware of? To some extent, it is misleading to attempt to list those commercial/financial/economic arrangements with respect to which an NFP needs to be tax law wary. Any form of partnership, limited liability company or other form of venture with a third party should be considered under these tax law principles. As noted earlier, however, the NFP must remain sensitive to these issues with respect to any other form of commercial relationship in which there is some element or variation of sharing of profits or success of a venture or activity.
3. If an NFP enters a joint venture relationship, what must it do? There is no generic answer to this question. As a general proposition, it is useful to appreciate that (at least as things stand today) in situations where an exempt organization has a significant interest in a joint venture that is not conducted inside a taxable corporation, the IRS places critical weight on the stated (and contractually/legally binding) objectives of the venture and on the governance and control over the venture's conduct.
4. When in Doubt, a Prudent Approach – As noted, often it is and remains unclear whether these tax law principles are implicated. The prudent NFP Board or manager, therefore, is on the lookout for and careful with any profit sharing activity/arrangement. In these situations, often the NFP is well-advised to consider and, perhaps, adhere to the following guidelines:

- Joint venture organizing documents should establish primary overriding charitable/exempt objective
- NFP should be provided with overriding control
- If third party management company is involved, ideally it should be one that is not affiliated with the non-exempt partner
- All joint venture contracts should be at “arm’s-length”/fair

V. IMPROVING THE WORLD: POLITICS, ADVOCACY, LOBBYING

5.1 Participating in Political Campaigns

1. A Section 501(c)(3) organization may not participate or intervene, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office.
2. The prohibition is absolute. Violation of it can result in revocation of exempt status.

5.2 Who Is a Candidate for Public Office?

1. A candidate for public office is any individual who has offered him/herself or has been proposed by others, as a contestant for an elective public office, whether federal, state or local.

5.3 What Activities Constitute Prohibited Participation or Intervention in a Political Campaign?

1. Such prohibited activities include, but are not limited to, the publication or distribution of written statements or the making of oral statements on behalf of or in opposition to a candidate.
2. Whether the activities of an organization or its members or officers have engaged in prohibited political activities depends upon all of the facts and circumstances. Organizations often struggle to find the line between permitted conduct – such as advocacy or education concerning important social issues – and prohibited involvement in political campaigns. There simply is no bright line that tells the NFP how far it may go. The extent to which specific NFP conduct may be found to run afoul of this absolute prohibition can depend, in large measure, on the factual/situational context.

5.4 IRS Guidance to Help Distinguish Between Prohibited and Permitted Political Activities

The IRS has issued authoritative guidance describing varying factual scenarios, intended to explain the difference between prohibited and permitted political activities. It is useful to consider these issues as divided into 7 classes of activities:

1. Voter Education and Registration and Get-Out-the-Vote Drives – These activities are permitted if conducted in a non-partisan manner. For example, activities designed to encourage voter registration by all eligible voters regardless of their position on candidates or issues is permitted; on the other hand, activities designed to encourage voter registration only by those likely to vote for a particular candidate would be prohibited.

2. Individual Activities by Leaders – Leaders of Section 501(c)(3) organizations may advocate the election of particular candidates but, may not do so at official functions of the organization or in official publications of the organization. In all cases, care should be taken to make clear that views expressed in an “individual” capacity are not those of, or, in effect, being advanced by, the organization.
3. Candidate Appearances – Inviting political candidates to speak at organizational functions is permitted if all candidates are given an equal opportunity to participate.
4. Candidate Appearances When Speaking as Non-Candidate – Candidates may appear or speak at organization events in a non-candidate capacity. Factors the IRS will take into account in determining whether this test is met include: whether the individual is chosen to speak solely for reasons other than his/her candidacy; whether he/she speaks in a non-candidate capacity; whether mention is made of his/her candidacy or the election; whether any campaign activity occurs in connection with the appearance; whether a nonpartisan atmosphere is maintained; and whether the organization clearly indicates the capacity in which he/she is appearing and does not mention the individual’s candidacy or the upcoming election in communications announcing the appearance. Experience shows that this candidate appearance test is not sufficiently objective to prevent serious disagreements over its application in particular situations.
5. Issue Advocacy – Section 501(c)(3) organizations may take positions on public policy issues, including issues on which candidates for public office disagree. They may not do so, however, in a manner that functions as political campaign intervention, such as by identifying the issue with a particular candidate. This issue, too, can become quite murky.
6. Business Activity – Business activity that could be prohibited intervention in a political campaign includes selling or renting of mailing lists or office space and the acceptance of paid advertising. Such activities will generally not be treated as prohibited intervention if the good, service or facility is available to candidates on an equal basis and if the fee charged is the organization’s normal fee.
7. Web sites – A link on a Section 501(c)(3)’s web site to a candidate’s web site or to material on another person’s web site that endorses a political candidate may constitute prohibited intervention. Factors to consider include: whether links are provided to the web sites of all candidates for a particular office; and whether there is a non-political reason for a link to another web site that may include, among other material, an endorsement of a particular candidate.

5.5 Lobbying For/Against Legislation

1. A Section 501(c)(3) organization may not carry on propaganda or other activities, or otherwise attempt to influence legislation *as any substantial part of its activities*. Violation of this prohibition can result in loss of tax exempt status.
2. What is “lobbying”?
 - Contacting or urging the public to contact legislators for the purpose of proposing, supporting or opposing legislation.

- Advocating the adoption or rejection of legislation.
 - “Legislation” is any bill that has been introduced or a draft bill that may be introduced in any legislative body.
3. What is “substantial”?
- There are no clear guidelines in the tax law. It is safe to say that “substantial” in this context means something less than the majority of an organization’s activities; indeed, it clearly means something considerably less. But how much less is not clear. Consequently, where an exempt organization otherwise restricted from “lobbying” does or expects to do more than an insignificant amount of “lobbying,” reliance on this test is risky.

5.6 The Expenditure Test – An Objective Guideline For Determining Allowable Lobbying

1. The Section 501(h) Election – Recognizing that many exempt organizations needed greater certainty regarding the amount of “lobbying” they could conduct while still retaining their exempt status, Congress (in 1976) enacted a provision that permits an organization, upon making an election, to undertake “lobbying” activity up to specifically defined dollar thresholds.
2. Section 501(h) permits a Section 501(c)(3) organization to elect an objective “expenditure test” in place of the subjective “substantial part test.”
3. May All Section 501(c)(3) Organizations Elect the Expenditure Test? No – The expenditure test election is not available to private foundations or churches, associations of churches or a member of an affiliated group of charities that includes as one of its members a church or association of churches.
4. What Does the Expenditure Test Do? It lays out specific limits on how much money a charity can spend for lobbying based on its exempt purpose expenditures. The rules distinguish between different forms of lobbying and spell out the amount of expenditures permitted for each type. Under this test, there are no limits on lobbying activities that do not require expenditures, including, for example, unreimbursed activities of volunteers.
5. For purposes of the expenditure test, the meaning of prescribed or limited “lobbying” is set out and excludes certain activity/conduct that otherwise might be thought of as “lobbying.”
6. Penalties for Exceeding Expenditure Test Limits – A Section 501(c)(3) organization that elects the expenditure test will not lose its tax exempt status unless it normally makes lobbying expenditures that are more than 150% of the permitted amount. Exceeding the limits can result in a 25% excess tax on the excess lobbying expenditures.

5.7 Reporting Lobbying Expenditures

1. Section 501(c)(3) organizations must report lobbying expenditures to the IRS.
 - Enhanced Form 990 (annual tax return) requires details regarding organizational lobbying expenditures

2. More detailed reporting is required of organizations that do not make the Section 501(h) election.

5.8 Private Foundations And Lobbying

1. Organizations treated under the tax law as “private foundations” are prohibited from any lobbying and can incur severe tax penalties for doing so.
2. Private foundations may make general support grants to publicly supported charities that lobby so long as the grant is not ear-marked for lobbying.

VI. THE FORM 990 TAX RETURN – DISCHARGING YOUR RESPONSIBILITY AND ANTICIPATING A SHIFTING LANDSCAPE

6.1 Overview of Form 990 – Annual Tax Return

1. Form 990 – In 2008, the IRS meaningfully revamped Form 990, the tax return filed annually by most (but not all) exempt organizations. The revised Form 990 demands considerably greater disclosure as to virtually every aspect of the organization’s activity and conduct than the prior version of the Form 990.
2. Form 990 Demands Significant Disclosure – Due to the broad scope and detailed nature of the information it requires, the Form 990 has often been compared to the 10K, the highly detailed GAAP financial statements and/or Annual Report s of publicly-traded, for-profit companies.
 - In most cases, the Form demands only disclosure, and does not purport to be changing in any respect the tax law requirements previously and still applicable to exempt organizations.
 - Expanded disclosure does, however, result in greater transparency (and reduced anonymity).

6.2 IRS Purposes in Making Revisions to Form 990

1. The IRS has indicated that the old (pre-2008) Form 990 “fail[ed] to meet the Service’s tax compliance interests, or the transparency and accountability needs of the states, the public, and local communities served by the organization.”
 - Thus, the IRS admittedly expanded the scope of the Form to serve non-tax reporting and non-federal purposes
2. New sections of the Form require more disclosure regarding the following areas, considered by the IRS to be “Hot Spots,” in order to curtail abuses:
 - Organizational Governance
 - Compensation
 - Fundraising Activities
 - Related Organizations

3. The goal of the IRS is to strongly encourage, by disclosure, the implementation of “good corporate governance” policies and provide the IRS the ability to better identify abusive transactions.

6.3 Form 990 Mandates Enhanced Disclosure Regarding Governance and Compensation – These Sometimes Sensitive and Sometimes Neglected Matters Cannot “Fly Below the Radar”

1. Organizational Governance – Revised Form Asks for Extensive Detail.
 - Organization is required to disclose whether it has policies relating to:
 - Conflicts of Interest
 - Whistleblower
 - Document Retention and Destruction
 - Compensation Review
 - Evaluations of Joint Ventures and Investments in Taxable Entities
 - The organization must disclose whether the board has reviewed the completed Form 990 prior to filing, the process used to have the board review the form, and the process used to make the governing documents, conflict of interest policy, and financial statements available to the public.
 - While adoption of these policies is not mandatory, the decision to adopt some or all of them is a “critical tax compliance consideration” that relates to the private benefit, excess benefit and private inurement prohibitions.
2. Compensation – Enhanced Disclosure Required.
 - Disclosure is required for **all** 501(c) organizations (not just 501(c)(3) organizations) with employees compensated in excess of \$100,000
 - Detailed information required
 - “Key Employees” is now a separate category from highly paid employees; also, disclosure is required for certain former officers, directors, trustees and key employees.
 - Questionnaire regarding details of compensation and benefits (*e.g.*, first class travel, companion travel, social club dues, compensation based on revenue).
 - Compensation Details Required – Base compensation, bonus/incentives, deferred compensation and nontaxable benefits.

6.4 Form 990 Mandates Other Areas of Operational Transparency

1. Fundraising Activities – Enhanced disclosure required for amounts paid to professional fundraisers and amounts received from fundraising events.
2. Foreign Operations – Organizations with revenues or expenses exceeding specified threshold amounts are required to provide information about foreign activities, including a listing of grants to foreign organizations and individuals.
3. Related Parties and Organizations
 - Disclosure of “excess benefit transactions,” loans, grants, and business transactions with “interested persons”
 - All Form 990-filing NFPs, not just 501(c)(3) and (c)(4), must disclose loans, grants and business transactions with “interested persons”
4. High Levels of Financial Transparency – An organization must disclose if its separate or consolidated financial statements for the tax year include a footnote that addresses the organization’s liability for uncertain tax positions under Fin 48. If so, the substance of the Fin 48 footnotes must be disclosed verbatim.

6.5 Other Significant Changes

1. Political Campaign and Lobbying Activities
 - Political Campaign activity disclosure is required by all 501(c) tax-exempt organizations, not just those exempt under Section 501(c)(3).
 - Disclosure of any funds contributed to other organizations for Section 527 function activities (generally, activities that influence elections).
2. Disclosure of Non-Cash Contributions – IRS focuses on valuation issues.

6.6 Form 990 - Potential Pitfalls and Consequences

1. Many governance practices are not required by federal tax law . . . but:
 - The IRS view is that “good governance and accountability practices provide safeguards that *the organization’s assets will be used consistently with its exempt purposes.*”
 - If issues of private inurement or non-tax-exempt purposes arise, the IRS may use the lack of policies as a factor in reaching a determination and choosing a course of action with respect to the issue.
 - Lack of good corporate governance may lead to increased likelihood of audit
2. Disclosures made on the Form 990 could, in extreme cases, lead to loss of tax-exempt status, for example:

- If new disclosures indicate charitable purpose is not being fulfilled
 - If activities such as lobbying and political contributions go beyond allowable limits
3. Disclosures made on the Form 990 could lead to an increase in actual tax liability. Disclosures create more transparency for UBTI related activities.
 4. Failure to file Form 990, Form 990-EZ, 990-PF or Form 990-N for three consecutive years leads to an automatic revocation of exempt status.

6.7 The Form 990 – What NFPs Should Do

1. Review the organization's by-laws and adopt "good governance procedures." For example, NFPs should consider adopting written policies regarding:
 - Conflicts of interest
 - Whistleblower
 - Document retention and destruction
 - Compensation
 - Joint Ventures
2. Review Financial and Data Reporting Systems – The Form and Schedules require detailed information; NFPs should confirm that their internal systems can generate the required data.
3. Review Compensation of Executives, Key Employees, and Board Members – Given that substantial information will be disclosed AND available to the public, NFPs should focus on their compensation policies and processes and assure that the required disclosure will not adversely affect them in any of their constituencies. Also, NFPs should recognize and anticipate that the enhanced disclosure may necessitate a significant additional expenditure of time and effort for organizations with complicated compensation arrangements and/or other activities that may give rise to compliance concerns or scrutiny.
4. Re-evaluate Fundraising Activities – If disclosing fundraising costs in greater details would have an adverse effect, an organization may consider changing its fundraising models or policies.
5. Evaluate organization's adherence with federal and state tax rules in anticipation of the greater transparency for taxing authorities to determine taxable activities.

VII. NFP GOVERNANCE – WHAT THE IRS WANTS, WHAT THE IRS EXPECTS, AND WHAT THE IRS DEMANDS

7.1 IRS Involvement in Governance Issues – Background

- On February 7, 2007, the IRS posted on its web site a discussion draft entitled “Good Governance Practices for 501(c)(3) Organizations”
- On June 7, 2007, the IRS released a draft new Form 990, which contained a section on governance topics
- The IRS’s attempt to create governance guidelines prompted significant public discussion, much of which was directed at the question of whether this was an arena best left to the states
- On December 20, 2007, the IRS released its new Form 990, which contains a revised governance section
- After the release of the new Form 990, the IRS removed its governance discussion draft from its web site

7.2 Current IRS Position

1. *“Despite the absence of explicit statutory provisions setting forth clear governance standards . . . we are not interlopers trying to regulate an area that is beyond our sphere. . . . The effects of good or bad nonprofit governance cut across virtually everything we see and do in our work. It impacts whether the organization is operated to further exempt purposes and public, rather than private, interests. It dictates whether the organization’s executives are compensated fairly or excessively. It influences whether the organization makes informed and fair decisions regarding its investments or its fund raising practices, or allows others to take unfair advantage. . . . It is no longer a question of whether IRS has a role to play, but what that role will be.”* Steven Miller, Commissioner of the IRS’s Tax-Exempt and Government-Entities Division, speaking at a Georgetown University conference on April 23, 2008.
2. In addition to the Form 990 information, the IRS has a paper entitled “Governance and Related Topics – 501(c)(3) Organizations” on its web site (linked through the portion of its web site dealing with the Life Cycle of a Public Charity).
3. On December 3, 2009, the IRS released a “check sheet” that will be used by examination agents “to capture data about governance practices and the related internal controls of organizations being examined.”
4. IRS View on NFP Mission.
 - The IRS believes a charity should have a mission statement and that it should be reviewed regularly
 - Form 990, Part I, Line 1 requires a description of the mission or most significant activities
5. IRS View Regarding Organizational Documents of NFP.

- A charity must have organizational documents that provide the framework for its governance and management
 - Copies of a charity's organizational documents must be submitted to the IRS in connection with its application for tax-exempt status
 - Form 990 requires the organization to report significant changes to its organizational documents
6. IRS View Regarding Governing Body of NFP.
- The IRS believes that the board of a charity should include individuals who are knowledgeable and informed
 - The IRS believes that a board should include independent members
 - Form 990 asks a fair amount of detailed questions about the board
 - The IRS's belief as to the desirability of independent board members has not (yet) been incorporated in any regulation or administrative rule
7. IRS View Regarding NFP Governance and Management Policies.
- The IRS will look to see if a charity has implemented policies relating to executive compensation, conflicts of interest, investments, fundraising, documenting governance decisions, document retention and destruction and whistleblower claims
 - Again, these concepts are not incorporated in any regulation or administrative rule
8. IRS View Regarding Financial Statements and Form 990 Reporting.
- The IRS encourages the NFP board to ensure that financial resources are used to further charitable purposes and that the organization's funds/assets are appropriately accounted for
9. Transparency and Accountability – The Internal Revenue Code requires a tax-exempt charity to make its Form 1023 (the application for tax-exempt status filed by an organization when first seeking tax-exempt status), Form 990 and Form 990T available for public inspection.

Not-For-Profit Practice Group

IRS Form 990

This memorandum provides a general overview of some of the most important governance, policy and practical issues to address when preparing for the Internal Revenue Service (“IRS”) Form 990, as revised in 2008.¹

Even though specific governance, management, and disclosure policies and procedures generally are not required under the federal tax rules, the IRS considers certain policies and procedures, as well as an active and independent board, important elements of an organization’s governance facilitating or even assuring improved tax compliance and protecting against misuse of organization resources. The IRS has observed that the absence of appropriate policies and procedures may lead to opportunities for excessive compensation, excess benefit transactions, private inurement, operation for non-exempt purposes, or other activities inconsistent with exempt status and thus may indicate to the IRS a need for further inquiry.

Whether a particular policy, procedure, or practice should be adopted by an organization depends on the organization’s particular circumstances, including its size, culture, type, structure, and activities. Accordingly, it is important that each organization consider the governance policies and practices that are most appropriate for that organization in assuring sound operations and compliance with tax law and its exempt purpose.

I. GOVERNANCE ACTION ITEMS

Form 990 asks many questions about the filing organization’s policies and practices that were in place at the end of the tax year. In short, the IRS is seeking affirmative confirmation that the filing organization has in place each of the policies and practices considered by the IRS to reflect and assure good governance. The consequences of answering negatively to any of these questions are not yet known (and may not be knowable). The IRS will use the information reported on the Form 990 to assess noncompliance and the risk of noncompliance with federal tax law for individual organizations and across the broader exempt sector. It is likely that some negative answers will have no consequence, and some will result in further inquiries from the IRS. So that an organization may answer affirmatively to as many of these questions as is appropriate, the following practices or policies should be considered for implementation by an organization:

1. ***Written Record of all Board Actions.*** Every meeting and action taken by the board (and its committees that act on behalf of the board), should be documented in writing before the next meeting or within 60 days. Typically the documentation should consist of minutes or written consents in the organization’s minute book, but this requirement may also be satisfied by emails, or similar writings, so long as the documentation clearly specifies the action taken, when it was taken, and who made the decision. (Part VI, Section A, Line 8)
2. ***Board Review of Form 990.*** An organization must report whether the completed Form 990 was provided to directors prior to filing and must also describe the process for review of the Form 990. Organizations have grappled with the “best” approach to satisfy this IRS request. By way of example, a fairly common approach is for the directors (or a committee thereof) to review and to discuss the Form 990 at a board meeting, with an opportunity to pose questions to management

about the information on the Form 990, typically in advance of filing. A copy of the organization's final Form 990 (including required schedules), should be provided to each director, preferably prior to its filing with the IRS. (Part VI, Section B, Line 11, and Schedule O) Generally, organizations have not altered their return preparation processes in a way that puts undue responsibility on board members or that places final decision-making authority in the hands of too large a group.

3. ***Conflict of Interest Policy.*** An organization should have a written conflict of interest policy. The policy should define conflicts of interest to include when a person in a position of authority over the organization, such as an officer, director, or manager, may benefit financially from a decision he or she could make in such capacity, including indirect benefits such as to family members or businesses with which the person is closely associated.

The organization's officers, directors, trustees, and key employees, should disclose or update annually their interests that could give rise to conflicts of interest, such as substantial business or investment holdings, and other transactions or affiliations with businesses and other organizations and those of family members. (Part VI, Section B, Line 12a-b)

The conflict of interest policy should also include practices for monitoring proposed or ongoing transactions for conflicts of interest and dealing with potential or actual conflicts, whether discovered before or after the transaction has occurred. The conflict of interest policy should specify the committee or other body that determines whether a conflict exists, and the body that reviews actual conflicts. Persons with a conflict should be prohibited from participating in the board's deliberations and other decisions regarding the conflict. (Part VI, Section B, Line 12a-c, and Schedule O)

4. ***Whistleblower Policy.*** Most organizations should have a whistleblower policy that encourages staff and volunteers to come forward with credible information on illegal practices or violations of adopted policies of the organization, specifies that the organization will protect the individual from retaliation, and identifies those staff or board members or outside parties to whom such information can be reported. (Part VI, Section B, Line 13)
5. ***Document Retention Policy.*** Most organizations should have a document retention and destruction policy which identifies the record retention responsibilities of staff, volunteers, board members, and outsiders for maintaining and documenting the storage and destruction of the organization's documents and records. (Part VI, Section B, Line 14)
6. ***Joint Venture Policy.*** At this point in time, it is fair to say that few tax-exempt organizations have formal and carefully designed policies governing joint ventures; indeed, for the significant majority of tax-exempt organizations, such policies—although now on the road to becoming legally mandatory—are largely or entirely irrelevant. Even so, all tax-exempt organizations are now well-advised to adopt a “joint venture policy.” (Part VI, Section B, Line 16a-b)

Ideally, an organization should have in place a process through which planned joint venture² activity is brought to the attention of the appropriate organization personnel, is considered through the prism of applicable tax and other legal constraints, and is fashioned and implemented in a manner that comports with the requirements and constraints imposed under law. If the

organization invested in, contributed assets to, or otherwise participated in a joint venture or similar arrangement with one or more taxable persons, then the organization should:

- a. adopt a written policy or procedure that requires the organization to negotiate, in its transactions and arrangements with other members of the venture or arrangement, such terms and safeguards as are adequate to ensure that the organization's exempt status is protected, and
- b. take steps to safeguard the organization's exempt status with respect to the venture or arrangement.

Some examples of safeguards include the following:

- Control over the venture or arrangement sufficient to ensure that the venture furthers the exempt purpose of the organization.
 - Requirements that the venture or arrangement give priority to exempt purposes over maximizing profits for the other participants.
 - Prohibitions on the venture or arrangement engaging in or involving activities that would jeopardize the organization's exemption (such as political intervention or substantial lobbying).
 - Requirements that all contracts entered into with the organization be on terms that are at arm's length or more favorable to the organization.
7. ***Public Availability of Governing Documents and Financial Statements.*** The organization should consider making its Form 1023 (Application for Exemption), Form 990, governing documents, conflict of interest policy, and financial statements (whether or not audited) available to the general public, for example by posting them on a website or providing copies upon request. (Part VI, Section C, Lines 18, 19)
 8. ***Audit Committee Charter.*** Most organizations should have an audit committee with a charter that specifies that the committee has responsibility for overseeing the compilation, review or audit of its financial statements, and selection of an independent accountant or auditor that compiled, reviewed or audited the financial statements. (Part XII, Line 2a-c)

II. GOVERNANCE, MANAGEMENT AND DISCLOSURE

The IRS has implemented its governance oversight through the revised Form 990 which asks many questions about governance and management. The revised Form 990 requires that organizations disclose the information listed below. Presumably certain types of answers to these questions could trigger further inquiry by the IRS.

1. Whether the organization has an **executive committee** or similar committee with broad authority to act on behalf of the governing body, and if so, its composition and scope. (Part VI, Section A, Line 1a, and Schedule O)
2. The number of **independent³ directors**. (Part VI, Section A, Line 1b)

3. Whether any of the organization's **officers, directors, trustees, or key employees, had a family relationship or business relationship** with another of the organization's officers, directors, trustees, or key employees. (Part VI, Section A, Line 2, and Schedule O)

To answer the questions on lines 1 and 2 of Part VI (regarding independent directors and business and family relationships among Board members, officers, and key employees) the organization should engage in a reasonable effort to obtain the necessary information to answer these questions. An example of a reasonable effort would be for the organization to distribute a questionnaire annually to each of the organization's officers, directors, trustees, and key employees asking for the information that needs to be reported in response to questions on relationships in lines 1 and 2. The questionnaire could include the name, title, date, and signature of the person reporting information, and contain the Form 990 Glossary definitions of "independent voting member of governing body," "family relationship," "business relationship," and "key employee." The organization may rely on information it obtains in response to such a questionnaire in answering questions on lines 1 and 2.

4. Whether the organization has **delegated to a management company key management duties** that are customarily performed, or supervised, by officers, directors, or key employees. Such management duties include, but are not limited to, hiring, firing, and supervising personnel, planning or executing budgets or financial operations, or supervising exempt operations or unrelated trades or businesses of the organization. Management duties do not include administrative services (such as payroll processing) that do not involve significant managerial decision-making. Management duties also do not include investment management unless the filing organization conducts investment management services for others. (Part VI, Section A, Line 3, and Schedule O)
5. Significant **changes to its certificate of incorporation or bylaws**. (Part VI, Section A, Line 4, and Schedule O)
6. Any **material diversion of the organization's assets**. A diversion of assets is any unauthorized or improper use of assets (including embezzlement or theft). Diversion does not include transfers for fair market value. A diversion is considered material if the gross dollar amount exceeds the lesser of \$250,000 or 5% of the organization's gross receipts or total assets. (A diversion of assets may in some cases constitute inurement of the organization's net earnings. In the case of Section 501(c)(3) and Section 501(c)(4) organizations, it also may be an excess benefit transaction taxable under section 4958 and reportable on Schedule L). (Part VI, Section A, Line 5, and Schedule O)
7. **Loans or grants to any current or former officer, director**, trustee, key employee, highly compensated employee, or other manager. (Part IV, Lines 26, 27, and Schedule L)
8. Certain types of **fringe benefits** such as first-class or charter travel, travel for companions, tax indemnification and gross-up payments, discretionary spending accounts, housing allowance or payment for business use of personal residence, health or social club dues, bodyguard, chauffeur, financial planner, lawyer, accountant, tax preparer or other personal service providers must be disclosed on Schedule J to the Form 990 regardless of whether the items are reported as compensation on a W-2 or 1099. The Organization must also indicate whether it followed a

written policy regarding payment or reimbursement of such expenses and, if not, it must explain why not. The IRS has stated that the reason for disclosure of these items is to highlight for the IRS potential areas of unreported compensation and arrangements that provide excess benefits to nonprofit executives. An IRS finding of unreported compensation or excess benefit could result in additional taxes and penalties to the executive on the unreported compensation and punitive excise taxes paid by the organization. The Form 990 provides an area for organizations to explain that their use of such benefits is proper and does not result in unreported executive compensation or excess benefits. Additionally, all Section 501(c)(3) and 501(c)(4) organizations must report and explain **compensation contingent** on the revenues or earnings of the organization or any related organization, and **non-fixed payments** (e.g., amounts paid subject to the initial contract exception of the intermediate sanctions provision⁴). (Part IV, Line 23, and Schedule J)

9. The Form 990 Part VI requires **disclosure of additional governance items on Schedule O** (Part VI, Lines 2-9, 11, 12, 15 and 19):
 - a. whether the organization has members and if they elect the directors;
 - b. whether minutes are taken of all board meetings and committees that have board authority;
 - c. the process by which the organization reviews its Form 990 and whether it is provided to the board prior to filing;
 - d. a description of how the organization monitors and enforces compliance with its conflicts policy, including the process for monitoring proposed or ongoing transactions for conflicts, and the process for dealing with potential or actual conflicts (see instructions for details); and
 - e. a description of the process by which the compensation of officers and key employees was determined

III. DISCLOSURE OF DIRECTORS, OFFICERS, AND COMPENSATION AMOUNTS AND PROCEDURES

The organization must list all of its current officers, directors, and trustees, as those terms are defined in the Form 990 instructions, regardless of whether any compensation was paid to such individuals. The revised Form 990 also requires more disclosure of compensation arrangements and the process used to determine the compensation amounts.

3.1 Disclosure of Compensation

In addition to current officers, directors, and trustees, the organization must list up to 20 current employees who satisfy the definition of key employee (persons with certain responsibilities and reportable compensation greater than \$150,000 from the organization and related organizations), and its five current highest compensated employees with reportable compensation of at least \$100,000 from the organization and related organizations who are not officers, directors, trustees, or key employees of the organization. The compensation must be reported when it is paid by the organization or from a related organizations (such as, parents, subsidiaries, sibling

organizations and other organization that share common control, supporting organizations and supported organizations).

Organizations are required to list the following officers, directors, trustees, and employees of the organization whose reportable compensation from the organization and related organizations exceeded the following thresholds:

Position	Current or former	List on Form 990, Part VII, Section A:	List on Schedule J (Form 990), Part II:
Directors and Trustees	Current	All	If reportable and other compensation > \$150,000 in the aggregate from organization and related organizations (do not report institutional trustees)
	Former	If reportable compensation in capacity as former director or trustee > \$10,000 in the aggregate	If listed on Form 990, Part VII, Section A (do not report institutional trustees)
Officers	Current	All	If reportable and other compensation > \$150,000 in the aggregate from organization and related organizations
	Former	If reportable compensation > \$100,000 in the aggregate from organization and related organizations	If listed on Form 990, Part VII, Section A
Key employees	Current	All	All
	Former	If reportable compensation > \$100,000 in the aggregate from organization and related organizations	If listed on Form 990, Part VII, Section A
Other Five Highest Compensated Employees	Current	If reportable compensation > \$100,000 in the aggregate from organization and related organizations	If reportable and other compensation > \$150,000 in the aggregate from organization and related organizations
	Former	If reportable compensation > \$100,000 in the aggregate from organization and related organizations	If listed on Form 990, Part VII, Section A

“Reportable compensation” generally means compensation reported in Box 5 of the employee’s Form W-2, or in Box 7 of a non-employee’s Form 1099-MISC. “Other compensation” generally means compensation that is not reportable compensation. The instructions to Part VII explain these terms, and also provide a more detailed table listing various types of compensation and where to report them in Part VII or in Schedule J.

3.2 Compensation Amounts

The organization should ensure that no more than *reasonable compensation* is paid. “Reasonable compensation” is the value that would ordinarily be paid for like services by like enterprises under like circumstances. The tax law generally prohibits, and can subject an organization to loss of exempt status as a result of any excessive compensation arrangement. Unreasonable compensation could also result in an *excess benefit transaction*: a transaction in which specified “insiders” and others thought to hold positions of power/authority, including a current or former manager, receives an economic benefit from the organization which exceeds the value of the consideration (such as performance of services) to the organization. An excess benefit transaction also can occur when a manager embezzles from the organization. Recipients of excess benefits and the directors or officers who approve the excess benefits are subject to tax penalties.⁵

3.3 Process for Determining Compensation

The revised Form 990 requires disclosure of whether the organization used a process for determining the compensation of the CEO (or executive director, or other person who is the top management official) and of other officers or key employees that included all of the elements listed below for a rebuttable presumption of reasonable compensation. If the organization did use such a process, then they must describe the process on Schedule O, identify the offices and persons for which the process was used to establish compensation, and state the year in which this process was last used for each such person. (Part VI, Line 15a, b, Schedule J and Schedule O)

3.4 Rebuttable Presumption of Reasonable Compensation

Fixed payments (but not discretionary bonuses⁶) under a compensation arrangement are presumed to be reasonable if the following three conditions are met:⁷

1. Review and approval of compensation arrangements by the **disinterested members of the board or the compensation committee** (*i.e.*, persons with conflicts were not involved).⁸
2. **Use of data showing comparable compensation** for similarly qualified persons in functionally comparable positions at similarly situated organizations (both taxable and non-taxable). This may include consulting an independent compensation consultant, reviewing Form 990s of other organizations, compensation surveys, actual written offers from similar organizations competing for the executive's services, or other objective external data to establish comparable values for executive compensation. The use of these items are also disclosed on Schedule J.
3. The board or committee **adequately documents its deliberations and the basis for its determination** that the compensation is reasonable in the minutes of the board or the committee. The minutes should include:
 - a. the terms of the compensation arrangement that were found reasonable;
 - b. the comparability data relied upon by the authorized body and how the data was obtained;
 - c. any member of the board or committee who abstained or voted against the arrangement; and
 - d. whether a member of the board or committee having a conflict of interest was recused or took other action.

In some cases, an organization may find it impossible or impracticable to fully implement each step of the rebuttable presumption process described above. In such cases, most organizations should try to implement as many steps as possible, in whole or in part, in order to substantiate the reasonableness of benefits as timely and as well as possible. These requirements for a "rebuttable presumption," however, may not be appropriate for certain organizations; even so, organizations are well-advised to take any and all steps that *are* reasonable, given their circumstances, to assure proper compensation arrangements. In addition to the steps above, having written documentation of the approved compensation amounts, (*e.g.*, in a written employment agreement, approved budget line item, or board or committee resolution) is helpful to avoid later assertions that a compensation amount is more (or less) than that agreed and that it was determined within the proper framework and procedures.

An important exception to the excess benefit rules and the reasonable compensation requirement is the exception for any fixed payment made pursuant to an initial contract when the contract is both in writing and is with a previously unaffiliated officer or manager.⁹ This is an “exception” because (and assuming) there had been no prior relationship between the organization and the other party. In these cases, however, the organization is well-advised to anticipate the application of these rules, and the need to conform with these rules at such later date when the contract is renewed or even materially changed or amended. Renewals and material amendments generally are treated under the tax law as new contracts and, consequently, the relationship with the contracting party may, at that subsequent time, have become one that is covered by these excess benefit transaction rules.

IV. WHEN TO FILE FORM 990

The Form 990 must be filed five months and 15 days after the organization’s accounting period ends. For a calendar year organization (where the accounting period ends on December 31st), the due date for Form 990 is May 15th. For an organization with a fiscal year ending September 31, the Form 990 is due February 15th. The due dates may be extended up to six months by filing Form 8868.

This memorandum is not designed to answer the many questions and issues that arise in connection with the preparation and filing of the Form 990, or otherwise to substitute for the expert advice of a qualified tax return preparer. Please contact your tax return preparer, accountant or an attorney if you have questions about the new requirements in the revised Form 990.

ENDNOTES

¹ Note that 501(c)(3) charities sub-categorized as “private foundations” file the Form 990-PF, and do not file the revised Form 990. In addition, depending on certain asset and/or revenue tests, many organizations will be eligible to file the less burdensome Form 990-EZ or Form 990-N.

² Under the tax law, “joint venture” is broadly defined and includes many economic relationships not conventionally or colloquially referred to or thought of as “joint ventures.” A joint venture or similar arrangement means any joint ownership or contractual arrangement through which there is an agreement to jointly undertake a specific business enterprise, investment, or exempt-purpose activity (without regard to (1) whether the organization controls the venture or arrangement, (2) the legal structure of the venture or arrangement, or (3) whether the venture or arrangement is treated as a partnership, association, or corporation for federal income tax purposes). Disregard ventures or arrangements that meet both of the following conditions: (1) 95% or more of the venture’s income for its tax year ending with or within the organization’s tax year is described in Sections 512(b)(1)-(5) (generally, passive investment income including unrelated debt-financed income) and (2) the primary purpose of the organization’s contribution to, or investment or participation in, the venture or arrangement is the production of income or appreciation of property.

³ According to the Form 990 Instructions, Directors are considered “independent” only if all three of the following circumstances apply:

- a. The director was not compensated as an officer or other employee of the organization or a related organization.
- b. The director did not receive total compensation exceeding \$10,000 during the tax year from the organization (or related organizations) other than reimbursement of expenses or reasonable compensation for services as a director. For example, a person who receives reasonable expense reimbursements and reasonable compensation as a director of the organization does not cease to be independent merely because he or she also receives payments of \$7,500 from the organization for other arrangements.
- c. Neither the director, nor any family member of the director, was involved in a loan, grant (*e.g.*, scholarship, award), excess benefit transaction, or certain business transactions involving interested persons, with the organization (whether directly or indirectly through affiliation with another organization). See instructions for transactions required to be reported on Schedule L.

⁴ See Schedule J instructions and Treas. Reg. § 53.4958-4(a)(3).

⁵ A recipient who receives an excess benefit from unreasonable compensation is liable for a 25% (or 200% if not corrected) tax on the excess benefit. Also, organization managers who participate in an excess benefit transaction knowingly, willfully, and without reasonable cause are liable for a 10% tax on the excess benefit (up to \$10,000). See Treas. Reg. § 53.4958-1(a).

⁶ Nonfixed payments (*e.g.*, a discretionary bonus) may not have a presumption of reasonableness unless there is a specified cap on the amount and the authorized body establishes a rebuttable presumption as to the maximum amount payable under the contract.

⁷ See Form 990, Part VI, Line 15. There is a special safe harbor for small organizations. If the organization has gross receipts of less than \$1 million, appropriate comparability data includes data on compensation paid by three comparable organizations in the same or similar communities for similar services.

⁸ The Nonprofit Sector report recommends that the entire board approve the compensation of the CEO while the compensation committee alone can approve the compensation of other officers.

⁹ Treas. Reg. § 53.4958-4(a)(3).

Not-For-Profit Practice Group

Sample Not-For-Profit Board Guidelines

The board of a not-for-profit organization may find it useful to set forth governance guidelines it applies in fulfilling its responsibilities, including board leadership, structures, composition, functions and processes, and the organization's expectations of directors. Board guidelines are intended as a component of the flexible governance framework within which the board, assisted by its committees, directs the affairs of the organization. The guidelines should be interpreted in the context of all applicable laws and regulations, as well as in the context of the organization's charter and bylaws, as they are not intended to establish by their own force any legally binding obligations.

Board guidelines are very specific to the needs and circumstances of the individual not-for-profit organization – one size does not fit all. Governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization. This sample provides only one example for a non-member organization, incorporating elements required by the Non-Profit Revitalization Act of 2013 (as amended, the "Revitalization Act") applicable to New York not-for-profits, which amended the New York Not-For-Profit Corporation Law (as amended by the Revitalization Act, the "NPCL"), as well as elements related to certain disclosure requirements under Internal Revenue Service ("IRS") rules. Organizations incorporated outside of New York may not be subject to some of the provisions of the Revitalization Act, and should tailor these Guidelines to their current circumstances. We have annotated herein the provisions required by the Revitalization Act.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate in particular circumstances.

It should also be noted that Section 8-1.9 of New York's Estates, Powers and Trusts Law makes applicable to charitable trusts a number of sections of the Revitalization Act, including the provisions addressing audit oversight, as well as related party transactions and conflict of interest and whistleblower policies.

[NAME OF NOT-FOR-PROFIT ORGANIZATION]

Board Guidelines

I. DUTIES AND RESPONSIBILITIES OF THE BOARD

The role of the Board of Directors (the “Board”) of _____ (the “Organization”) is to manage and direct the affairs of the Organization, and set expectations about the tone and ethical culture of the Organization. In fulfilling their roles on the Board, directors are expected to apply their business judgment and act with due care, in good faith and in accordance with the best interests and mission of the Organization.

The Board delegates the day-to-day management of the Organization to the [Chief Executive Officer/Executive Director/President] and other senior management of the Organization, and provides guidance to and oversight of management.

The Board fulfills its role (directly or by delegating certain responsibilities to its committees) by:

1. Identifying, reviewing and updating as necessary, the mission and purposes of the Organization;
2. Setting the values and expectations about the ethical culture of the Organization – the “tone at the top” – and reviewing management efforts to instill an appropriate tone and culture throughout the Organization;
3. Providing advice, counsel and support to the [Chief Executive Officer/Executive Director/President] and other senior management;
4. Selecting, regularly evaluating, fixing the compensation of, and, where appropriate, replacing the [Chief Executive Officer/Executive Director/President];
5. Establishing measures of organizational performance and utilizing those measures to ensure senior management accountability;
6. Planning for senior management succession and guiding and overseeing management development;
7. Providing oversight of the Organization’s performance to evaluate whether the business is being appropriately managed in accordance with the Organization’s mission;
8. Reviewing and approving strategic plans and providing guidance to management in formulating the Organization’s strategy;
9. Reviewing and approving the Organization’s annual budget, financial objectives, fundraising plans and major corporate and development activities (including material capital expenditures and transactions outside the ordinary course of business);

10. Reviewing and approving significant changes in the Organization's auditing and accounting principles and practices;
11. Providing oversight of internal and external audit processes, financial reporting, recordkeeping and disclosure controls and procedures;
12. Reviewing the Organization's Form 990 prior to filing with the Internal Revenue Service;¹
13. Providing oversight of risk assessment and monitoring processes;
14. Ensuring that compliance systems and processes designed to promote legal and ethical compliance are reasonably effective, and overseeing the Organization's compliance with relevant laws and regulations;
15. Designing governance structures and practices to position the Board to fulfill its duties effectively and efficiently, and making changes as needed; and
16. Performing such other functions as the Board believes appropriate or necessary, or as otherwise prescribed by law or regulation.

II. DIRECTOR QUALIFICATION STANDARDS

Selection of Board Members

The Board is responsible for selecting the members of the Board. [The Board has delegated the selection process to the Nominating and Governance Committee.] The Board will review [annually/periodically] the appropriate experience, qualifications, attributes and skills required of directors in the context of the Organization's current circumstances and the Board's needs.

The Board expects that all directors will, at a minimum:

1. Have experience or knowledge with respect to at least one area of the Organization's operations or area of board responsibility, such as [strategic planning, financial management, technology, fundraising and development, public relations or human resources]; and
2. Be committed to the Organization's mission and programs.

[The Nominating and Governance Committee is responsible for reviewing with the Board / The Board is responsible for reviewing,] on an annual basis, the appropriate skills and characteristics required of directors in the context of the current make up of the Board.

Director Independence²

Directors should be "independent-minded" and be able to exercise objective judgment. The Board should ensure that only "independent" directors are appointed to the Audit Committee[, Compensation Committee and Nominating and Governance Committee, as these committees are responsible for making decisions with respect to issues where management may have a potential conflict].³

In determining whether or not a director is “independent,” the Board should consider all relevant facts and circumstances that could affect a director’s ability to exercise objective judgment, including materiality of relationships (business, familial and social) each director may have with the Organization, management, beneficiaries, donors, clients, suppliers and other important constituents. In addition, a director may only be considered “independent” if:⁴

[For a New York not-for-profit:

1. The director was an employee or a key person⁵ of the Organization or a related organization or affiliate⁶ during the past three years;
2. The director does not have a relative who is, or has been within the last three years, a key person of the organization or an affiliate of the organization;
3. The director did not receive and does not have a relative who received total direct compensation exceeding \$10,000 in any of the past three tax years from the Organization or related organizations or affiliates for services provided in the director’s capacity as an advisor, consultant or independent contractor other than any reasonable compensation for service as a director;
4. The director is not a current employee of and does not have a substantial financial interest in, and does not have a relative who is an officer of or has a substantial financial interest in, any entity that has made payments to, or received payments (not including charitable contributions) from, the corporation or an affiliate thereof for property or services in an amount that, in any of the last three fiscal years, has exceeded (a) the lesser of \$10,000 or 2% of such other entity’s consolidated gross revenue if such other entity’s consolidated gross revenue was less than \$500,000, (b) \$25,000 if such other entity’s consolidated gross revenue was \$500,000 or more but less than \$10 million and (c) \$100,000 if such other entity’s consolidated gross revenue was \$10 million or more;
5. The director is not, and does not have a relative who is, a current owner, director, officer or employee of [insert name of Organization’s outside auditor], or who has worked on the Organization’s audit at any time during the last three years; and
6. Neither the director, nor any relative of the director, was involved in a loan, grant, excess benefit transaction, or a business transaction involving an interested person that is reportable on Schedule L of Form 990, with the Organization (whether directly or indirectly through affiliation with another organization) during the most recent tax year.]

[For other not-for-profits required to file Form 990:

1. The director was not compensated as an officer or other employee of the Organization or a related organization during the most recent tax year;
2. The director did not receive total compensation exceeding \$10,000 in the most recent tax year from the Organization or related organizations for services provided in the director’s capacity as an advisor, consultant or independent contractor other than any reasonable compensation for service as a director;

3. The director is not, and does not have a relative who is, a current owner, director, officer or employee of [insert name of Organization's outside auditor], or who has worked on the Organization's audit at any time during the last three years; and
4. Neither the director, nor any relative of the director, was involved in a loan, grant, excess benefit transaction, or a business transaction involving an interested person that is reportable on Schedule L of Form 990, with the Organization (whether directly or indirectly through affiliation with another organization) during the most recent tax year.]

For purposes of these Guidelines, a "relative" of a director is that person's (i) spouse or domestic partner; (ii) ancestors, brothers and sisters (whether whole or half-blood), children (whether natural or adopted), grandchildren, great-grandchildren; or spouse or domestic partner of that person's brothers, sisters, children, grandchildren and great-grandchildren.⁷

III. BOARD LEADERSHIP

The Board is led by a [non-employee]⁸ chair, who is responsible for:

1. Convening and chairing meetings of the Board;
2. Organizing the Board's agenda with input from management and helping to identify the Board's information needs;
3. Leading Board discussions of management performance and compensation in executive sessions; and
4. Encouraging frank but collegial discussions both at the Board level and as between the Board and management.

IV. DUE CARE AND LOYALTY

Directors are expected to exercise appropriate diligence in providing oversight, and are expected to:

1. Attend and participate actively at all Board and committee meetings;
2. Review meeting materials and agendas in advance;
3. Request other information from management and trustworthy and reliable experts where appropriate before making decisions or taking actions;
4. Be sensitive to indications of potential problems or concerns and make further inquiry until reasonably satisfied that management is dealing with those concerns appropriately;
5. Act with integrity and adhere to all applicable laws, regulations and organizational policies; and
6. Keep confidential all non-public information that relates to the Organization's business, unless disclosure and/or use of such information is otherwise authorized.

V. OTHER EXPECTATIONS

In addition to fulfilling the duties outlined above, the Board is expected to:⁹

1. Meet at least [three] times per year;
2. Meet periodically without members of management present;
3. Maintain minutes of Board and committee meetings;¹⁰
4. Review and approve policies and procedures relating to the work and structure of the Board;
5. Approve major engagements with respect to public policy and other external affairs activities; and
6. Consider appropriate orientation of new directors and make available continuing director education opportunities as appropriate.

[In addition to fulfilling the duties outlined above, each director is expected to:

1. Join and participate actively in the activities of at least one committee of the Board;
2. Pay for a ticket to and attend the Organization's annual benefit;
3. Make every reasonable effort to bring financial support to the Organization annually from external sources;
4. Make personally meaningful financial gifts to the Organization at least annually;
5. Leverage personal relationships with others (including corporations, professional service firms, foundations, individuals and government agencies) to assist the staff of the Organization with implementing fundraising strategies, including adding names of potential sources of support to the Organization's mailing list;
6. Act as an ambassador for the Organization with respect to dealings with the general public, donors, government agencies and clients;
7. Advise the Chair of the Nominating and Governance Committee upon a change in the director's professional responsibilities (such as resignation or change of employment) and prior to accepting an invitation to serve on another board of directors;
8. Act as a mentor to other directors; and
9. Suggest to the Nominating and Governance Committee any potential Board candidates who fulfill the Board's criteria for directors and who could make significant contributions to the Board and the Organization.]¹¹

VI. BOARD COMMITTEES

The Board currently has [six] standing committees: [Audit, Compensation, Nominating and Governance, Development, Finance and Investment, and Public Relations]; and [two] task-specific committees: [Executive and Strategic Planning].¹² Each committee has its own charter, which sets forth the responsibilities of each committee, the qualifications of its members and the procedures of the committee. The Board retains discretion to form new committees, including sub-committees, and can disband committees where appropriate.

VII. CONFIDENTIALITY

Pursuant to their fiduciary duties of loyalty and care, directors have an obligation to keep confidential all non-public information obtained by a director that relates to the Organization's business and that he or she receives in connection with serving on the Board. Directors may not use such information for personal benefit or the benefit of persons or entities outside the Organization, nor may they disclose this information for any purpose without written authorization of the Board or as may be otherwise required by law or regulation. Confidential information includes, but is not limited to, information regarding the strategy, business, finances, operations and fundraising efforts or plans of the Organization (or any of the Organization's suppliers, customers, donors, volunteers or other constituents), minutes, reports and materials of the Board and its committees, and other documents identified as confidential by the Organization. The proceedings and deliberations of the Board and its committees are also confidential non-public information and are subject to strict protection.

VIII. BOARD INTERACTION WITH THE PUBLIC¹³

In most situations, the [Chief Executive Officer/Executive Director/President] speaks on behalf of the Organization with donors, employees, clients, suppliers, the media and others. The Chair of the Board is the spokesperson of the Board. Other directors should not communicate with representatives of the media unless duly authorized by the Chair of the Board or the [Chief Executive Officer/Executive Director/President], so as to prevent any inadvertent disclosure of confidential information.

IX. TENOR OF BOARDROOM DELIBERATIONS

Achieving an atmosphere in which full and frank discussion can thrive, and consensus can ultimately be reached, is a challenge. It is the responsibility of the Board to act in the best interests of the Organization and disagreements may arise. Within the context of their fiduciary duties, directors should seek to participate and express disagreement in an open and collegial manner, with developing consensus and resolution as the ultimate goal.

ENDNOTES

¹ IRS Form 990 requires disclosure of whether the organization has provided a complete copy of its Form 990 to all members of the board before filing the form, as well as disclosure of the process, if any, used by the organization to review its Form 990. *See* Form 990, Part VI, Lines 11a-b and related instructions.

² IRS Form 990 requires disclosure of the number of voting members of the board who are independent, in accordance with IRS tests. *See* Form 990, Part VI, Line 1b and related instructions.

³ The NPCL does not require the compensation committee or the nominating and governance committee to be composed of solely independent directors. However, the NPCL requires New York not-for-profits to form an audit committee comprised of “independent directors” (as defined in the NPCL), or identify independent directors to oversee the audit (if any), approve certain transactions and oversee the conflict of interest policy and the whistleblower policy (if any), unless the board or another committee comprised solely of independent members already performs such governance activities. Only independent directors of New York not-for-profits are permitted by the NPCL to participate in any board or committee deliberations or voting relating to such matters. *See* NPCL § 712-a. IRS Form 990 also requires disclosure of whether the process for determining compensation of certain key employees included a review and approval by independent persons. *See* Form 990, Part VI, Lines 15a-b and related instructions. In addition, compensation will be presumed reasonable under the relevant tax rules if: (1) the compensation arrangement is approved by disinterested members of the board or the committee; (2) the board or committee obtained and relied upon appropriate data as to comparability of compensation such as the compensation paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions (which may include reviewing compensation surveys, actual written offers from similar organizations competing for the person’s services, or other objective external data to establish comparable values for executive compensation); and (3) the board or committee adequately documents the basis for its determination that the compensation is reasonable concurrently with making that determination. *See* IRC § 4958 and related regulations.

⁴ The bright-line tests for “independence” set forth in IRS rules are different in some respects to the bright-line tests set forth in the Revitalization Act’s definition of “independent director,” for example, the required “look-back” period is different (the most recent tax year under IRS tests, compared with the past three years under New York tests).

The IRS considers a director to be “‘independent’ only if all four of the following circumstances applied at all times during the organization’s tax year: (1) [t]he member was not compensated as an officer or other employee of the organization or of a related organization...except as provided in the religious exception [n]or was the member compensated by an unrelated organization or individual for services provided to the filing organization or to a related organization, if such compensation is required to be reported in Part VII, Section A [of Form 990]; (2) [t]he member did not receive total compensation exceeding \$10,000 during the organization’s tax year ... from the organization and related organizations as an independent contractor, other than reasonable compensation for services provided in the capacity as a member of the governing body; (3) [n]either the member, nor any family member of the member, was involved in a transaction with the organization (whether directly or indirectly through affiliation with another organization) that is required to be reported on Schedule L (Form 990 or 990-EZ) for the organization’s tax year; (4) [n]either the member, nor any family member of the member, was involved in a transaction with a taxable or tax-exempt related organization (whether directly or indirectly through affiliation with another organization) of a type and amount that would be reportable on Schedule L (Form 990 or 990-EZ) if required to be filed by the related organization. A member of the governing body is not considered to lack independence merely because of the following circumstances: (1) [t]he member is a donor to the organization, regardless of the amount of the contribution;” (2) the religious exception applies; or (3) “the member receives financial benefits from the organization solely in the capacity of being a member of the charitable or other class served by the organization in the exercise of its exempt function.” Instructions to Form 990, Part VI, Line 1b.

The Revitalization Act defines “independent director” to mean “a director who: (i) is not, and has not been within the last three years, an employee or a key person of the corporation or an affiliate of the corporation, and does not have a relative who is, or has been within the last three years, a key person of the corporation or an affiliate of the corporation; (ii) has not

received, and does not have a relative who has received, in any of the last three fiscal years, more than \$10,000 in direct compensation from the corporation or an affiliate of the corporation; (iii) is not a current employee of or does not have a substantial financial interest in, and does not have a relative who is a current officer of or has a substantial financial interest in, any entity that has provided payments, property or services to, or received payments, property or services from, the corporation or an affiliate of the corporation if the amount paid by the corporation to the entity or received by the corporation from the entity for such property or services, in any of the last three fiscal years, exceeded the lesser of \$10,000 or 2% of such entity's consolidated gross revenues if the entity's consolidated gross revenue was less than \$500,000; \$25,000 if the entity's consolidated gross revenue was \$500,000 or more but less than \$10 million; or \$100,000 if the entity's consolidated gross revenue was \$10 million or more; or (iv) is not and does not have a relative who is a current owner, whether wholly or partially, director, officer or employee of the corporation's outside auditor or who has worked on the corporation's audit at any time during the past three years. For purposes of this subparagraph, the terms: 'compensation' does not include reimbursement for expenses reasonably incurred as a director or reasonable compensation for service as a director; and 'payment' does not include charitable contributions, dues or fees paid to the corporation for services which the corporation performs as part of its nonprofit purposes, or payments made by the corporation at fixed or non-negotiable rates or amounts for services received, provided that such services by and to the corporation are available to individual members of the public on the same terms, and such services received by the corporation are not available from another source." NPCL § 102(a)(21).

⁵ A "key person" is defined in the Revitalization Act as any person, other than a director or officer, whether or not an employee of the corporation who (i) has responsibilities, or exercises powers or influence over the corporation as a whole similar to the responsibilities, powers, or influence of directors and officers; (ii) manages the corporation, or a segment of the corporation that represents a substantial portion of the activities, assets, income or expenses of the corporation; or (iii) alone or with others controls or determines a substantial portion of the corporation's capital expenditures or operating budget, in accordance with applicable IRS rules. *See* NPCL § 102(a)(25).

⁶ The Revitalization Act defines an "affiliate" of a corporation as "any entity controlled by, or in control of, such corporation." NPCL § 102(a)(19). The Instructions to Form 990 define a "related organization" to include, among others, "an organization that controls the filing organization," "an organization controlled by the filing organization," and "an organization controlled by the same person or persons that control the filing organization." Instructions to Form 990, Glossary.

⁷ The definitions of "relative" in the Revitalization Act and "family member" in the Instructions to Form 990 are substantially the same. *See* NPCL § 102(a)(22); Instructions to Form 990, Glossary.

⁸ No employee of a New York not-for-profit serve as chair of the board or hold any other title with similar responsibilities, unless the board approves such employee serving as the chair by a two-thirds vote of the entire board and contemporaneously documents in writing the basis for approval. *See* NPCL § 713(f); Revitalization Act § 132.

⁹ Note that not all actions listed below are required by law, but are best practices. This list should be tailored to the specific needs of the organization.

¹⁰ IRS Form 990 requires disclosure of whether the organization contemporaneously documents, by any means permitted by state law, the meetings held by the board and any committee authorized to act on behalf of the board. The related instructions provide that "[d]ocumentation permitted by state law can include approved minutes, email, or similar writings that explain the action taken, when it was taken, and who made the decision. For this purpose, *contemporaneous* means by the later of (1) the next meeting of the governing body or committee (such as approving the minutes of the prior meeting) or (2) 60 days after the date of the meeting or written action." *See* Form 990, Part VI, Line 8 and related instructions. The NPCL requires that New York not-for-profits keep minutes of the proceedings of the board and any executive committee, and the Revitalization Act requires that New York not-for-profits contemporaneously document in writing the basis for the board or authorized committee's approval of certain specified related party transactions, including the consideration of any alternative transactions. *See* NPCL §§ 621(a), 715(b).

¹¹ Board responsibilities may be tailored to the specific needs of the organization.

¹² While these Guidelines contemplate the formation of various committees, the Board is not required to form committees, but may do so for administrative ease, especially for larger boards.

¹³ This section should be tailored to the specific circumstances of the organization. Each organization should assess who it wishes to speak publicly on behalf of the organization.

Not-For-Profit Practice Group

Sample Not-For-Profit Code of Conduct and Ethics

The board of a not-for-profit organization may find it useful to adopt a code of conduct and ethics applicable to the board, management, employees and volunteers of the organization and its affiliates requiring fulfillment of responsibilities in a manner that furthers the mission of the organization and complies with law, regulations, ethical standards and policies adopted by the organization.

Each not-for-profit organization will need to decide for itself the level of detail required in its code of conduct and ethics. This sample provides only one example incorporating elements required by the Non-Profit Revitalization Act of 2013 (as amended, the “Revitalization Act”) applicable to New York not-for-profits, which amended the New York Not-For-Profit Corporation Law (as amended by the Revitalization Act, the “NPCL”). “One size does not fit all” – governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization.

Note that the US Federal Sentencing Guidelines provide for the mitigation of certain penalties depending on a number of factors, including the existence and adequacy of the organization’s compliance program, one part of which is the code of conduct and ethics.¹ Although the Department of Justice has not issued formal guidelines for not-for-profit compliance programs, among the most critical factors in evaluating the effectiveness of such a program is whether it is designed to prevent and detect wrongdoing by employees and whether management enforces the program.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate in particular circumstances.

[NAME OF NOT-FOR-PROFIT ORGANIZATION]

Code of Conduct and Ethics

[Consider including a letter from the Chair of the Board or Executive Director. This introductory letter should be aspirational in tone and addressed to employees, volunteers, officers and directors explaining the purpose of the Code.]

I. YOUR OBLIGATIONS

This Code of Conduct and Ethics (this “Code”) is designed to promote **honest, ethical and lawful conduct** by all employees, volunteers, officers and directors of [_____] and all of its affiliates (collectively, the “Organization”). This Code is intended to help you understand the Organization’s standards of ethical business practices and to stimulate awareness of ethical and legal issues that you may encounter in carrying out your responsibilities to the Organization. In addition, independent contractors, consultants and agents who represent the Organization are expected to apply the same high standards while working on Organization business.

The actions of every employee, volunteer, officer and director affect the **reputation and integrity** of the Organization. Therefore, it is essential that you take the time to review this Code and develop a working knowledge of its provisions. You are required to complete a certificate attesting to compliance with the Code upon becoming an employee, volunteer, officer or director and, thereafter, on an annual basis.

At all times, you are expected to:

- **Avoid conflicts** between personal and professional interests where possible;
- **Comply with the Organization’s Conflict of Interest and Related Party Transaction Policy**, including by disclosing any conflict to the [Board of Directors of the Organization (the “Board”)] *[[insert name of authorized Board committee, if applicable]* (the “Committee”)]² and otherwise pursue the ethical handling of conflicts (whether actual or apparent) when conflicts or the appearance of conflicts are unavoidable;
- **Provide accurate and complete information** in a timely manner in the course of fulfilling your obligations;
- **Provide full, fair, accurate, timely and understandable disclosure** in reports required to be filed by the Organization with regulators and in other public communications made by the Organization;
- **Comply with all applicable laws**, regulations and Organization policies;
- **Seek guidance** where necessary from a responsible supervisor;
- **Promptly report any violations of this Code** to a responsible supervisor, who will in turn report any violations to the [Board][Committee] in accordance with the Organization’s Whistleblower Policy)³; and
- **Be personally accountable** for adherence to this Code.

WHO DO I CONTACT FOR GUIDANCE OR TO REPORT CONCERNS?

If you believe a situation may involve or lead to a violation of this Code, you have an affirmative duty to seek guidance and report such concerns.

- **Seek guidance** from a responsible supervisor or other appropriate internal authority (for example, a Human Resources manager).
- **Disclose concerns or violations** of this Code [in accordance with the Organization's Whistleblower Policy] to a supervisor, manager[, the Whistleblower Policy Administrator,] the Chair of the [Board][Committee] or the Organization's legal counsel.

[BOARD CHAIR] [COMMITTEE CHAIR]:

[INSERT CONTACT DETAILS]

[WHISTLEBLOWER POLICY ADMINISTRATOR]:

[INSERT CONTACT DETAILS]

[LEGAL COUNSEL]:

[INSERT CONTACT DETAILS]

It is the Organization's policy to encourage the communication of bona fide concerns relating to the lawful and ethical conduct of business, and audit and accounting procedures or related matters. It is also the policy of the Organization to protect those who communicate bona fide concerns from any retaliation for such reporting.

Confidential and anonymous mechanisms for reporting concerns are available and are described in this Code. However, anonymous reporting does not serve to satisfy a duty to disclose your own potential involvement in a conflict of interest or in unethical or illegal conduct.

This Code is part of a broader set of Organization policies and compliance procedures [described in greater detail in the Organization's employee manuals and distributed memoranda]. This Code is not intended to supersede or materially alter specific Organization policies and procedures already in place and applicable to particular employees as [set forth in the Organization's employee manuals and distributed memoranda, and] communicated to Organization employees.

No Organization policy can provide definitive answers to all questions. It is difficult to anticipate every decision or action that you may face or consider. **Whenever there is doubt about the right ethical or legal choice to make, or questions regarding any of the standards discussed or policies referenced in this Code, you should fully disclose the circumstances, seek guidance about the right thing to do, and keep asking until guidance is obtained.**

Those who violate the standards in this Code will be subject to disciplinary action. Failure to follow this Code, as well as to comply with federal, state, local and any applicable foreign laws, and the Organization's policies and procedures, may result in termination of board service or of employment with the Organization.

II. COMPLIANCE WITH LAWS, RULES AND REGULATIONS

The Organization requires you to comply with all applicable laws, rules and regulations. Violation of laws and regulations may subject you, as well as the Organization, to civil and/or criminal penalties. To assure compliance with applicable laws and regulations, the Organization has established various policies and procedures, including those relating to: [List policies, e.g., Conflict of Interest and Related Party Transaction Policy, Whistleblower Policy, Records Retention Policy]. You have an obligation to comply with these policies and procedures and to promptly alert [a responsible supervisor, the Organization's legal counsel, the Whistleblower Policy Administrator, the Chair of the [Board] [Committee], and/or other appropriate internal authority], whose contact information is set forth above, of any deviation from them.

Legal compliance is not always intuitive. To comply with the law, you must learn enough about the national, state and local laws that affect your work at the Organization to spot potential issues and to obtain proper guidance on the right way to proceed. When there is any doubt as to the lawfulness of any proposed activity, you should seek advice from the Organization's legal counsel, whose contact information is set forth above.

Certain legal obligations and policies that are particularly important are summarized below. Further information on any of these matters may be obtained from the Organization's legal counsel, whose contact information is set forth above.

III. CONFLICTS OF INTEREST AND RELATED PARTY TRANSACTIONS⁴

The Organization expects you to exercise good judgment and the highest ethical standards in your activities on behalf of the Organization as well as in your private activities outside the Organization. Particular care should be taken to ensure that no detriment to the interests of the Organization (or appearance of such detriment) may result from a conflict or potential conflict between those interests and any personal or business interests which you may have. In particular, you have an obligation to avoid, and where avoidance is not feasible, to disclose to the appropriate individual (as set forth in the Organization's Conflict of Interest and Related Party Transaction Policy), any activity, agreement, business investment or interest or other situation that might in fact or in appearance cause you to place your own interests, or those of another, in tension with or above your obligation to the Organization. Care should be taken about the appearance of a conflict since such appearance might impair confidence in, or the reputation of, the Organization even if there is no actual conflict and no wrongdoing.

While it is not possible to describe or anticipate all the circumstances that might involve a conflict of interest, a conflict of interest may arise whenever you take action or have (directly or indirectly) interests that may make it difficult to perform your work objectively or effectively or when you (directly or indirectly) receive personal benefits as a result of your position or relationship with respect to the Organization. For example, a conflict may arise if you have a financial or personal interest in a contract or transaction to which the Organization is a party. In addition, receipt by you or a member of your family of a personal benefit as a result of your position with the Organization may be deemed a conflict of interest. Procedures relating to disclosure and review of conflicts of

interest and related party transactions are set forth in the Organization's Conflict of Interest and Related Party Transaction Policy.

In all instances where the appearance of a conflict exists, you must disclose the nature of the conflict and all material facts related to such conflict to the Chair of the [Board][Committee], who shall communicate that information to the [full Board] [Committee].⁵ We will then work with you to determine what to do next.

IV. COMMUNITY, POLITICAL, CHARITABLE AND OTHER OUTSIDE ACTIVITIES

The Organization generally encourages participation in community activities outside the Organization. However, employees should avoid any outside personal interest or activity (whether or not for profit) that will interfere with their duties to the Organization. As a guideline, such activities should not encroach on time or attention employees should be devoting to Organization business, adversely affect the quality of their work, compete with the Organization's business, imply Organizational sponsorship or support without express approval by the Organization, and/or adversely affect the reputation of the Organization.

No employee shall publicly utilize any affiliation of the Organization in connection with the promotion of partisan politics, religious matters, or positions on any issue not in conformity with the official position of the Organization.

V. PROTECTION AND PROPER USE OF THE ORGANIZATION'S ASSETS

You have a personal responsibility to protect the assets of the Organization from misuse or misappropriation. The assets of the Organization include tangible assets, such as products, equipment and facilities, as well as intangible assets, such as intellectual property, trade secrets, reputation and business information (including any non-public information learned as an employee, volunteer, officer or director of the Organization).

5.1 Theft/Misuse of Assets

The Organization's assets may only be used for business purposes and such other purposes as are approved by the Organization. You must not take, make use of, or knowingly misappropriate the assets of the Organization for personal use, for use by another, or for an improper or illegal purpose. You are not permitted to remove, dispose of, or destroy anything of value belonging to the Organization without the Organization's express prior written consent, including both physical items and electronic information.

5.2 Confidential or Proprietary Information/Privacy

You must not use or disclose any confidential or proprietary information to any person or entity outside the Organization, either during or after service with the Organization, except with written authorization of the Organization or as may be otherwise required by law or regulation. You may not use confidential or proprietary information for your own personal benefit or the benefit of persons or entities outside the Organization.

Confidential or proprietary information includes all non-public information learned as an employee, volunteer, officer or director of the Organization. It includes, but is not limited to:

- Non-public information that might be (i) of use to suppliers, vendors, joint venture partners or others, (ii) of interest to the press, or (iii) harmful to the Organization or any of its constituents, if disclosed;

- Non-public information relating to the Organization's operations, including financial information, donor lists, mailing lists and any information relating to fundraising (including fundraising efforts, plans, ideas and proposals), minutes, reports and materials of the Board and its committees, and other documents identified as confidential;
- Non-public information about discussions and deliberations, relating to business issues and decisions, between and among employees, volunteers, officers and directors; and
- Non-public information about fellow employees, directors, officers or volunteers, or any other individuals about whom the Organization may hold information from time to time.

5.3 Outside Communication

The Organization is committed to providing full, fair and accurate disclosure in all public communications and in compliance with all applicable law, regulations and rules. Consistent with this commitment, employees may not answer questions from the media, donors, potential donors or any other members of the public unless specifically authorized to do so by the Organization. If you receive such an inquiry, you should obtain the name of the person and their contact information if possible and immediately notify [the Public Relations Manager or other appropriate person].

As individuals, we all have rights to speak out on issues including in a public forum, whether at your town hall or on a social networking media application or website. However, when you speak as an individual it is critical that you do not give the appearance of speaking or acting on the Organization's behalf and that you do not speak about the Organization. You should be especially aware of the broad reach of social networking media applications and websites, and that such media is increasingly being monitored by donors, customers, competitors, regulators and colleagues. Your comments may be attributed to the Organization, even though you did not intend for your comments to be attributed that way.

Whether or not you identify yourself as an employee of the Organization, you may not comment on or provide information relating to the Organization's business (even if such information is not confidential) in an internet chat room, newsgroup, guest book, bulletin board, blog, social or business networking site or similar forum unless you are specifically authorized to do so by the Organization. You should not comment in such a forum on any subject matter as to which you have knowledge or expertise by virtue of your duties with the Organization. (For additional rules regarding confidential information, see "Confidential or Proprietary Information/Privacy" above.) Finally, you should not post in such a forum your opinions about the Organization unless you are specifically authorized to do so by the Organization.

5.4 Network Use, Integrity & Security

The Organization reserves the right to monitor or review any and all data and information contained on any employee's or officer's computer or other electronic device issued by the Organization. In addition, the Organization reserves the right to monitor or review an employee's or officer's use of the Internet, Organization Intranet and Organization e-mail or any other electronic communications without prior notice.

Access to Organization systems will be revoked and disciplinary action may be taken in the event that such systems are used to commit illegal acts, or to violate the nondiscrimination, harassment, pornography, solicitation or proprietary information terms of this Code, or any other terms of this Code.

In order to maintain systems integrity and protect the Organization's network, no employee or officer should divulge any passwords used to access any Organization computer or database. Any suspected breach of the Organization's network security systems should be reported to a responsible supervisor or appropriate internal authority immediately.

All employees and officers should refrain from using or distributing software that may damage or disrupt the Organization's work environment by transmitting a virus or conflicting with Organization systems.

No employee or officer should engage in the unauthorized use, copying, distribution or alteration of computer software whether obtained from outside sources or developed internally. All software, including "shareware," contains terms of use that must be adhered to.

VI. ILLEGAL PAYMENTS

No illegal payments of any kind are to be made to any local, state or Federal Government officials in the United States or to government officials of any other country, territory or municipality at any time or under any circumstances. Moreover, no funds or other assets of the Organization are to be paid, directly or indirectly, to government officials or persons acting on their behalf or to representatives of other businesses for the purpose of influencing decisions or actions with respect to the Organization's activities. Kickbacks to or from any person are prohibited.

Any question as to whether a gift or payment would be considered improper under the Organization's guidelines or under law must be discussed with the Organization's legal counsel.

Under no circumstance is it acceptable for you to offer, give, solicit or receive any form of bribe, kickback, payoff, or inducement.

You may not use agents, consultants, independent contractors or other representatives to do indirectly what you could not do directly under this Code or under applicable law, rules and regulations.

VII. MAINTAINING A SAFE, HEALTHY AND AFFIRMATIVE WORKPLACE

The Organization is an equal opportunity employer and bases its recruitment, employment, development and promotion decisions solely on a person's ability and potential in relation to the needs of the job, and complies with local, state and federal employment laws. The Organization makes reasonable job-related accommodations for any qualified employee or officer with a disability when notified by the employee that he/she needs an accommodation.

The Organization is committed to maintaining a workplace that is free from sexual, racial, or other unlawful harassment, and from threats or acts of violence or physical intimidation. Abusive, harassing or other offensive conduct is unacceptable, whether verbal, physical or visual. If you believe that you have been harassed or threatened with or subjected to physical violence in or related to the workplace, you should report the incident to an appropriate supervisor or Human Resources [or the Organization's legal counsel], who will arrange for it to be investigated. All efforts will be made to handle the investigation confidentially.

The Organization will not tolerate the possession, use or distribution of offensive materials on the Organization's property, or the use of the Organization's personal computers or other equipment to obtain or view such materials.

All employees and officers must promptly contact an appropriate supervisor or Human Resources [or the Organization's legal counsel] about the existence of offensive materials, especially child pornography, on the Organization's systems or premises so that appropriate action may be taken, including notifying the proper authorities if necessary.

The Organization is committed to providing a drug-free work environment. The illegal possession, distribution, or use of any controlled substances on the Organization's premises or at Organization functions is strictly prohibited. Similarly, reporting to work under the influence of any illegal drug or alcohol and the abuse of alcohol or medications in the workplace is not in the Organization's best interest and violates this Code.

All accidents, injuries, or concerns about unsafe equipment, practices, conditions or other potential hazards should be immediately reported to an appropriate supervisor.

VIII. ACCOUNTING PRACTICES, BOOKS AND RECORDS AND RECORD RETENTION

Honest and accurate recording and reporting of information is critical to our ability to make responsible business decisions. You have a strict obligation to provide accurate information in the records of the Organization.

You are expected to support the Organization's efforts in fully and fairly disclosing the financial condition of the Organization in compliance with applicable accounting principles, laws, rules and regulations and making full, fair, accurate timely and understandable disclosure in our reports filed with regulatory agencies and other communications. Our financial statements and the books and records on which they are based must accurately reflect all transactions and conform to all legal and accounting requirements and our system of internal controls.

All employees, volunteers, officers and directors – and, in particular, the executive director[, the chief financial officer, the controller and the principal accounting officer] – have a responsibility to ensure that the Organization's accounting records do not contain any false or misleading entries. Any known or suspected false or misleading entries should be reported immediately to the [Chair of the Board].

We do not tolerate any misclassification of transactions as to accounts, departments or accounting periods and, in particular:

- All accounting records, as well as reports produced from those records, are to be kept and presented in accordance with law and are to comply with generally accepted accounting principles;
- All records are to fairly and accurately reflect the transactions or occurrences to which they relate;
- All records are to fairly and accurately reflect in reasonable detail the Organization's assets, liabilities, revenues and expenses;
- No accounting records are to contain any false or misleading entries;
- All transactions are to be supported by accurate documentation in reasonable detail and recorded in the proper account and in the proper accounting period; and

- The Organization's system of internal accounting controls, including compensation controls, is required to be followed at all times.

You must always record data in a timely and accurate manner. This protects the Organization's resources and meets the expectations of the people who rely on the accuracy of the Organization's records to perform their jobs. Falsifying business records is a serious offense, which may result in criminal prosecution, civil action and/or disciplinary action up to and including termination of employment. If you are authorized to make expenditures or enter into transactions on behalf of the Organization, you must ensure that the applicable records comply with the Organization's accounting and purchasing policies and that all transactions are recorded properly.

Consistent with the reporting and recordkeeping commitments discussed above, you should accurately and truthfully complete all records used to determine compensation or expense reimbursement. This includes, among other items, reporting of hours worked (including overtime) and reimbursable expenses (including travel and meals).

Compliance with applicable law regarding record retention [and the Organization's Records Retention Policy] is mandatory. Destroying or altering a document with the intent to impair the document's integrity or availability for use in any potential official proceeding is a crime. *Destruction of records may only take place in compliance with applicable law [and the Organization's Records Retention Policy].* Documents relevant to any pending, threatened, or anticipated litigation, investigation, or audit shall not be destroyed for any reason. If you believe that Organization records are being improperly altered or destroyed, you must report it to a responsible supervisor, the appropriate internal authority or the Organization's legal counsel.

IX. RAISING QUESTIONS AND CONCERNS

Each employee, volunteer, officer and director is responsible for promptly reporting to the Organization any circumstances that such person believes in good faith may constitute a violation of this Code or any other Organization policy, or applicable law, regulations or rules. If you are in a situation that you believe may involve or lead to a violation of this Code, you have an affirmative duty to disclose to, and seek guidance from, a responsible supervisor, the Organization's legal counsel, the Chair of the [Board] [Committee] or other appropriate internal authority. *See "Who Do I Contact for Guidance or to Report Concerns?" above [and the Whistleblower Policy] for additional details.*

You are strongly encouraged to report any complaint regarding financial wrongdoing (including circumvention of internal controls or violation of the accounting policies of the Organization), fraud, harassment, or any other illegal, unethical or proscribed conduct (including confidential and anonymous complaints) to the Organization's [Helpline on [INSERT NUMBER(S)] or to the administrator of the Organization's Whistleblower Policy, to a supervisor or manager or to the Chair of the [Board] [Committee] – see "Who Do I Contact for Guidance or to Report Concerns?" above.

[The Helpline is a special toll-free line available 24 hours a day, 365 days a year. It is intended to operate in addition to other resources available to you to voice complaints or concerns, such as supervisors, managers and Human Resources staff. The Helpline is monitored by a third party for reporting to the Organization's [Board] [Committee].

It is the Organization's policy to encourage the communication of bona fide concerns relating to the lawful and ethical conduct of business, and audit and accounting procedures or related matters. It is also the

policy of the Organization to protect those who communicate bona fide concerns from any retaliation for such reporting.⁶ No retribution against any individual who reports violations of this Code in good faith will be permitted. Confidential and anonymous mechanisms for reporting concerns are available and are described in this Code [and the Whistleblower Policy]. However, anonymous reporting does not serve to satisfy a duty to disclose your potential involvement in a conflict of interest or in unethical or illegal conduct. Every effort will be made to investigate confidential and anonymous reports within the confines of the limits on information or disclosure such reports entail. While self-reporting a violation will not excuse the violation itself, the extent and promptness of such reporting will be considered in determining any appropriate sanction, including dismissal. The Organization will investigate any matter which is reported and will take any appropriate corrective action.

X. VIOLATIONS OF THIS CODE

Allegations of Code violations will be reviewed and investigated by the Organization's legal counsel, or, in appropriate circumstances by the Organization's [Board] [Committee].

Those who violate the standards in this Code will be subject to disciplinary action. Failure to follow this Code, or to comply with federal, state, local and any applicable foreign laws, and the Organization's policies and procedures may result in, among other actions, suspension of work duties, diminution of responsibilities or demotion, and termination of board service or employment with the Organization.

CERTIFICATE OF COMPLIANCE

I _____ hereby certify that I have read, understand
(Print name)

and am in compliance with the terms of the foregoing Code of Conduct and Ethics.

Date: _____

Signature: _____

Title: _____

If you have any questions, please contact the Organization's legal counsel:

[INSERT CONTACT DETAILS]

ENDNOTES

¹ See US Federal Sentencing Guidelines, Chapter 8.

² The Revitalization Act requires that the board oversee the adoption, implementation of, and compliance with the conflict of interest policy. Either the board or an authorized committee thereof may review and approve conflicts of interest. See NPCL § 715-a(a).

³ The Revitalization Act requires New York not-for-profits that have 20 or more employees and annual revenue in excess of \$1 million in the prior year to have a whistleblower policy adopted and overseen by the corporation's board of directors to protect from retaliation persons who report suspected improper conduct. Such whistleblower policy must include procedures for reporting of violations or suspected violations of law or corporate policies, including procedures for preserving the confidentiality of reported information. In addition, the whistleblower policy must designate a specific employee, officer or director of the organization to administer the policy and report to the board or an authorized committee thereof, except that directors who are employees may not participate in any board or committee deliberations or voting relating to administration of the whistleblower policy. See NPCL § 715-b.

⁴ The Revitalization Act requires every New York not-for-profit organization (regardless of size) to adopt a conflict of interest policy applicable to directors, officers, and key persons (as defined in the Revitalization Act). The Revitalization Act requires that such policy, among other things: (i) define the circumstances that constitute a conflict; (ii) include procedures for disclosing a conflict of interest, (iii) require that the person with the conflict not be present at or participate in board or committee deliberation or vote on the matter giving rise to such conflict; (iv) prohibit attempts by the person with the conflict from influencing improperly the deliberation or voting on the matter giving rise to such conflict; (v) require that the existence and resolution of the conflict be documented; (vi) include procedures for disclosing, addressing, and documenting related party transactions; and (vii) require directors to disclose to the organization (upon joining the board and annually thereafter) any entities with which they are affiliated and with which the organization has a relationship, and any corporate transactions possibly giving rise to a conflict to the director. See NPCL § 715-a.

The Revitalization Act includes definitions and requires specific procedures to be adhered to with respect to “related party transactions.” A “related party transaction” is defined to mean any transaction, agreement or other arrangement in which a “related party” (defined below) has a financial interest and in which the corporation or any affiliate of the corporation is a participant, except that a transaction shall not be a related party transaction if: (i) the transaction or the related party's financial interest in the transaction is de minimis, (ii) the transaction would not customarily be reviewed by the board, or boards of similar organizations, in the ordinary course of business and is available to others on the same or similar terms, or (iii) the transaction constitutes a benefit provided to a related party solely as a member of a class of the beneficiaries that the trust intends to benefit as part of the accomplishment of its mission which benefit is available to all similarly situated members of the same class on the same terms. See NPCL §102(a)(24). A “related party” is defined to mean (i) any director, officer or key person of the corporation or any affiliate of the corporation; (ii) any relative of any individual described in the foregoing clause (i); or (iii) any entity in which any individual described in the foregoing clauses (i) and (ii) has a 35% or greater ownership or beneficial interest or, in the case of a partnership or professional corporation, a direct or indirect ownership interest in excess of 5%. See NPCL § 102(a)(23). The Revitalization Act provides that “[n]o corporation shall enter into any related party transaction unless the transaction is determined by the board, or an authorized committee thereof, to be fair, reasonable and in the corporation's best interests at the time of such determination. Any director, officer or key person who has an interest in a related party transaction shall disclose in good faith to the board, or an authorized committee thereof, the material facts concerning such interest. With respect to any related party transaction involving a charitable corporation and in which a related party has a substantial financial interest, the board of such corporation, or an authorized committee thereof, shall: (1) [p]rior to entering into the transaction, consider alternative transactions to the extent available; (2) [a]pprove the transaction by not less than a majority vote of the directors or committee members present at the meeting; and (3) [c]ontemporaneously document in writing the basis for the board or authorized committee's approval, including its consideration of any alternative transactions.” NPCL § 715(a)-(b).

⁵ The Revitalization Act requires that conflicts of interest, or potential conflicts of interests, be disclosed to the board or to a committee of the board. NPCL § 715-a(b)(2).

⁶ Whistleblower policies that are required by the Revitalization Act must “protect from retaliation persons who report suspected improper conduct [and] provide that no director, officer, employee or volunteer of a corporation who in good faith reports any action or suspected action taken by or within the corporation that is illegal, fraudulent or in violation of any adopted policy of the corporation shall suffer intimidation, harassment, discrimination or other retaliation, or in the case of employees, adverse employment consequence.” NPCL § 715-b(a).

Not-For-Profit Practice Group

Sample Not-For-Profit Conflict of Interest and Related Party Transaction Policy

The board of a not-for-profit organization should (even if not required to) adopt a conflict of interest policy to assist the directors, officers and others in the organization in identifying, evaluating and resolving conflicts of interest.

While there is no federal legal requirement that an organization have a conflict of interest policy, the organization, its directors and officers may be subject to liability, and the organization's tax-exempt status may be at risk, if the organization enters into transactions that result in improper financial benefit to persons affiliated with the organization. In addition, since July 1, 2014, the Non-Profit Revitalization Act of 2013 (as amended, the "Revitalization Act") has required that all New York not-for-profits adopt a conflict of interest policy that meets certain requirements, and that certain review and approval procedures be applied with respect to "related party transactions" as defined in the Revitalization Act. If a corporation has previously adopted a conflict of interest policy that is substantially consistent with the provisions of the Revitalization Act, such corporation is deemed to be in compliance with this requirement. Additionally, the Internal Revenue Service ("IRS") requires tax-exempt organizations to disclose on their Form 990 whether they have a conflict of interest policy that meets certain requirements. This sample provides only one example for an organization, incorporating elements required by the Revitalization Act, which amended the New York Not-For-Profit Corporation Law (as amended by the Revitalization Act, the "NPCL"), as well as elements related to certain IRS disclosure requirements and is designed to be used in conjunction with a code of conduct and ethics that further describes the policies and values of the organization.

This sample provides a single set of procedures applicable to all types of conflicts of interest, which include but are not limited to "related party transactions" as defined in the Revitalization Act. In particular, this sample policy includes additional requirements for "charitable corporations," where a related party has a "substantial financial interest" in a proposed transaction, as recommended best practices applicable to all conflicts.

The Revitalization Act provides that the New York Attorney General may bring an action to enjoin, void or rescind related party transactions or proposed related party transactions that have been entered into, or would be entered into, without complying with applicable procedural requirements and/or that are not reasonable and/or were not in the best interests of the organization at the time of approval, as well as to, among other things, remove directors or officers, order an account of profits, payment for the value of the use of property or assets used in the transaction, or the return of lost assets, payment of double the amount of certain improperly obtained benefits, or seek restitution.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions that should be included. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate in particular circumstances.

It should also be noted that Section 8-1.9 of New York's Estates, Powers and Trusts Law makes applicable to charitable trusts a number of sections of the Revitalization Act, including the provisions addressing related party transactions and conflict of interest policies.

[NAME OF NOT-FOR-PROFIT ORGANIZATION]

Conflict of Interest and Related Party Transaction Policy¹

I. PURPOSE

All directors, officers and staff owe a duty of loyalty to _____ (the “Organization”) and must act in good faith toward the Organization and in the Organization’s best interests, rather than in their own interests or the interests of another entity or person, and must comply with applicable legal requirements. The purpose of this Conflict of Interest and Related Party Transaction Policy (this “Policy”) is to set forth procedures for monitoring, reporting, review and oversight of, and review, approval or ratification of any action taken in connection with, conflicts of interest and related party transactions.

II. APPLICABILITY

This Policy applies to any person who [is][at any time during the past five years was]²:

1. A director of the Organization or an “affiliate” (as defined below);
2. An officer of the Organization or an affiliate;
3. A “key person” (as defined below) of the Organization or an affiliate or any other person who exercises the powers of a trustee/director, officer or key person of the Organization or an affiliate;
4. [; and any other employee, volunteer, independent contractor of, or substantial contributor to, the Organization],³

(each, a “Covered Person” or “you”).

This Policy also applies to transactions or arrangements with an “Other Related Party” (as defined below).

An “affiliate” is a person or entity that is directly or indirectly through one or more intermediaries controlled by or in control of the Organization.⁴

A “key person” is a person, other than a director or officer, whether or not an employee of the corporation who (i) has responsibilities, or exercises powers or influence over the corporation as a whole similar to the responsibilities, powers, or influence of directors and officers; (ii) manages the corporation, or a segment of the corporation that represents a substantial portion of the activities, assets, income or expenses of the corporation; or (iii) alone or with others controls or determines a substantial portion of the corporation’s capital expenditures or operating budget, in accordance with applicable IRS rule.⁵

An “Other Related Party” is a “relative” (as defined below) of a Covered Person or an entity in which a Covered Person or relative of a Covered Person has a 35% or greater ownership or beneficial interest or, in the case of a partnership or professional corporation, a direct or indirect ownership interest in excess of 5%.

A “relative” is a (i) spouse or domestic partner (as defined in Section 2994(a) of the New York Public Health Law); (ii) ancestor, child (whether natural or adopted), grandchild, great-grandchild, sibling (whether whole- or half-blood); or (iii) spouse or domestic partner of a child (whether natural or adopted), grandchild, great-grandchild or sibling (whether whole- or half-blood).⁶

III. CONFLICTS OF INTEREST

A conflict of interest arises whenever the interests of the Organization come into conflict with a financial or personal interest of a Covered Person, or otherwise whenever a Covered Person's personal or financial interest could be reasonably viewed as affecting his or her objectivity or independence in fulfilling their duties to the Organization.

While it is not possible to describe or anticipate all the circumstances that might involve a conflict of interest, a conflict of interest typically arises whenever a Covered Person or Other Related Party has (directly or indirectly):

1. a direct or indirect interest (financial or otherwise) in a transaction, agreement or any other arrangement and in which the Organization or any affiliate participates;
2. a compensation arrangement or other interest in a transaction with the Organization;
3. a compensation arrangement or other interest in or affiliation with any entity or individual that: (i) sells goods or services to, or purchases goods or services from, the Organization; (ii) competes with the Organization; or (iii) the Organization has, or is negotiating, or contemplating negotiating, any other transaction or arrangement with;
4. the ability to use his or her position, or confidential information or the assets of the Organization, to his or her (or an affiliated party's or relative's) personal advantage or for an improper or illegal purpose;
5. solicited or accepted any gift, entertainment, or other favor where such gift might create the appearance of influence on the Covered Person (other than gifts of nominal value, which are clearly tokens of respect and friendship unrelated to any particular transaction);
6. acquired any property or other rights in which the Organization has, or the Covered Person or Other Related Party knows or has reason to believe at the time of acquisition that the Organization is likely to have, an interest;
7. an opportunity related to the activities of the Organization, unless the [Board][authorized Board committee (the "Committee")] has made an informed decision that the Organization will not pursue that opportunity;
8. been indebted to the Organization, other than for amounts due for ordinary travel and expense advances; or
9. any other circumstance that may, in fact or in appearance, make it difficult for the Covered Person to exercise independent, objective judgment or otherwise perform effectively.

IV. CONFLICT OF INTEREST DISCLOSURE AND QUESTIONNAIRE

You are required to disclose in good faith and in writing to the [Board] [Committee] at [*insert contact information*]⁷ all material facts related to conflicts of interest (including those that implicate an Other Related Party but not a Covered Person) (including the nature of your or the Other Related Party's interest and information about any proposed transaction or other arrangement). Disclosures should be made in advance, before any action is taken on the matter. Conflict identification and analysis can be difficult and, therefore, you are at all times expected to err on the side of caution and disclose all instances where a conflict of interest or the appearance of a conflict exists, even if you do not believe that there is an actual conflict.

Each current director, officer and key person of the Organization, as well as nominees for election as director (prior to his or her initial election), must submit to the Secretary of the Organization or a designated compliance

officer at least once per year (and updated as appropriate) a questionnaire substantially in the form of the Appendix to this Policy. The Secretary of the Organization or the designated compliance officer shall provide copies of all completed statements to the Chair of the [Board] [Committee].

V. REVIEW, APPROVAL AND RATIFICATION⁸

The [Board] [Committee] will review all conflicts of interest and related party transactions and determine whether to approve or ratify any such matters; however, a transaction with a related party may proceed without [Board] [Committee] review if the transaction: (i) is of limited monetary value; (ii) would not usually be reviewed by the Board in the ordinary course of business and is available to others on the same or similar terms; or (iii) provides a charitable benefit to a member of a charitable class where the benefit is available to others on similar terms.⁹ The [Board] [Committee] may only approve the underlying matter if it determines that such matter, under the terms and within the circumstances and conditions presented, is fair, reasonable, and in the best interests of the Organization at the time of such determination. In making its determination, the [Board] [Committee] will consider, without limitation:

1. Alternative or comparable transactions to the extent available;
2. The Organization's mission and resources;
3. The possibility of creating an appearance of impropriety that might impair the confidence in, or the reputation of, the Organization (even if there is no actual conflict or wrongdoing); and
4. Whether the conflict may result in any private inurement, excess benefit transaction or impermissible private benefit under laws applicable to tax-exempt organizations.¹⁰

When considering the comparability of transactions, the [Board] [Committee] may consider: (i) fees paid by similarly situated organizations, both exempt and non-exempt; (ii) the availability of similar products or services within the same geographic area; (iii) survey or other data compiled by independent firms; or (iv) written offers from similar institutions competing for the same person's products or services. When the transaction involves the transfer of real property as consideration, the relevant factors include, but are not limited to (i) current independent appraisals of the property; and (ii) offers received in a competitive bidding process.

Unless provided otherwise in [the Organization's By-laws] [the relevant Board Committee's charter], a majority of the members of the [Board] [Committee] shall constitute a quorum for a meeting and the affirmative vote of a majority of member present at a meeting at which a quorum is present shall constitute the action of the [Board] [Committee] with respect to any matter that is the subject of this Policy.

Persons with an interest in any matter under review by the [Board] [Committee] are not permitted to be present at or participate in any deliberations or voting by the [Board] [Committee] with respect to the matter giving rise to the potential conflict, and must not attempt to influence improperly the deliberation or voting on such matter. In appropriate circumstances, any such person may be called upon to provide information as background or answer questions at a committee or board meeting relevant to the determination prior to the commencement of deliberations or voting related thereto. Notwithstanding the foregoing, a director with an interest in a matter under review by the [Board] [Committee] shall be deemed to be present at the meeting for purposes of determining whether a quorum is present.

In the event the Organization and/or a Covered Person in error enters into or otherwise participates in a conflict of interest transaction that requires pre-approval by the [Board] [Committee] pursuant to this Policy, such transaction shall promptly upon discovery of such error be presented to the [Board] [Committee] for its review and the [Board] [Committee] shall in accordance with the procedures prescribed by applicable law consider whether to (i)

ratify such transaction; (ii) direct the rescission or modification of the transaction (if possible to do so); (iii) take any disciplinary action; and/or (iv) make changes to the Organization's controls and procedures in connection with such error.¹¹

VI. RECORDS

The minutes of the [Board] [Committee] meeting during which a potential or actual conflict of interest is disclosed or discussed shall be documented contemporaneously with the meeting and reflect the name of the interested Covered Person, the nature of the conflict, and details of the deliberations of the disinterested directors (such as documents reviewed, any alternatives or comparable transactions considered, comparative costs or bids, market value information and other factors considered in deliberations) and the resolution of the conflict including any ongoing procedures to manage any conflict that was approved.¹² The interested person shall only be informed of the final decision and not of particular directors' positions or how they voted. In addition, certain related party transactions are required to be disclosed in the notes to the Organization's audited financial statements and its annual federal tax filing on Form 990.

VII. COMPLIANCE

If the [Board] [Committee] has reasonable cause to believe that a Covered Person has failed to comply with this Policy, it may make such further investigation as may be warranted in the circumstances and if it determines that a Covered Person has failed to comply with this Policy, it shall take appropriate action which may include, in the case of directors and officers, removal of the Covered Person from the board or from office or, in the case of key persons or others, termination of employment with the Organization or an affiliate.

VIII. POLICY ADOPTION AND OVERSIGHT¹³

The Board is responsible for providing oversight of the adoption and implementation of, and compliance with this Policy.¹⁴

This Conflict of Interest and Related Party Transaction Policy was adopted by the Board [on / and amended through] [month] [day], [year].

[NAME OF NOT-FOR-PROFIT ORGANIZATION]

Questionnaire Concerning Conflicts of Interest and
Affirmation re: Organization Policies**Part A: To be Completed by Directors, Director Nominees, Officers and Key Persons¹⁵**

- Please identify, to the best of your knowledge, any and all entities of which you are an officer, director, trustee, member, owner (either as a sole proprietor or a partner or, if in a partnership or professional corporation, in which you have a 5% ownership interest), or employee and with which _____ (the “Organization”) has a relationship:

- Please identify, to the best of your knowledge, any and all transactions in which the Organization is a participant and in which you have or might have a financial or personal interest:

- Please confirm whether you or any “relative” (as defined in the Conflict of Interest and Related Party Transaction Policy), have or have engaged in, or whether you know of any other “Covered Person” (as defined in the Conflict of Interest and Related Party Transaction Policy) that has or has engaged in, any of the following (other than matters already fully disclosed, evaluated and resolved):

	Yes	No
1. a direct or indirect interest (financial or otherwise) in a transaction, agreement or any other arrangement and in which the Organization or any affiliate participates.		
2. a compensation arrangement or other interest in a transaction with the Organization (other than, with respect to Key persons, your salary as an employee with the Organization).		
3. a compensation arrangement or other interest in or affiliation with any entity or individual that: (a) sells goods or services to, or purchases goods or services from, the Organization; (b) competes with the Organization; or (c) the Organization has, or is negotiating, or contemplating negotiating, any other transaction or arrangement with.		
4. used your/their position, or confidential information or the assets of the Organization to your/their (or an affiliated party’s or relative’s) personal advantage or for an improper or illegal purpose.		

5.	solicited or accepted any gift, entertainment, or other favor where such gift might create the appearance of influence on you/them (other than gifts of nominal value, which are clearly tokens of respect and friendship unrelated to any particular transaction).		
6.	acquired any property or other rights in which the Organization has, or you/they know or have reason to believe at the time of acquisition that the Organization is likely to have, an interest.		
7.	an opportunity related to the activities of the Organization that is available to the Organization or to you/them, unless the Board has made an informed decision that the Organization will not pursue that opportunity.		
8.	indebtedness to the Organization, other than for amounts due for ordinary travel and expense advances.		
9.	any other circumstances that may, in fact or in appearance, make it difficult for you/them to exercise independent, objective judgment or otherwise perform effectively.		

If yes, to any of the above please describe the relevant facts (attach a separate sheet if necessary):

Part B: To be Completed by Directors Only

	Yes	No
1. Have you been an employee or key person of the Organization or an “affiliate” (as defined in the Conflict of Interest and Related Party Transaction Policy) ¹⁶ of the Organization within the last three years?		
2. Do you have a “relative” (as defined in the Conflict of Interest and Related Party Transaction Policy) who has been a “key person” (as defined in the Conflict of Interest and Related Party Transaction Policy) of the Organization or an affiliate of		

	the Organization within the last three years?		
3.	Have you received and/or do you have a relative who has received more than \$10,000 in direct compensation from the Organization or an affiliate of the Organization in any of the last three fiscal years (not including reasonable compensation or reimbursement for services as a director)?		
4.	Do you have a financial interest in, and/or are you an employee of, any entity that has provided payments, property or services to or received payments, property or services from, the Organization or an affiliate of the Organization in the last three fiscal years that exceeded the lesser of: (i) \$10,000 or 2% of such entity's consolidated gross revenues if the entity's consolidated gross revenue was less than \$500,000; (ii) \$25,000 if the entity's consolidated gross revenue was \$500,000 or more but less than ten million dollars; or (iii) \$100,000 if the entity's consolidated gross revenue was ten million dollars or more? If so, what is or was the nature of your financial interest or relationship?		
5.	Do you have a relative who has a financial interest in, and/or who is an officer of, any entity that has provided payments, property or services to or received payments, property or services from, the Organization or an affiliate of the Organization in the last three fiscal years that exceeded the lesser of: (i) \$10,000 or 2% of such entity's consolidated gross revenues if the entity's consolidated gross revenue was less than \$500,000; (ii) \$25,000 if the entity's consolidated gross revenue was \$500,000 or more but less than ten million dollars; or (iii) \$100,000 if the entity's consolidated gross revenue was ten million dollars or more? If so, what is or was the nature of your relative's financial interest or relationship?		

If yes to any of the above, please describe the relevant facts (attach a separate sheet if necessary):

The answers to the foregoing questions are stated to the best of my knowledge and belief.

I also acknowledge that I have received a copy of, read and understood the Conflict of Interest and Related Party Transaction Policy[, Code of Conduct and Ethics,] and Whistleblower Policy of the Organization and agree that I have adhered and will continue to adhere to such policies.

Additionally, I understand that in order to maintain its federal tax exemption the Organization must engage primarily in activities that accomplish one or more of its tax exempt purposes.

Date: _____

Signature: _____

Printed
Name: _____

ENDNOTES

¹ The Revitalization Act requires every New York not-for-profit corporation (regardless of size) to adopt a conflict of interest policy applicable to directors, officers, and “key persons” (as defined in the Revitalization Act). The Revitalization Act requires that such policy, among other things: (i) define the circumstances that constitute a conflict of interest; (ii) include procedures for disclosing a conflict of interest to the audit committee or, if there is no audit committee, to the board, (iii) require that the person with the conflict not be present at or participate in board or committee deliberation or vote on the matter giving rise to such conflict; (iv) prohibit any attempt by the person with the conflict to influence improperly the deliberation or voting on the matter giving rise to such conflict (although a person with a conflict is allowed to present information prior to the commencement of deliberations or voting); (v) require that the existence and resolution of the conflict be documented in the corporation’s records, including in the relevant minutes of meeting; (vi) include procedures for disclosing, addressing, and documenting related party transactions; and (vii) require directors to disclose to the corporation (prior to initial election and annually thereafter) any entities with which they are affiliated and with which the corporation has a relationship, and any transactions in which the corporation is a participant and in which the director might have a conflicting interest. If a corporation’s board of directors has adopted a conflict of interest policy that is substantially consistent with the provisions of the Revitalization Act, such corporation is deemed to be in compliance with the Revitalization Act’s conflict of interest policy requirements. *See* NPCL § 715-a.

The Revitalization Act includes definitions and requires specific procedures to be adhered to with respect to “related party transactions.” A “related party transaction” is defined to mean any transaction, agreement or other arrangement in which a “related party” (defined below) has a financial interest and in which the corporation or any affiliate of the corporation is a participant, except that a transaction shall not be a related party transaction if: (i) the transaction or the related party’s financial interest in the transaction is de minimis, (ii) the transaction would not customarily be reviewed by the board, or boards of similar organizations, in the ordinary course of business and is available to others on the same or similar terms, or (iii) the transaction constitutes a benefit provided to a related party solely as a member of a class of the beneficiaries that the trust intends to benefit as part of the accomplishment of its mission which benefit is available to all similarly situated members of the same class on the same terms. *See* NPCL §102(a)(24). A “related party” is defined to mean (i) any director, officer or key person of the corporation or any affiliate of the corporation; (ii) any relative of any individual described in the foregoing clause (i); or (iii) any entity in which any individual described in the foregoing clauses (i) and (ii) has a 35% or greater ownership or beneficial interest or, in the case of a partnership or professional corporation, a direct or indirect ownership interest in excess of 5%. *See* NPCL § 102(a)(23). The Revitalization Act provides that “[n]o corporation shall enter into any related party transaction unless the transaction is determined by the board, or an authorized committee thereof, to be fair, reasonable and in the corporation’s best interests at the time of such determination. Any director, officer or key person who has an interest in a related party transaction shall disclose in good faith to the board, or an authorized committee thereof, the material facts concerning such interest. With respect to any related party transaction involving a charitable corporation and in which a related party has a substantial financial interest, the board of such corporation, or an authorized committee thereof, shall: (1) [p]rior to entering into the transaction, consider alternative transactions to the extent available; (2) [a]pprove the transaction by not less than a majority vote of the directors or committee members present at the meeting; and (3) [c]ontemporaneously document in writing the basis for the board or authorized committee’s approval, including its consideration of any alternative transactions.” NPCL § 715(a)-(b).

² The NPCL does not require a 5-year look-back. Under the tax law applicable to public charities, however, the “excess benefit transaction” rule that focuses on related party transactions does have a 5-year look-back in determining who is a “related party.” Since, as a general proposition, private not-for-profit organizations may be subject to even greater tax scrutiny than public charities, they may consider it prudent to adopt the 5-year look-back approach with respect to the scope of their conflict of interest and related party transaction policy. *See* Section 4958(f) of the Internal Revenue Code.

³ The Revitalization Act does not specifically require that the conflict of interest policy apply to employees who are not officers or key persons or to volunteers, independent contractors or substantial contributors; however, the organization may wish to broaden the scope of the policy depending on its circumstances.

⁴ *See* NPCL § 102(a)(19).

⁵ *See* NPCL § 102(a)(25).

⁶ See NPCL § 102(a)(22). “Domestic partner” has the meaning ascribed to such term in section 2994-A of the New York Public Health Law, where it is defined to mean “a person who, with respect to another person: (a) is formally a party in a domestic partnership or similar relationship with the other person, entered into pursuant to the laws of the United States or of any state, local or foreign jurisdiction, or registered as the domestic partner of the other person with any registry maintained by the employer of either party or any state, municipality, or foreign jurisdiction; or (b) is formally recognized as a beneficiary or covered person under the other person’s employment benefits or health insurance; or (c) is dependent or mutually interdependent on the other person for support, as evidenced by the totality of the circumstances indicating a mutual intent to be domestic partners including but not limited to: common ownership or joint leasing of real or personal property; common householding, shared income or shared expenses; children in common; signs of intent to marry or become domestic partners under paragraph (a) or (b) . . . ; or the length of the personal relationship of the persons.” New York Public Health Law § 2994-A.

⁷ The Revitalization Act requires that conflicts of interest, or potential conflicts of interests, be disclosed to the board or to a committee of the board. NPCL § 715-a(b)(2).

⁸ The procedures in Section V incorporate the additional requirements for “charitable corporations” (as defined by the NPCL § 102(a)(3-a)), where a related party has a “substantial financial interest” in a proposed transaction, as a best practice. See note 1.

⁹ See NPCL § 102(a)(24).

¹⁰ The Organization may determine to include other factors to consider.

¹¹ The Revitalization Act has recently been amended to provide not-for-profit corporations with defenses to actions involving related party transactions as follows. In an action by any person or entity other than the attorney general, it shall be a defense to a claim of violation of any provisions of NCPL § 715 that a transaction was fair, reasonable and in the corporation's best interest at the time the corporation approved the transaction. See NCPL § 715(i).

In an action by the attorney general with respect to a related party transaction not approved in accordance with paragraphs (a) or (b) of NCPL § 715 at the time it was entered into, whichever is applicable, it shall be a defense to a claim of violation of any provisions of NCPL § 715 that (1) the transaction was fair, reasonable and in the corporation's best interest at the time the corporation approved the transaction and (2) prior to receipt of any request for information by the attorney general regarding the transaction, the board has: (A) ratified the transaction by finding in good faith that it was fair, reasonable and in the corporation's best interest at the time the corporation approved the transaction; and, with respect to any related party transaction involving a charitable corporation and in which a related party has a substantial financial interest, considered alternative transactions to the extent available, approving the transaction by not less than a majority vote of the directors or committee members present at the meeting; (B) documented in writing the nature of the violation and the basis for the board's or committee's ratification of the transaction; and (C) put into place procedures to ensure that the corporation complies with paragraphs (a) and (b) of NCPL § 715 as to related party transactions in the future. See NCPL § 715(j).

¹² The Revitalization Act requires that the existence and resolution of the conflict be documented in the corporation’s records, including in the minutes of any meeting at which the conflict was discussed or voted upon. See NPCL § 715-a(b)(5).

¹³ IRS Form 990 requires disclosure of whether the organization has a conflict of interest policy. The federal tax law (and IRS Form 990) does not require that an organization have a conflicts policy; however, the IRS believes that the absence of a conflicts policy is a factor suggesting substandard corporate governance, which (the IRS maintains) may lead to violation of tax law principles applicable to exempt organizations, and therefore warrants heightened scrutiny. See IRS Form 990, Part VI, Lines 12a-b and related instructions. Appendix A to the instructions to IRS Form 1023 (Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code) includes a sample conflict of interest policy; the NPCL requirements for such a policy are more stringent than those set forth in the IRS sample policy.

¹⁴ The Revitalization Act requires that the board oversee the adoption, implementation of, and compliance with the conflict of interest policy (although committees of the board may help to resolve actual or potential conflicts). See NPCL § 715-a(a)

¹⁵ The Revitalization Act requires that each director must complete (prior to the director's initial election and annually thereafter) and submit to the secretary of the corporation a written statement identifying, to the best of the director's knowledge, any entity of which such director is an officer, director, trustee, member, owner (either as a sole proprietor or a partner), or employee and with which the corporation has a relationship, and any transaction in which the corporation is a participant and in which the director might have a conflicting interest. The secretary of the corporation must provide a copy of all completed statements to the chair of the audit committee or, if there is no audit committee, to the chair of the board. *See* NPCL § 715-a(d).

¹⁶ Consider including a list of affiliates in a schedule to the questionnaire.

Not-For-Profit Practice Group

Sample Not-For-Profit Whistleblower Policy

The board of a not-for-profit organization should establish a whistleblower policy that encourages individuals to report in good faith violations of law or policies of the organization, specifies that the organization will protect the individual from retaliation and identifies the parties to whom such information can be reported. Each organization must also decide what reporting mechanisms will best balance the organization's valid interests in promoting the internal reporting of concerns about conduct and ethics, achieving efficiency in the use of resources for compliance efforts and preserving attorney-client privilege.

While there are no federal legal requirements regarding whistleblower policies, tax-exempt organizations are required to disclose on their Form 990 whether a whistleblower policy has been adopted, and the Non-Profit Revitalization Act of 2013 (as amended, the "Revitalization Act") applicable to New York not-for-profits requires that certain not-for-profit organizations (those with 20 or more employees and annual revenue above \$1 million) have a whistleblower policy. The whistleblower policy must be adopted and overseen (both in terms of its implementation and compliance therewith) by the not-for-profit corporation's board. Note that an organization that has adopted and possesses a whistleblower policy pursuant to federal, state or local laws that is substantially consistent with the relevant provisions of the Revitalization Act will be deemed by the Revitalization Act to be in compliance with this requirement. This sample provides only one example for an organization, incorporating elements required by the Revitalization Act, which amended the New York Not-For-Profit Corporation Law (as amended by the Revitalization Act, the "NPCL"), as well as elements related to certain disclosure requirements under Internal Revenue Service ("IRS") rules. "One size does not fit all" – governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate in particular circumstances.

It should also be noted that Section 8-1.9 of New York's Estates, Powers and Trusts Law makes applicable to charitable trusts a number of sections of the Revitalization Act, including the provisions addressing whistleblower policies.

[NAME OF NOT-FOR-PROFIT ORGANIZATION]

Whistleblower Policy

I. PURPOSES

_____ (the “Organization”) is committed to honest, ethical and lawful conduct, full, fair, accurate, timely and transparent disclosure in all public communications, and compliance with applicable laws, rules and regulations. In furtherance of these commitments, all directors, officers, employees and volunteers of the Organization (each, a “Covered Person” or “you”) must act in accordance with all applicable laws and regulations, and with the policies of the Organization at all times, and assist in ensuring that the Organization conducts its business and affairs accordingly.

This Whistleblower Policy (this “Policy”) (a) establishes procedures for the reporting and handling of concerns regarding action or suspected action taken by or within the Organization that is or may be illegal, fraudulent or in violation of any policy of the Organization, as well as any other matter that could cause serious damage to the Organization’s reputation (each, a “Concern”), and (b) prohibits retaliation against any Covered Person who reports a Concern in good faith.¹

By appropriately responding to Concerns, we can better support an environment where compliance is valued and ensure that the Organization is meeting its ethical and legal obligations.

II. WHEN TO RAISE A CONCERN

You are encouraged to disclose to and seek guidance from an appropriate supervisor or manager if you believe any Covered Person or other person associated or doing business with the Organization has engaged, is engaging, or may engage in any illegal or unethical behavior or has violated, or may violate any law, rule, regulation or policy of the Organization. Such reportable activity may include, for example, financial wrongdoing (including circumvention of internal controls or violation of the accounting policies of the Organization), fraud, harassment, or any other illegal, unethical, or proscribed conduct. While Concerns may be submitted at any time, you should report a Concern as soon as reasonably possible after becoming aware of the matter.

III. HOW TO RAISE A CONCERN

Concerns may be submitted either in writing or orally. No specific form is required to be filled out in order to submit a Concern, but you are encouraged to provide as much information and detail as possible so that the Concern can be properly investigated. A Concern may be submitted:

- To the administrator of this Policy (the “Policy Administrator,” who is an employee, officer or director of the Organization, as required by law²), at [*insert contact information*];
- By discussing it with a supervisor or manager, who will in turn forward the Concern to the Policy Administrator for review where appropriate; or

- In writing (including by e-mail) to the Chair of the [Board of Directors of the Organization (the “Board”) at *[insert contact information]*] [authorized board committee (the “Committee”) *[insert contact information, if applicable]*], who will in turn forward the Concern to the Policy Administrator for review where appropriate.³

Concerns may be raised anonymously; however, any individual reporting his or her own violation shall not satisfy his/her disclosure obligation hereunder with a Concern raised anonymously. Any individual who is the subject of a Concern is prohibited from participating in any board or committee deliberations or voting relating to the evaluation of such Concern in accordance with this Policy; provided, that the [Board] [Committee] is not prohibited from requesting that such individual present information as background or answer questions at a meeting of the Board [or of the committee] prior to the commencement of deliberations or voting relating thereto.⁴

IV. PROCEDURES FOR RECEIVING AND REVIEWING CONCERNS

Any supervisor, manager, or other person receiving a Concern should contact the Policy Administrator (whose contact information is provided in Section III above), who will coordinate further action.

The Policy Administrator will assess each Concern on a preliminary basis to determine to what extent an investigation into the Concern is required, and will direct all aspects of the investigation of any Concern. The Organization will use its best efforts to conduct the review in a confidential manner, so that information will be disclosed only as needed to facilitate review of the investigation materials or otherwise as required by law. You must cooperate as necessary in connection with any such investigation. In the event a Concern involves or implicates the Policy Administrator, the Policy Administrator will promptly recuse himself or herself from the investigation and inform the [Board] [Committee] in writing. The [Board][Committee] may investigate such Concern or appoint impartial attorneys to investigate the Concern.

V. RECORDS OF CONCERNS AND INVESTIGATION REPORTS

The Policy Administrator will maintain a written record of all Concerns, summarizing in reasonable detail for each Concern: (i) the nature of the Concern (including any specific allegations made and the persons involved); (ii) the date of receipt of the Concern; (iii) the current status of any investigation into the Concern and information about such investigation (including the steps taken in the investigation, any factual findings, and the recommendations for corrective action); and (iv) any final resolution of the Concern. The Policy Administrator will distribute an update of this record to the Chair of the [Board] [Committee] in advance of each regularly scheduled meeting thereof.

VI. CONFIDENTIALITY

All Concerns received will be treated confidentially or anonymously, as applicable, to the extent reasonable and practicable under the circumstances.⁵

VII. NO RETALIATION

It is the Organization’s policy to encourage the communication of bona fide Concerns relating to the lawful and ethical conduct of the Organization’s business. It is also the policy of the Organization to protect those who communicate bona fide Concerns from any retaliation for such reporting. **No adverse employment action may be taken and retaliation is strictly prohibited, including, without limitation, intimidation, harassment, discrimination, coercion, or otherwise, whether express or implied, against any Covered Person who in**

good faith reports any Concern or assists in an investigation of, or the fashioning or implementation of any corrective action or response made in connection with, any Concern. Any person who violates this prohibition against retaliation will be subject to appropriate disciplinary action, which may include termination of employment or other relationship with the Organization.⁶

VIII. POLICY DISTRIBUTION

A copy of this Policy will be distributed to each Covered Person promptly following the adoption of or any amendments to this Policy, and at such time as a person becomes a Covered Person. This distribution requirement may be satisfied by posting a copy of this Policy on the Organization's website or at the Organization's offices in a conspicuous location accesible to employees and volunteers.⁷

IX. POLICY ADOPTION AND OVERSIGHT

The Board is ultimately responsible for providing oversight of the adoption and implementation of, and compliance with, this Policy.⁸

This Whistleblower Policy was adopted by the Board [on / and amended through] [month] [day], [year].

ENDNOTES

¹ The Revitalization Act requires New York not-for-profits that have 20 or more employees and annual revenue in excess of \$1 million in the prior year to have a whistleblower policy adopted and overseen by the corporation's board of directors that includes certain provisions and that protects from retaliation persons who report suspected improper conduct. *See* NPCL § 715-b.

² Whistleblower policies that are required by the Revitalization Act must include "[a] requirement that an employee, officer or director of the corporation be designated to administer the whistleblower policy and to report to the to the board or an authorized committee thereof, except that directors who are employees may not participate in any board or committee deliberations or voting relating to administration of the whistleblower policy." *See* NPCL § 715-b(b)(2).

³ Whistleblower policies that are required by the Revitalization Act must include "[p]rocedures for the reporting of violations or suspected violations of laws or corporate policies." NPCL § 715-b(b)(1).

⁴ NPCL § 715-b(b)(3).

⁵ Whistleblower policies that are required by the Revitalization Act must include "procedures for preserving the confidentiality of required information." NPCL § 715-b(b)(1).

⁶ Whistleblower policies that are required by the Revitalization Act must "protect from retaliation persons who report suspected improper conduct [and] provide that no director, officer, employee or volunteer of a corporation who in good faith reports any action or suspected action taken by or within the corporation that is illegal, fraudulent or in violation of any adopted policy of the corporation shall suffer intimidation, harassment, discrimination or other retaliation, or in the case of employees, adverse employment consequence." NPCL § 715-b(a).

⁷ Whistleblower policies that are required by the Revitalization Act must include "[a] requirement that a copy of the policy be distributed to all directors, officers, employees and to volunteers who provide substantial services to the corporation. For purposes of this [requirement], posting the policy on the corporation's website or at the corporation's offices in a conspicuous location accessible to employees and volunteers are among the methods a corporation may use to satisfy the distribution requirement." NPCL § 715-b(b)(4). It may be administratively more convenient to distribute the policy to all volunteers, not just those providing "substantial services."

⁸ The Revitalization Act requires that the board oversee the adoption and implementation of and compliance with the whistleblower policy. *See* NPCL § 715-b(a).

Not-For-Profit Practice Group

Sample Not-For-Profit Audit Committee Charter

The board of a not-for-profit organization is responsible for ensuring the integrity of the organization's accounting and financial reporting systems and processes. The board may wish to establish an audit committee comprised of independent directors to assist it in fulfilling this responsibility although it is not required by law to do so.

While there are no federal legal requirements regarding audit committees, tax-exempt organizations are required to disclose on their Form 990 whether they have an audit committee with responsibility for (i) overseeing the compilation, review or audit of its financial statements, and (ii) selecting of an independent accountant or auditor to compile, review or audit the financial statements.¹ In addition, the Non-Profit Revitalization Act of 2013 (as amended, the "Revitalization Act") applicable to New York not-for-profits requires that, in the case of not-for-profits required to file an independent certified public accountant's audit report with the New York Attorney General because such organization's annual gross revenue exceeds certain thresholds (see "Gross Revenue & Support Thresholds for Independent Audit or Review" below), either the audit committee (which, for this purpose, must be comprised entirely of "independent"² directors) or the full board of directors (with only "independent" directors participating in the deliberations or voting), is required to oversee the accounting and financial reporting of the organization and the audit of the organization's financial statements, annually retain the independent auditor to conduct the audit, and review the results of the audit and any related management letter with the independent auditor.

The audit committee or full board of a New York not-for-profit with annual revenues in excess of \$1 million must comply with additional enhanced audit oversight requirements.

Whether a not-for-profit organization would find it valuable to establish an audit committee will depend on the financial resources and complexity of the organization (including the size and composition of its board) and its accounting and reporting systems. "One size does not fit all" – governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization. For example, a not-for-profit organization with significant financial resources or complex financial arrangements may benefit significantly by establishing an audit committee comprised of independent directors who are financially literate, responsible for retaining and compensating the organization's independent auditor (if any) and providing oversight of internal controls and related processes designed to assure that reported financial data is reliable. In contrast, a small not-for-profit organization with simple financial structures may decide that it would be more efficient and effective to entrust responsibility for ensuring the integrity of financial reporting to the entire board. (In either case, it is important that some members of the board be independent and financially literate, and at least one director should be sophisticated concerning financial reporting and accounting.)

This sample charter is intended to comport with generally accepted practices for audit committees of not-for-profit organizations. This sample provides only one example for an organization, incorporating elements required by the Revitalization Act, which amended the New York Not-For-Profit Corporation Law (as amended by the Revitalization Act, the "NPCL"), as well as elements related to certain disclosure requirements under Internal Revenue Service ("IRS") rules. This sample includes, in addition to generally applicable provisions: (i) provisions relating to independent audit oversight that may be removed for organizations that are not required to file audit reports; (ii) provisions relating to enhanced oversight that may be removed for organizations with

revenues below \$1 million; and (iii) provisions relating to an internal audit function which is led by a member of management, which may be removed or modified as appropriate. This sample is intended as a component of the flexible governance framework within which the board, assisted by its committees, directs the affairs of the organization. While this sample audit committee charter should be interpreted in the context of all applicable laws and regulations, as well as in the context of the organization's certificate of incorporation and bylaws; it is not intended to establish by its own force any legally binding obligations.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms and applicable requirements of local, regional or national law) may affect the provisions that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate in particular circumstances.

It should also be noted that Section 8-1.9 of New York's Estates, Powers and Trusts Law makes applicable to charitable trusts a number of sections of the Revitalization Act, including the provisions addressing audit oversight.

Gross Revenue & Support Thresholds for Independent Audit or Review

Organizations registered in New York for charitable solicitation purposes may need (i) their financial statements to be audited or reviewed by an independent certified public accountant and (ii) to file the resulting audit report or review report. The chart below reflects the gross revenue and support thresholds above which a New York not-for-profit will require an independent audit or accountant review:³

Gross Revenue & Support Threshold Applicability

Requirement	July 1, 2014 until June 30, 2017	July 1, 2017 until June 30, 2021	Beginning July 1, 2021
	In excess of	In excess of	In excess of \$1
Audit report	\$500,000	\$750,000	million
	\$250,000 to	\$250,000 to	\$250,000 to \$1
Review report	\$500,000	\$750,000	million

[NAME OF NOT-FOR-PROFIT-ORGANIZATION]

Audit Committee Charter

I. PURPOSES

The Audit Committee (the “Committee”)⁴ is appointed by the Board of Directors (the “Board”) of _____ (the “Organization”) to fulfill its responsibilities to provide oversight of: (i) the Organization’s accounting and financial reporting processes, and systems of internal controls and risk management; (ii) the integrity of the Organization’s financial statements and the audit of the Organization’s financial statements; (iii) the Organization’s compliance with legal and regulatory requirements and ethical standards; and (iv) the engagement, independence and performance of the Organization’s independent auditor.⁵

II. COMMITTEE MEMBERSHIP

Composition. The Committee shall consist of three or more members of the Board.⁶ Except as otherwise directed by the Board, a director selected as a Committee member shall continue to be a member for as long as he or she remains a director or until his or her earlier resignation or removal from the Committee. Any member may be removed from the Committee by the Board, with or without cause, at any time. Committee members shall have a basic understanding of finance, accounting and fundamental financial statements. At least one member of the Committee shall have a sophisticated understanding of financial reporting and accounting as determined by the Board.

Chair. The Chair of the Committee shall be appointed from among the Committee members by, and serve at the pleasure of, the Board, shall preside at meetings of the Committee and shall have authority to convene meetings, set agendas for meetings and determine the Committee’s information needs, except as otherwise provided by the Board or the Committee. In the absence of the Chair at a duly convened meeting, the Committee shall select a temporary substitute from among its members to serve as chair of the meeting.

Independence. Each member of the Committee shall be an “independent”⁷ director as required by applicable law [and in accordance with the Organization’s Board Guidelines]. Any action duly taken by the Committee shall be valid and effective, whether or not the members of the Committee at the time of such action are later determined not to have satisfied the requirements for membership provided herein.

III. AUTHORITY

The Committee’s role is one of oversight. The Organization’s management is responsible for preparing the Organization’s financial statements and the independent auditor is responsible for auditing those financial statements. The Committee recognizes that management, including the internal audit staff and the independent auditor, has more time, knowledge and detailed information about the Organization than do the Committee members. Consequently, in carrying out its oversight responsibilities, the Committee is not providing any expert or special assurance as to the Organization’s financial statements or any professional certification as to the independent auditor’s work.

In discharging its role, the Committee is empowered to inquire into any matter it considers appropriate to carry out its responsibilities, with access to all books, records, facilities and personnel of the Organization and, subject

to the direction of the Board, the Committee is authorized and delegated the authority to act on behalf of the Board with respect to any matter necessary or appropriate to the accomplishment of its purposes. The Committee shall have the sole discretion to retain or obtain advice from, oversee and terminate any independent or other auditor, legal counsel or other adviser to the Committee and be directly responsible for the appointment, compensation and oversight of any work of such adviser retained by the Committee, and the Organization will provide appropriate funding (as determined by the Committee) for the payment of reasonable compensation to any such adviser.

Nothing herein shall preclude the Committee from (i) seeking advice from individuals with expertise in accounting and financial matters who are not members of the Board or the Committee, provided that participation in formal deliberations and voting shall be limited to the independent director members of the Committee (as described above) or (ii) providing honorific designations to such persons; provided, that members of current management who are responsible for developing and maintaining financial controls should not also be involved in the Committee's performance of its duties as set forth herein and in Section 712-a(b) of the New York Not-For-Profit Corporation Law.⁸

IV. COMMITTEE MEETINGS

The Committee shall meet on a regularly scheduled basis, at least [four] times per year and additionally as circumstances dictate. The Committee shall meet at least [twice] each year with the head of internal audit and with the independent auditor in separate executive sessions to provide the opportunity for full and frank discussion without members of senior management present.

The Committee shall establish its own schedule of meetings. The Committee may also act by the unanimous written consent of its members.

Notice of meetings shall be given to all Committee members, or may be waived, in the same manner as required for meetings of the Board. Any one or more members of the Committee may participate in a meeting of the Committee by means of a conference telephone or similar communications equipment or by electronic video screen communication as long as all persons participating in the meeting can speak to and hear each other at the same time and each member can participate in all matters before the Committee, including, without limitation, the ability to propose, object to and vote upon a specific action to be taken by the Committee. Participation by such means shall constitute presence in person at a meeting. A majority of the members of the Committee shall constitute a quorum for a meeting and the affirmative vote of a majority of members present at a meeting at which a quorum is present shall constitute the action of the Committee. The Committee shall otherwise establish its own rules of procedure.

V. KEY RESPONSIBILITIES

The following responsibilities are set forth as a guide for fulfilling the Committee's purposes in such manner as the Committee determines is appropriate:

5.1 Independent Auditor Retention and Oversight

1. Annually retain or renew the retention of the independent auditor;⁹
2. Annually evaluate the qualification and performance of, compensate and oversee the work of, the independent auditor, who shall report directly to the Committee;¹⁰

3. Assess the independence of the independent auditor annually by obtaining and reviewing a report from the independent auditor delineating all relationships between the independent auditor and the Organization and discussing with the independent auditor any such disclosed relationships and their impact on the independent auditor's independence, and by obtaining the independent auditor's assertion of independence in accordance with professional standards;¹¹ and
4. Pre-approve any audit-related and non-audit services to be provided by the independent auditor to the Organization;
5. At least annually, review a report from the independent auditor describing the auditing firm's internal quality-control procedures and any material issues raised by the most recent quality-control review of the firm, or by any inquiry or investigation by governmental or professional authorities within the preceding five years, with respect to one or more independent audits carried out by the firm and any steps taken to deal with any such issues.

5.2 Audit Oversight, Accounting and Financial Reporting¹²

1. Prior to the commencement of the audit, review with the independent auditor the scope and planning of the audit;¹³
2. Upon completion of the audit and as otherwise appropriate, review and discuss with the independent auditor the results of the audit and any problems the independent auditor has encountered performing the audit, any management letter provided and the Organization's response to that letter;¹⁴
3. Upon completion of the audit and as otherwise appropriate, review and discuss with the independent auditor any significant disagreements between the independent auditor and management,¹⁵ and any other matters that the independent auditor is required by applicable professional standards or otherwise to communicate to the Committee;
4. Review and discuss with management, the independent auditor and the internal auditor any significant findings during the year, any restrictions on the scope of the independent auditor's activities or access to requested information,¹⁶ any changes required in the scope of the audit plan, the audit budget and staffing and coordination of audit efforts;
5. Review and discuss with management and the independent auditor all critical accounting policies and practices used by the Organization and any significant changes in the Organization's accounting policies;
6. Review with the independent auditor significant accounting and reporting issues, including recent professional and regulatory pronouncements, understand their impact on the financial statements, and ensure that all such issues have been considered in the preparation of the financial statements;
7. Review with management the annual financial statements, the annual audit report and recommendations of the independent auditor, including any audit problems or difficulties and management's response; and
8. Review with management and the independent auditor any complex and/or unusual transactions or other significant matters or events not in the ordinary course of business.

5.3 Internal Audit¹⁷

1. Review the risk assessment that drives the internal audit plan and annually approve the plan;
2. Review the activities and evaluate the performance of the internal audit function;
3. Review significant adverse internal audit findings and management's response; and
4. Review the effectiveness of the internal audit function, including staffing.

5.4 Internal Control and Risk Oversight

1. Review and discuss with management and the independent auditor the adequacy and effectiveness of, and any material risks and weaknesses in, the Organization's internal controls and accounting and financial reporting processes;¹⁸ and
2. Review and assess with management and the independent auditor the Organization's major financial and other material risks or any significant exposures, the Organization's policies with respect to risk and the steps management has taken to minimize such exposures.

5.5 Oversight of Legal and Ethical Compliance

1. Review periodically with the Organization's legal counsel the scope and effectiveness of the Organization's legal and regulatory compliance policies and programs, and ethical standards and policies;
2. Oversee legal and regulatory compliance and compliance with the Organization's ethical standards and policies;
3. Review possible areas of noncompliance with laws or policies and ensure that management follows up with relevant procedures where appropriate; and
4. Annually review with management and the external tax advisor any issues relating to the Organization's tax compliance.

5.6 Other Responsibilities

1. Conduct a periodic self-evaluation of the performance of the Committee, including its effectiveness and compliance with this charter, and recommend to the Board such amendments of this charter as the Committee deems appropriate;
2. Report regularly to the Board any Committee findings, recommendations and actions and any other matters the Committee deems appropriate or the Board requests,¹⁹ and maintain minutes or other records of Committee meetings and activities;²⁰ and
3. Undertake such other responsibilities as the Board may delegate or assign to the Committee from time to time.

This Audit Committee Charter was adopted by the Board on [Month] [Day], [Year].

ENDNOTES

¹ See Form 990, Part XII, Line 2c and related instructions.

² The Revitalization Act defines “independent director” to mean “a director who: (i) is not, and has not been within the last three years, an employee or a key person of the corporation or an affiliate of the corporation, and does not have a relative who is, or has been within the last three years, a key person of the corporation or an affiliate of the corporation; (ii) has not received, and does not have a relative who has received, in any of the last three fiscal years, more than \$10,000 in direct compensation from the corporation or an affiliate of the corporation; (iii) is not a current employee of or does not have a substantial financial interest in, and does not have a relative who is a current officer of or has a substantial financial interest in, any entity that has provided payments, property or services to, or received payments, property or services from, the corporation or an affiliate of the corporation if the amount paid by the corporation to the entity or received by the corporation from the entity for such property or services, in any of the last three fiscal years, exceeded the lesser of \$10,000 or 2% of such entity’s consolidated gross revenues if the entity’s consolidated gross revenue was less than \$500,000; \$25,000 if the entity’s consolidated gross revenue was \$500,000 or more but less than \$10 million; or \$100,000 if the entity’s consolidated gross revenue was \$10 million or more; or (iv) is not and does not have a relative who is a current owner, whether wholly or partially, director, officer or employee of the corporation’s outside auditor or who has worked on the corporation’s audit at any time during the past three years. For purposes of this subparagraph, the terms: ‘compensation’ does not include reimbursement for expenses reasonably incurred as a director or reasonable compensation for service as a director; and ‘payment’ does not include charitable contributions, dues or fees paid to the corporation for services which the corporation performs as part of its nonprofit purposes, or payments made by the corporation at fixed or non-negotiable rates or amounts for services received, provided that such services by and to the corporation are available to individual members of the public on the same terms, and such services received by the corporation are not available from another source.” NPCL § 102(a)(21).

³ See New York Attorney General’s Charities Bureau Guidance Document 2014-1, “Guidance on Provisions of the Nonprofit Revitalization Act of 2013; Revised CPA Review and Audit Thresholds and Annual Filing Fees for 7A and DUAL Filers” (April 15, 2014), available at http://www.charitiesnys.com/pdfs/NYSGuidance2014_Audit%20Thresholds%20and%20Fee.pdf.

⁴ Unless the board already performs such governance activities, the Revitalization Act requires New York not-for-profits to form an audit committee comprised of “independent directors” (as defined in the Revitalization Act), or identify independent directors to oversee the audit (if any). Only independent directors of New York not-for-profits will be permitted to participate in any board or committee deliberations or voting relating to such matters. See NPCL § 712-a. See Note 2 above for definition of “independent director.”

⁵ The NPCL requires that authority delegated to committees of the board be set forth in the certificate of incorporation, bylaws or resolutions of the board. See NPCL § 712(a).

⁶ The NPCL requires that committees of the board (i.e., those with the power to bind the board) consist of three or more directors. See NPCL § 712(a).

⁷ The bright-line tests for “independence” set forth in IRS rules are different in some respects to the bright-line tests set forth in the Revitalization Act’s definition of “independent director,” for example, the required “look-back” period is different (the most recent tax year under IRS tests, compared with the past three years under New York tests).

The IRS considers a director to be “‘independent’ only if all four of the following circumstances applied at all times during the organization’s tax year: (1) [t]he member was not compensated as an officer or other employee of the organization or of a related organization...except as provided in the religious exception [n]or was the member compensated by an unrelated organization or individual for services provided to the filing organization or to a related organization, if such compensation is required to be reported in Part VII, Section A [of Form 990]; (2) [t]he member did not receive total compensation exceeding \$10,000 during the organization’s tax year ... from the organization and related organizations as an independent contractor,

other than reasonable compensation for services provided in the capacity as a member of the governing body; (3) [n]either the member, nor any family member of the member, was involved in a transaction with the organization (whether directly or indirectly through affiliation with another organization) that is required to be reported on Schedule L (Form 990 or 990-EZ) for the organization's tax year; (4) [n]either the member, nor any family member of the member, was involved in a transaction with a taxable or tax-exempt related organization (whether directly or indirectly through affiliation with another organization) of a type and amount that would be reportable on Schedule L (Form 990 or 990-EZ) if required to be filed by the related organization. A member of the governing body is not considered to lack independence merely because of the following circumstances: (1) [t]he member is a donor to the organization, regardless of the amount of the contribution;" (2) the religious exception applies; or (3) "the member receives financial benefits from the organization solely in the capacity of being a member of the charitable or other class served by the organization in the exercise of its exempt function." Instructions to Form 990, Part VI, Line 1b.

See Note 2 above for definition of "independent director."

The Revitalization Act defines an "affiliate" of a corporation as "any entity controlled by or in control of such corporation." NPCL § 102(a)(19).

A "relative" of a person is that person's spouse, domestic partner, ancestors, brothers and sisters (whether whole or half-blood), children (whether natural or adopted), grandchildren, great-grandchildren or the spouse or domestic partner of his or her brothers, sisters, children, grandchildren and great-grandchildren. See NPCL § 102(a)(22).

A "key person" is a person, other than a director or officer, whether or not an employee of the corporation, who: (i) has responsibilities, or exercises powers or influence over the corporation as a whole similar to the responsibilities, powers, or influence of directors and officers; (ii) manages the corporation, or a segment of the corporation that represents a substantial portion of the activities, assets, income or expenses of the corporation; or (iii) alone or with others controls or determines a substantial portion of the corporation's capital expenditures or operating budget, , in accordance with applicable IRS rules. See NPCL § 102(a)(25).

⁸ See New York Attorney General's Charities Bureau Guidance Document 2015-1, V. 1.0, "Audit Committees and the Nonprofit Revitalization Act of 2013" (February 24, 2015), available at <https://www.charitiesnys.com/pdfs/AuditCommittees.pdf>.

⁹ The Revitalization Act requires that for not-for-profits that are required to file an independent certified public accountant's audit report with the New York Attorney General pursuant to New York Executive Law § 172-b(1), the board or a designated audit committee of the board comprised solely of independent directors shall annually retain or renew the retention of an independent auditor to conduct the audit. See NPCL § 712-a(a). The Revitalization Act defines "independent auditor" to mean any certified public accountant performing the audit of the financial statements of a corporation required by Section 172-b(1) of the New York Executive Law. See NPCL § 102(a)(20).

¹⁰ The Revitalization Act requires that for not-for-profits that had in the prior fiscal year, or reasonably expect to have in the upcoming year, annual gross revenue in excess of \$1 million, the board or a designated audit committee of the board comprised solely of independent directors must annually consider the performance of the independent auditor. See NPCL § 712-a(b)(3).

¹¹ The Revitalization Act requires that for not-for-profits that had in the prior fiscal year, or reasonably expect to have in the upcoming year, annual gross revenue in excess of \$1 million, the board or a designated audit committee of the board comprised solely of independent directors must annually consider the independence of the independent auditor. See NPCL § 712-a(b)(3).

¹² The Revitalization Act requires that for not-for-profits that are required to file an independent certified public accountant's audit report with the New York Attorney General pursuant to New York Executive Law § 172-b(1), the board or a designated

audit committee of the board comprised solely of independent directors shall oversee the audit of the corporation's financial statements. *See* NPCL § 712-a(a).

¹³ The Revitalization Act requires that for not-for-profits that had in the prior fiscal year, or reasonably expect to have in the upcoming year, annual gross revenue in excess of \$1 million, the board or a designated audit committee of the board comprised solely of independent directors must, prior to the commencement of the audit, review with the independent auditor the scope and planning of the audit. *See* NPCL § 712-a(b)(1).

¹⁴ The Revitalization Act requires that for not-for-profits that are required to file an independent certified public accountant's audit report with the New York Attorney General pursuant to New York Executive Law § 172-b(1), the board or a designated audit committee of the board comprised solely of independent directors shall upon completion of the audit, review the results of the audit and any related management letter with the independent auditor. *See* NPCL § 712-a(a).

¹⁵ The Revitalization Act requires that for not-for-profits that had in the prior fiscal year, or reasonably expect to have in the upcoming year, annual gross revenue in excess of \$1 million, the board or a designated audit committee of the board comprised solely of independent directors must, upon completion of the audit, review and discuss with the independent auditor any significant disagreements between the auditor and management. *See* NPCL § 712-a(b)(2)(C).

¹⁶ The Revitalization Act requires that for not-for-profits that had in the prior fiscal year, or reasonably expect to have in the upcoming year, annual gross revenue in excess of \$1 million, the board or a designated audit committee of the board comprised solely of independent directors must, upon completion of the audit, review and discuss with the independent auditor any restrictions on the scope of the auditor's activities or access to requested information. *See* NPCL § 712-a(b)(2)(B).

¹⁷ An internal audit function may not be found at most not-for-profit organizations other than those operating at a large scale.

¹⁸ The Revitalization Act requires that for not-for-profits that are required to file an independent certified public accountant's audit report with the New York Attorney General pursuant to New York Executive Law § 172-b(1), the board or a designated audit committee of the board comprised solely of independent directors shall oversee the accounting and financial reporting processes of the corporation. *See* NPCL § 712-a(a). In addition, the Revitalization Act requires that for not-for-profits that had in the prior fiscal year, or reasonably expect to have in the upcoming year, annual gross revenue in excess of \$1 million, the board or a designated audit committee of the board comprised solely of independent directors must, upon completion of the audit, review and discuss with the independent auditor (a) any material risks and weaknesses in internal controls identified by the auditor, and (b) the adequacy of the corporation's accounting and financial reporting processes. *See* NPCL § 712-a(b)(2)(A), (D).

¹⁹ The Revitalization Act requires that for not-for-profits that had in the prior fiscal year, or reasonably expect to have in the upcoming year, annual gross revenue in excess of \$1 million, if the audit oversight duties set forth in NPCL § 712-a are performed by an audit committee, the committee must report to the board on the committee's activities. *See* NPCL § 712-a(b)(4).

²⁰ IRS Form 990 requires disclosure of whether the organization contemporaneously documents, by any means permitted by state law, the meetings held by the board and any committee authorized to act on behalf of the board. The related instructions provide that "[d]ocumentation permitted by state law can include approved minutes, email, or similar writings that explain the action taken, when it was taken, and who made the decision. For this purpose, contemporaneous means by the later of (1) the next meeting of the governing body or committee (such as approving the minutes of the prior meeting) or (2) 60 days after the date of the meeting or written action." *See* Form 990, Part VI, Line 8 and related instructions. The NPCL requires that New York not-for-profits (i) keep minutes of the proceedings of the board and any executive committee and (ii) contemporaneously document in writing the basis for the board or authorized committee's approval of certain specified related party transactions, including the consideration of any alternative transactions. *See* NPCL §§ 621(a), 715(b).

Not-For-Profit Practice Group

Sample Not-For-Profit Nominating and Governance Committee Charter

The board of a not-for-profit organization is typically responsible for nominating candidates to the board, for ensuring that the size, leadership and composition of the board are appropriate and for overseeing governance structure and policies, including the structure of the board committees and the organization's bylaws. The board may wish to establish a nominating and governance committee in order to assist with such responsibilities, however, it is not required by law to do so.

Nominating and governance committees may represent best practice for certain not-for-profit organizations. Whether it would be valuable for a not-for-profit organization to establish a nominating and governance committee will depend on the size and complexity of the particular organization. One size does not fit all – governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization.

The following sample nominating and governance committee charter is intended to comport with generally accepted practices for nominating and governance committees of not-for-profit organizations and incorporates elements required by the Non-Profit Revitalization Act of 2013 (as amended, the "Revitalization Act") applicable to New York not-for-profits, which amended the New York Not-For-Profit Corporation Law (as amended by the Revitalization Act, the "NPCL"). It is intended as a component of the flexible governance framework within which the board, assisted by its committees, directs the affairs of the organization. The sample nominating and governance committee charter should be interpreted in the context of all applicable laws and regulations, as well as in the context of the organization's certificate of incorporation and bylaws; it is not intended to establish by its own force any legally binding obligations.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions of the charter that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate depending upon the circumstances.

[NAME OF NOT-FOR-PROFIT ORGANIZATION]

Nominating and Governance Committee Charter

I. PURPOSES

The Nominating and Governance Committee (“Committee”) is appointed by the Board of Directors (the “Board”) of _____ (the “Organization”) to: (1) develop and provide oversight of (a) implementation of policies and procedures regarding Board size, leadership and composition, (b) recommendations of candidates for nomination to the Board, and (c) Board Guidelines; (2) determine qualifications and characteristics required to become a director; (3) identify and screen individuals who are qualified to serve as directors; (4) recommend to the Board candidates for nomination and election or appointment to the Board, and its committees, or to fill Board vacancies; (5) assist in orientation programs for newly appointed directors; (6) coordinate and oversee self-evaluations of the Board and its committees; and (7) review on a regular basis the overall governance of the Organization and recommend improvements for approval by the Board where appropriate.¹

II. COMMITTEE MEMBERSHIP

Composition. The Committee shall consist of three or more members of the Board.² Except as otherwise directed by the Board, a director selected as a Committee member shall continue to be a member for as long as he or she remains a director or until his or her earlier resignation or removal from the Committee. Any member may be removed from the Committee by the Board, with or without cause, at any time.

Chair. The Chair of the Committee shall be appointed from among the Committee members by, and serve at the pleasure of, the Board, shall preside at meetings of the Committee and have authority to convene meetings set agendas for meetings, and shall determine the Committee’s information needs, except as otherwise provided by the Board or the Committee. In the absence of the Chair at a duly convened meeting, the Committee shall select a temporary substitute from among its members to serve as chair of the meeting.

[Independence. Each member of the Committee shall be an “independent”³ director as determined in accordance with the Organization’s Board Guidelines. Any action duly taken by the Committee shall be valid and effective, whether or not the members of the Committee at the time of such action are later determined not to have satisfied the requirements for membership provided herein.]

III. AUTHORITY

In discharging its role, the Committee is empowered to inquire into any matter it considers appropriate to carry out its responsibilities, with access to all books, records, facilities and personnel of the Organization and, subject to the direction of the Board, the Committee is authorized and delegated the authority to act on behalf of the Board with respect to any matter necessary or appropriate to the accomplishment of its purposes.

The Committee shall have the sole discretion to retain or obtain advice from, oversee and terminate any director search or recruitment consultant, legal counsel or other adviser to the Committee and be directly responsible for the appointment, compensation and oversight of any work of such adviser retained by the Committee, and the

Organization will provide appropriate funding (as determined by the Committee) for the payment of reasonable compensation to any such adviser.

IV. COMMITTEE MEETINGS

The Committee shall meet on a regularly scheduled basis, at least [two] times per year and additionally as circumstances dictate.

The Committee shall establish its own schedule of meetings. The Committee may also act by unanimous written consent of its members.

Notice of meetings shall be given to all Committee members, or may be waived, in the same manner as required for meetings of the Board. Any one or more members of the Committee may participate in a meeting of the Committee by means of a conference telephone or similar communications equipment or by electronic video screen communication, as long as all persons participating in the meeting can speak to and hear each other at the same time and each member can participate in all matters before the Committee, including, without limitation, the ability to propose, object to, and vote upon a specific action to be taken by the Committee. Participation by such means shall constitute presence in person at a meeting. A majority of the members of the Committee shall constitute a quorum for a meeting, and the affirmative vote of a majority of members present at a meeting at which a quorum is present shall constitute the action of the Committee. The Committee shall otherwise establish its own rules of procedure.

V. KEY RESPONSIBILITIES

The following responsibilities are set forth as a guide for fulfilling the Committee's purposes in such manner as the Committee determines is appropriate:

1. Oversee the process of selection and nomination of directors, including ensuring that director nominees meet the qualifications required by the certificate of incorporation, bylaws, and Board Guidelines, as applicable, and establish other criteria that are desirable for directors;
2. Identify and screen director candidates (including incumbent directors for potential renomination) consistent with criteria approved by the Board, and recommend to the Board candidates for:
(a) nomination for election or re-election and (b) any Board vacancies that are to be filled by the Board;
3. Review annually the relationships between directors, the Organization and members of management and recommend to the Board whether each director qualifies as "independent" under the definition of "independence" set forth in the Organization's Board Guidelines;
4. Review annually the size, composition and leadership of the Board as a whole, its committees, and any advisory bodies including whether the Board, its committees and any advisory bodies reflect the appropriate balance of independence, sound judgment, business specialization, technical skills, diversity, fundraising and development ability, geographic representation, and other desired qualities, and recommend any appropriate changes to the Board;
5. Coordinate and oversee a periodic self-evaluation of the role and performance of the Board, its committees, and any advisory bodies in the governance of the Organization;

6. Develop and recommend to the Board, review the effectiveness of, and recommend modifications as appropriate to, the Organization's committee structure and organizational documents, including the certificate of incorporation, bylaws and Board Guidelines;⁴
7. Coordinate with management to develop an appropriate director orientation program, including identification of experienced directors as appropriate mentors of new directors;
8. Review emerging corporate governance issues and practices and make appropriate recommendations to the Board;
9. Conduct a periodic self-evaluation of the performance of the Committee, including its effectiveness and compliance with this charter, and recommend to the Board such amendments of this charter as the Committee deems appropriate;
10. Report regularly to the Board on Committee findings, recommendations and any other matters the Committee deems appropriate or the Board requests, and maintain minutes or other records of Committee meetings and activities;⁵ and
11. Undertake such other responsibilities as the Board may delegate or assign to the Committee from time to time.

ENDNOTES

¹ The NPCL requires that authority delegated to committees of the board be set forth in the certificate of incorporation, bylaws or resolutions of the board. *See* NPCL § 712(a). It is considered best practice for not-for-profit boards to delegate responsibility for director nominations and governance matters such as those set forth in this sample charter to a nominating and governance committee, but such a delegation is not required by law.

² The NPCL requires that committees of the board consist of three or more directors. *See* NPCL § 712(a).

³ It is considered a best practice for independent directors to be responsible for director nominators and governance matters, but independence is not required by law. The bright-line tests for “independence” set forth in IRS rules are different in some respects to the bright-line tests set forth in the Revitalization Act’s definition of “independent director,” for example, the required “look-back” period is different (the most recent tax year under IRS tests, compared with the past three years under New York tests).

The IRS considers a director to be “‘independent’ only if all four of the following circumstances applied at all times during the organization’s tax year: (1) [t]he member was not compensated as an officer or other employee of the organization or of a related organization...except as provided in the religious exception [n]or was the member compensated by an unrelated organization or individual for services provided to the filing organization or to a related organization, if such compensation is required to be reported in Part VII, Section A [of Form 990]; (2) [t]he member did not receive total compensation exceeding \$10,000 during the organization’s tax year ... from the organization and related organizations as an independent contractor, other than reasonable compensation for services provided in the capacity as a member of the governing body; (3) [n]either the member, nor any family member of the member, was involved in a transaction with the organization (whether directly or indirectly through affiliation with another organization) that is required to be reported on Schedule L (Form 990 or 990-EZ) for the organization’s tax year; (4) [n]either the member, nor any family member of the member, was involved in a transaction with a taxable or tax-exempt related organization (whether directly or indirectly through affiliation with another organization) of a type and amount that would be reportable on Schedule L (Form 990 or 990-EZ) if required to be filed by the related organization. A member of the governing body is not considered to lack independence merely because of the following circumstances: (1) [t]he member is a donor to the organization, regardless of the amount of the contribution;” (2) the religious exception applies; or (3) “the member receives financial benefits from the organization solely in the capacity of being a member of the charitable or other class served by the organization in the exercise of its exempt function.” Instructions to Form 990, Part VI, Line 1b.

The Revitalization Act defines “independent director” to mean “a director who: (i) is not, and has not been within the last three years, an employee or a key person of the corporation or an affiliate of the corporation, and does not have a relative who is, or has been within the last three years, a key person of the corporation or an affiliate of the corporation; (ii) has not received, and does not have a relative who has received, in any of the last three fiscal years, more than \$10,000 in direct compensation from the corporation or an affiliate of the corporation; (iii) is not a current employee of or does not have a substantial financial interest in, and does not have a relative who is a current officer of or has a substantial financial interest in, any entity that has provided payments, property or services to, or received payments, property or services from, the corporation or an affiliate of the corporation if the amount paid by the corporation to the entity or received by the corporation from the entity for such property or services, in any of the last three fiscal years, exceeded the lesser of \$10,000 or 2% of such entity’s consolidated gross revenues if the entity’s consolidated gross revenue was less than \$500,000; \$25,000 if the entity’s consolidated gross revenue was \$500,000 or more but less than \$10 million; or \$100,000 if the entity’s consolidated gross revenue was \$10 million or more; or (iv) is not and does not have a relative who is a current owner, whether wholly or partially, director, officer or employee of the corporation’s outside auditor or who has worked on the corporation’s audit at any time during the past three years. For purposes of this subparagraph, the terms: ‘compensation’ does not include reimbursement for expenses reasonably incurred as a director or reasonable compensation for service as a director; and ‘payment’ does not include charitable contributions, dues or fees paid to the corporation for services which the corporation performs as part of its nonprofit purposes, or payments made by the corporation at fixed or non-negotiable rates or amounts

for services received, provided that such services by and to the corporation are available to individual members of the public on the same terms, and such services received by the corporation are not available from another source.” NPCL § 102(a)(21).

The Revitalization Act defines an “affiliate” of a corporation as “any entity controlled by, or in control of, such corporation.” NPCL § 102(a)(19). The Instructions to Form 990 define a “related organization” to include, among others, “an organization that controls the filing organization,” “an organization controlled by the filing organization,” and “an organization controlled by the same person or persons that control the filing organization.” Instructions to Form 990, Glossary.

The definitions of “relative” in the Revitalization Act and “family member” in the Instructions to Form 990 are substantially the same. A “relative” or “family member” of a director is that person’s spouse, domestic partner, ancestors, brothers and sisters (whether whole or half-blood), children (whether natural or adopted), grandchildren, great-grandchildren and spouses or domestic partners of brothers, sisters, children, grandchildren and great-grandchildren. *See* NPCL § 102(a)(22); Instructions to Form 990, Glossary.

A “key person” is defined in the Revitalization Act as any person, other than a director or officer, whether or not an employee of the corporation who (i) has responsibilities, or exercises powers or influence over the corporation as a whole similar to the responsibilities, powers, or influence of directors and officers; (ii) manages the corporation, or a segment of the corporation that represents a substantial portion of the activities, assets, income or expenses of the corporation; or (iii) alone or with others controls or determines a substantial portion of the corporation’s capital expenditures or operating budget, in accordance with applicable IRS rules. *See* NPCL § 102(a)(25).

⁴ Unless the board or another committee comprised solely of independent members performs such governance activities, the Revitalization Act requires New York not-for-profits to approve certain transactions and oversee the conflict of interest policy and the whistleblower policy (if any). Only independent directors of New York not-for-profits are permitted to participate in any board or committee deliberations or voting relating to such matters. *See* NPCL § 712-a. This charter should be modified as appropriate if this committee (instead of the audit committee) has the responsibility for approval of transactions and/or oversight of such matters.

⁵ IRS Form 990 requires disclosure of whether the organization contemporaneously documents, by any means permitted by state law, the meetings held by the board and any committee authorized to act on behalf of the board. The related instructions provide that “[d]ocumentation permitted by state law can include approved minutes, email, or similar writings that explain the action taken, when it was taken, and who made the decision. For this purpose, *contemporaneous* means by the later of (1) the next meeting of the governing body or committee (such as approving the minutes of the prior meeting) or (2) 60 days after the date of the meeting or written action.” *See* Form 990, Part VI, Lines 8a-b and related instructions.

Not-For-Profit Practice Group

Sample Not-For-Profit Compensation Committee Charter

The board of a not-for-profit organization is responsible for determining and reviewing the compensation of the chief executive officer/executive director/president, other senior managers and “disqualified persons” (as defined in the Internal Revenue Code (the “IRC”)) and for ensuring that such compensation is reasonable. Compensation decisions of tax-exempt organizations are presumed reasonable if they are based on objective, documented, comparable information. The board may wish to establish a compensation committee in order to assist with such responsibilities, although it is not required by law to do so.¹

Additionally, while there are no federal legal requirements regarding compensation committees, tax-exempt organizations are required to disclose on their Form 990 whether, among other things, the process for determining compensation of certain key employees included review and approval by independent persons, comparability data and contemporaneous substantiation of the deliberation and decision.² In addition, the Non-Profit Revitalization Act of 2013 (as amended, the “Revitalization Act”) applicable to New York not-for-profits, which amended the New York Not-For-Profit Corporation Law (as amended by the Revitalization Act, the “NPCL”), limits the extent to which a person can participate in any board or committee deliberations or vote with respect to his or her compensation, and includes certain requirements with respect to the review and approval by disinterested directors of “related party transactions” such as compensation arrangements with officers and key persons.

Compensation committees may represent best practice for certain not-for-profit organizations, but one size does not fit all. Whether it would be valuable for a not-for-profit organization to establish a compensation committee will depend on the size of the particular organization and the complexity of its compensation policies. Governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization.

The following sample compensation committee charter is intended to comport with generally accepted practices for compensation committees of not-for-profit organizations, and incorporates elements required by the NPCL, as well as elements related to certain disclosure requirements under Internal Revenue Service (“IRS”) rules. It is intended as a component of the flexible governance framework within which the board, assisted by its committees, directs the affairs of the organization. The sample compensation committee charter should be interpreted in the context of all applicable laws and regulations, as well as in the context of the organization’s certificate of incorporation and bylaws; it is not intended to establish by its own force any legally binding obligations.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions of the charter that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate depending upon the circumstances.

[NAME OF NOT-FOR-PROFIT ORGANIZATION]

Compensation Committee Charter

I. PURPOSES

The Compensation Committee (the “Committee”) is appointed by the Board of Directors (the “Board”) of _____ (the “Organization”) to assist the Board in fulfilling its oversight of the Organization’s executive compensation policies and practices, including: (1) making recommendations to the independent directors with respect to the reasonable compensation of the Organization’s [Chief Executive Officer/Executive Director/President] (“[CEO/ED/President]”); and (2) reviewing and approving the reasonable compensation of the Organization’s other managers, employees and any other persons who are in a position to exercise substantial influence over the affairs of the Organization (“key persons”).³

II. COMMITTEE MEMBERSHIP

Composition. The Committee shall consist of three or more members of the Board.⁴ Except as otherwise directed by the Board, a director selected as a Committee member shall continue to be a member for as long as he or she remains a director or until his or her earlier resignation or removal from the Committee. Any member may be removed from the Committee by the Board, with or without cause, at any time.

Chair. The Chair of the Committee shall be appointed from among the Committee members by, and serve at the pleasure of, the Board, shall preside at meetings of the Committee and shall have authority to convene meetings set agendas for meetings, and shall determine the Committee’s information needs, except as otherwise provided by the Board or the Committee. In the absence of the Chair at a duly convened meeting, the Committee shall select a temporary substitute from among its members to serve as chair of the meeting.

[Independence. Each member of the Committee shall be an “independent”⁵ director as determined in accordance with the Organization’s Board Guidelines.⁶ Any action duly taken by the Committee shall be valid and effective, whether or not the members of the Committee at the time of such action are later determined not to have satisfied the requirements for membership provided herein.]

III. AUTHORITY

In discharging its role, the Committee is empowered to inquire into any matter it considers appropriate to carry out its responsibilities, with access to all books, records, facilities and personnel of the Organization and, subject to the direction of the Board, the Committee is authorized and delegated the authority to act on behalf of the Board with respect to any matter necessary or appropriate to the accomplishment of its purposes.

The Committee shall have the sole discretion to retain or obtain advice from, oversee and terminate any compensation consultant, legal counsel or other adviser to the Committee and be directly responsible for the appointment, compensation and oversight of any work of such adviser retained by the Committee, and the Organization will provide appropriate funding (as determined by the Committee) for the payment of reasonable compensation to any such adviser.

IV. COMMITTEE MEETINGS

The Committee shall meet on a regularly scheduled basis, at least [two] times per year and additionally as circumstances dictate. The Committee shall meet at least [annually] with the [CEO/ED/President] and any other officers or key persons the Committee or the Board deem appropriate to discuss and review the performance criteria and compensation levels of officers and key persons.

The Committee shall establish its own schedule of meetings. The Committee may also act by unanimous written consent of its members.

Notice of meetings shall be given to all Committee members, or may be waived, in the same manner as required for meetings of the Board. Any one or more members of the Committee may participate in a meeting of the Committee by means of a conference telephone or similar communications equipment or by electronic video screen communication, as long as all persons participating in the meeting can speak to and hear each other at the same time and each member can participate in all matters before the Committee, including, without limitation, the ability to propose, object to, and vote upon a specific action to be taken by the Committee. Participation by such means shall constitute presence in person at a meeting. A majority of the members of the Committee shall constitute a quorum for a meeting, and the affirmative vote of a majority of members present at a meeting at which a quorum is present shall constitute the action of the Committee. Members of the Committee who have a financial or other interest in or otherwise have a conflict of interest with respect to any compensation arrangement to be voted on by the Committee are disqualified from deliberations and voting on such matter, but shall be determined to be present to constitute a quorum. The Committee shall otherwise establish its own rules of procedure.

V. KEY RESPONSIBILITIES

The following responsibilities are set forth as a guide for fulfilling the Committee's purposes in such manner as the Committee determines is appropriate:

1. Establish and review the Organization's overall management compensation philosophy and policy;
2. Review and approve the Organization's goals and objectives relevant to the compensation of the Organization's key executives, including annual performance goals and objectives;
3. Oversee compliance with the compensation policies and procedures and the terms of employment contracts;
4. Review and authorize any employment, compensation, benefit or severance agreement with officers and key persons;
5. Evaluate at least annually the performance of the key executives against the Organization's goals and objectives, including the annual performance objectives and, based on this evaluation, determine and approve (or recommend to the Board for approval in the case of the [CEO/ED/President]) the compensation level (including any incentive awards and any material perquisites) for officers and key persons, reviewing as appropriate, any agreement or understanding relating to their employment, incentive compensation, or other benefits based on this evaluation;

6. Determine and approve the compensation level (including any incentive awards and any material perquisites) for other employees as the Committee or the Board may from time to time determine to be appropriate;
7. Ensure that compensation paid to the Organization's employees is "reasonable," such that it would ordinarily be paid for like services by similar organizations under similar circumstances. In determining if compensation is reasonable, the Committee will, where appropriate and available, obtain data (such as compensation surveys, third party offer letters or other objective data) as to comparability of compensation such as the compensation paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions;⁷
8. Review on a periodic basis the Organization's management compensation programs, including any management incentive compensation plans as well as plans and policies pertaining to perquisites or other benefits, to determine whether they are reasonable and appropriate, properly coordinated and achieve their intended purpose(s), and recommend to the Board any appropriate modifications or new plans or programs;
9. Conduct a periodic self-evaluation of the performance of the Committee, including its effectiveness and compliance with this charter, and recommend to the Board such amendments of this charter as the Committee deems appropriate;
10. Report regularly to the Board on Committee findings, recommendations and any other matters the Committee deems appropriate or the Board requests, and maintain minutes or other records of Committee meetings and activities (which should, among other things, document the basis for the Committee's determination that compensation is reasonable);⁸ and
11. Undertake such other responsibilities as the Board may delegate or assign to the Committee from time to time.

ENDNOTES

¹ See endnote 5 for committee independence requirements under the NPCL and IRC.

² See Form 990, Part VI, Lines 15a-b and related instructions.

³ A “key person” is defined in the Revitalization Act as any person, other than a director or officer, whether or not an employee of the corporation who (i) has responsibilities, or exercises powers or influence over the corporation as a whole similar to the responsibilities, powers, or influence of directors and officers; (ii) manages the corporation, or a segment of the corporation that represents a substantial portion of the activities, assets, income or expenses of the corporation; or (iii) alone or with others controls or determines a substantial portion of the corporation’s capital expenditures or operating budget, in accordance with applicable IRS rules. See NPCL § 102(a)(25); IRC § 4958 and related regulations.

⁴ The NPCL requires that standing committees of the board consist of three or more directors; however, there is no such requirement applicable to non-board committees of the Organization. See NPCL § 712(a)-(b).

⁵ The NPCL does not require a compensation committee of independent directors. However, Form 990 requires disclosure of whether the process for determining compensation of certain key employees included review and approval by independent persons. See note 2 above. The bright-line tests for “independence” set forth in IRS rules are different in some respects to the bright-line tests set forth in the NPCL’s definition of “independent director,” for example, the required “look-back” period is different (the most recent tax year under IRS tests, compared with the past three years under New York tests).

The IRS considers a director to be “‘independent’ only if all four of the following circumstances applied at all times during the organization’s tax year: (1) [t]he member was not compensated as an officer or other employee of the organization or of a related organization...except as provided in the religious exception [n]or was the member compensated by an unrelated organization or individual for services provided to the filing organization or to a related organization, if such compensation is required to be reported in Part VII, Section A [of Form 990]; (2) [t]he member did not receive total compensation exceeding \$10,000 during the organization’s tax year ... from the organization and related organizations as an independent contractor, other than reasonable compensation for services provided in the capacity as a member of the governing body; (3) [n]either the member, nor any family member of the member, was involved in a transaction with the organization (whether directly or indirectly through affiliation with another organization) that is required to be reported on Schedule L (Form 990 or 990-EZ) for the organization’s tax year; (4) [n]either the member, nor any family member of the member, was involved in a transaction with a taxable or tax-exempt related organization (whether directly or indirectly through affiliation with another organization) of a type and amount that would be reportable on Schedule L (Form 990 or 990-EZ) if required to be filed by the related organization. A member of the governing body is not considered to lack independence merely because of the following circumstances: (1) [t]he member is a donor to the organization, regardless of the amount of the contribution;” (2) the religious exception applies; or (3) “the member receives financial benefits from the organization solely in the capacity of being a member of the charitable or other class served by the organization in the exercise of its exempt function.” Instructions to Form 990, Part VI, Line 1b.

The Revitalization Act defines “independent director” to mean “a director who: (i) is not, and has not been within the last three years, an employee or a key person of the corporation or an affiliate of the corporation, and does not have a relative who is, or has been within the last three years, a key person of the corporation or an affiliate of the corporation; (ii) has not received, and does not have a relative who has received, in any of the last three fiscal years, more than \$10,000 in direct compensation from the corporation or an affiliate of the corporation; (iii) is not a current employee of or does not have a substantial financial interest in, and does not have a relative who is a current officer of or has a substantial financial interest in, any entity that has provided payments, property or services to, or received payments, property or services from, the corporation or an affiliate of the corporation if the amount paid by the corporation to the entity or received by the corporation from the entity for such property or services, in any of the last three fiscal years, exceeded the lesser of \$10,000 or 2% of such entity’s consolidated gross revenues if the entity’s consolidated gross revenue was less than \$500,000; \$25,000 if the entity’s consolidated gross revenue was \$500,000 or more but less than \$10 million; or \$100,000 if the entity’s consolidated

gross revenue was \$10 million or more; or (iv) is not and does not have a relative who is a current owner, whether wholly or partially, director, officer or employee of the corporation's outside auditor or who has worked on the corporation's audit at any time during the past three years. For purposes of this subparagraph, the terms: 'compensation' does not include reimbursement for expenses reasonably incurred as a director or reasonable compensation for service as a director; and 'payment' does not include charitable contributions, dues or fees paid to the corporation for services which the corporation performs as part of its nonprofit purposes, or payments made by the corporation at fixed or non-negotiable rates or amounts for services received, provided that such services by and to the corporation are available to individual members of the public on the same terms, and such services received by the corporation are not available from another source." NPCL § 102(a)(21).

The Revitalization Act defines an "affiliate" of a corporation as "any entity controlled by, or in control of, such corporation." NPCL § 102(a)(19). The Instructions to Form 990 define a "related organization" to include, among others, "an organization that controls the filing organization," "an organization controlled by the filing organization," and "an organization controlled by the same person or persons that control the filing organization." Instructions to Form 990, Glossary.

The definitions of "relative" in the Revitalization Act and "family member" in the Instructions to Form 990 are substantially the same. A "relative" or "family member" of a director is that person's spouse, domestic partner, ancestors, brothers and sisters (whether whole or half-blood), children (whether natural or adopted), grandchildren, great-grandchildren and spouses or domestic partners of brothers, sisters, children, grandchildren and great-grandchildren. *See* NPCL § 102(a)(22); Instructions to Form 990, Glossary.

⁶ A compensation arrangement between a New York not-for-profit organization and a director, officer or key person (each of whom would qualify as a "related party" pursuant to the NPCL) would constitute a "related party transaction" requiring review and approval by disinterested directors pursuant to the Revitalization Act. *See* NPCL §§ 102(a)(23)-(24)). The NPCL requires that any director, officer or key person who has an interest in a related party transaction must disclose in good faith to the board or an authorized board committee the material facts concerning his or her interest in the transaction. *See* NPCL § 715(a). In addition, when a related party has a "substantial financial interest" in a related party transaction, the board or authorized committee must, among other things, "consider alternative transactions to the extent available." *See* NPCL § 715(b). The Revitalization Act also prohibits any person from being present at or otherwise participating in any board or committee deliberation or vote concerning such person's compensation, although such person may present background information or answer questions prior to the commencement of the relevant deliberations or voting. *See* NPCL § 515(b). Similarly, related parties are not permitted to participate in deliberations or voting relating to relevant related party transactions; however, they may be requested to present information concerning such transaction prior to the commencement of deliberations or voting relating thereto. *See* NPCL § 715(h).

⁷ Compensation will be presumed reasonable under the relevant tax rules if: (1) the compensation arrangement is approved by disinterested members of the board or the committee; (2) the board or committee obtained and relied upon appropriate data as to comparability of compensation such as the compensation paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions (which may include reviewing compensation surveys, actual written offers from similar organizations competing for the person's services, or other objective external data to establish comparable values for executive compensation); and (3) the board or committee adequately documents the basis for its determination that the compensation is reasonable concurrently with making that determination. *See* IRC § 4958 and related regulations; Form 990, Part VI, Lines 15a-b and related instructions. The NPCL provides that a New York not-for-profit "may pay compensation in a reasonable amount to members, directors, or officers, for services rendered" and that related party transactions must be determined by the board to be "fair, reasonable and in the corporation's best interest at the time of such determination." NPCL §§ 515(b), 715(a).

⁸ IRS Form 990 requires disclosure of whether the organization contemporaneously documents, by any means permitted by state law, the meetings held by the board and any committee authorized to act on behalf of the board. The related instructions provide that "[d]ocumentation permitted by state law can include approved minutes, email, or similar writings that explain the action taken, when it was taken, and who made the decision. For this purpose, *contemporaneous* means by the later of (1) the next meeting of the governing body or committee (such as approving the minutes of the prior meeting) or (2) 60 days

after the date of the meeting or written action.” *See* Form 990, Part VI, Line 8 and related instructions. The Revitalization Act requires that New York not-for-profits contemporaneously document in writing the basis for the board or authorized committee’s approval of certain specified related party transactions, including the consideration of any alternative transactions. *See* NPCL § 715(b).

Not-For-Profit Practice Group

Sample Not-For-Profit Executive Committee Charter

The board of a not-for-profit organization directs the affairs of the organization and is ultimately accountable for the organization's performance. The responsibilities of the board are wide-ranging and require the board to make decisions on a consensus basis. The boards of some not-for-profits may find that their size or structure makes it difficult for the board to efficiently make timely decisions. Such boards may benefit by establishing an executive committee to make decisions on behalf of the board if required, provided it is appropriate to do so. However, one size does not fit all – governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization.

Additionally, while there are no federal legal requirements regarding executive committees, tax-exempt organizations are required to disclose on their Form 990 whether they have an executive committee or similar committee with broad authority to act on behalf of the organization.

This sample executive committee charter is intended to comport with generally accepted practices for executive committees of not-for-profit organizations. This sample provides only one example for a non-member organization, incorporating elements required by the Non-Profit Revitalization Act of 2013 (as amended, the "Revitalization Act") applicable to New York not-for-profits, which amended the New York Not-For-Profit Corporation Law (as amended by the Revitalization Act, the "NPCL"), as well as elements related to certain disclosure requirements under Internal Revenue Service ("IRS") rules. It is intended as a component of the flexible governance framework within which the board, assisted by its committees, directs the affairs of the organization. While it should be interpreted in the context of all applicable laws and regulations, as well as in the context of the organization's certificate of incorporation and bylaws, it is not intended to establish by its own force any legally binding obligation.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate in particular circumstances.

[NAME OF NOT-FOR-PROFIT ORGANIZATION]

Executive Committee Charter

I. PURPOSES

The Executive Committee (“Committee”) is appointed by the Board of Directors (the “Board”) of _____ (the “Organization”) to exercise the powers of the Board in relation to matters that arise between regularly scheduled Board meetings or when it is not practical or feasible for the Board to meet. The Committee is delegated the authority to act as the full Board when exercising the powers and authority under this charter, subject to the limitations listed below and applicable law.¹

II. COMMITTEE MEMBERSHIP

Composition. The Committee shall consist of three or more members of the Board² and shall include [the chair of each of the standing committees of the Board and any additional directors selected by the Board]. Except as otherwise directed by the Board, a director selected as a Committee member shall continue to be a member for as long as he or she remains a director or until his or her earlier resignation or removal from the Committee. Any member may be removed from the Committee by the Board, with or without cause, at any time.

Chair. The Chair of the Committee shall be appointed from among the Committee members by, and serve at the pleasure of, the Board, shall preside at meetings of the Committee and shall have authority to convene meetings, set agendas for meetings, and determine the Committee’s information needs, except as otherwise provided by the Board or the Committee. In the absence of the Chair at a duly convened meeting, the Committee shall select a temporary substitute from among its members to serve as chair of the meeting.

III. AUTHORITY

In discharging its role, the Committee is empowered to inquire into any matter it considers appropriate to carry out its responsibilities, with access to all books, records, facilities and personnel of the Organization and, subject to the direction of the Board, the Committee is authorized and delegated the authority to act on behalf of the Board with respect to any matter necessary or appropriate to the accomplishment of its purposes.

The Committee shall have the sole discretion to retain or obtain advice from, oversee and terminate any consultant, legal counsel or other adviser to the Committee and be directly responsible for the appointment, compensation, and oversight of any work of such adviser retained by the Committee, and the Organization will provide appropriate funding (as determined by the Committee) for the payment of reasonable compensation to any such adviser.

IV. COMMITTEE MEETINGS

The Committee shall meet as circumstances dictate. The Committee may also act by unanimous written consent of its members.

Notice of meetings shall be given to all Committee members, or may be waived, in the same manner as required for meetings of the Board. Any one or more members of the Committee may participate in a meeting of the

Committee by means of a conference telephone or similar communications equipment or by electronic video screen communication as long as all persons participating in the meeting can speak to and hear each other at the same time and each member can participate in all matters before the Committee, including, without limitation, the ability to propose, object to, and vote upon a specific action to be taken by the Committee. Participation by such means shall constitute presence in person at a meeting. A majority of the members of the Committee shall constitute a quorum for a meeting, and the affirmative vote of a majority of members present at a meeting at which a quorum is present shall constitute the action of the Committee. The Committee shall otherwise establish its own rules of procedure.

V. KEY RESPONSIBILITIES

The following responsibilities are set forth as a guide for fulfilling the Committee's purposes in such manner as the Committee determines is appropriate:

1. Act on behalf of the Board on matters that arise between scheduled Board meetings or when it is not practical or feasible for the Board to meet, to the extent permitted by applicable law and regulations, the certificate of incorporation, and the bylaws. However, the Committee shall not have the power or authority to act on behalf of the Board with respect to the following matters:
 - a. Adopting, amending or repealing any provision of the certificate of incorporation or bylaws;
 - b. Amending the Organization's mission;
 - c. Filling Board vacancies;
 - d. Changing the membership of, or filling vacancies in, any committee of the Board;
 - e. Adopting an agreement of merger or consolidation;
 - f. Authorizing the sale, lease or exchange of all or substantially all of the Organization's property and assets;
 - g. Authorizing the dissolution of the Organization or a revocation of a dissolution;
 - h. Fixing compensation of directors for service on the Board or any committee;
 - i. Appointing or terminating the appointment of the officers and directors; and
 - j. Amending or repealing any resolution of the Board which by its terms shall not be so amendable or repealable.³
2. [Consider whether other functions should be specifically reserved to the Executive Committee];
3. Call special meetings of the Board when required;

4. Report regularly to the Board on Committee findings, recommendations, and any other matters the Committee deems appropriate or the Board requests, and maintain minutes or other records of Committee meetings and activities;⁴ and
5. Undertake such other responsibilities as the Board may delegate or assign to the Committee from time to time.

ENDNOTES

¹ The New York Not-For-Profit Corporation Law (the “NPCL”) requires that authority delegated to committees of the board be set forth in the certificate of incorporation, bylaws, or resolutions of the board. *See* NPCL § 712(a).

² The NPCL requires that committees designated by the board consist of three or more directors; however, there is no such requirement applicable to other committees of the organization. *See* NPCL § 712(a).

³ *See, e.g.*, NPCL § 712(a).

⁴ IRS Form 990 requires disclosure of whether the organization contemporaneously documents, by any means permitted by state law, the meetings held by the board and any committee authorized to act on behalf of the board. The related instructions provide that “[d]ocumentation permitted by state law can include approved minutes, email, or similar writings that explain the action taken, when it was taken, and who made the decision. For this purpose, *contemporaneous* means by the later of (1) the next meeting of the governing body or committee (such as approving the minutes of the prior meeting) or (2) 60 days after the date of the meeting or written action.” *See* Form 990, Part VI, Lines 8a-b and related instructions. The NPCL requires that New York not-for-profits keep minutes of the proceedings of the board and any executive committee. *See* NPCL § 621(a).

Not-For-Profit Practice Group

Sample Finance and Investment Committee Charter

The board of a not-for-profit organization is typically responsible for the fiscal management of the organization, including the oversight of its present and historic finances and its planning and review of its finance and investment objectives. The board may wish to establish a finance and investment committee in order to assist with such responsibilities; however, it is not required by law to do so.

Whether a not-for profit organization would find it valuable to establish a finance and investment committee will depend on the financial resources and complexity of the organization. One size does not fit all – governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions of the charter that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate depending upon the circumstances.

Not-For-Profit Practice Group

[NAME OF NOT-FOR-PROFIT ORGANIZATION]

Finance and Investment Committee Charter

I. PURPOSES

The Finance and Investment Committee (the “Committee”) is appointed by the Board of Directors (the “Board”) of the _____ (the “Organization”) to assist the Board in fulfilling its oversight responsibilities relating to fiscal management by: (1) overseeing the management of organization-wide financial assets; (2) reviewing investment policies and strategies; (3) reviewing financial results; (4) ensuring the maintenance of an appropriate capital structure; and (5) reviewing and recommending an annual operating budget for approval by the Board.¹

In addition, in order to assist the Organization in the proper and prudent management of its financial resources, the Committee will ensure that the Organization employs personnel, systems and investment managers, capable of providing timely and accurate financial information to key decision-makers.

II. COMMITTEE MEMBERSHIP

Composition. The Committee shall consist of three or more members of the Board.² Except as otherwise directed by the Board, a director selected as a Committee member shall continue to be a member for as long as he or she remains a director or until his or her earlier resignation or removal from the Committee. Any member may be removed from the Committee by the Board, with or without cause, at any time.

Chair. The Chair of the Committee shall be appointed from among the Committee members by, and serve at the pleasure of, the Board, shall preside at meetings of the Committee and shall have authority to convene meetings, set agendas for meetings, and determine the Committee’s information needs, except as otherwise provided by the Board or the Committee. In the absence of the Chair at a duly convened meeting, the Committee shall select a temporary substitute from among its members to serve as chair of the meeting.

Financial Literacy. Committee members shall have a basic understanding of finance, accounting, investment management and fundamental financial statements.³

III. AUTHORITY

In discharging its role, the Committee is empowered to inquire into any matter it considers appropriate to carry out its responsibilities, with access to all books, records, facilities and personnel of the Organization and, subject to the direction of the Board, the Committee is authorized and delegated the authority to act on behalf of the Board with respect to any matter necessary or appropriate to the accomplishment of its purposes.

The Committee shall have the sole discretion to retain or obtain advice from, oversee and terminate any investment manager, consultant, legal counsel or other adviser to the Committee and be directly responsible for the appointment, compensation and oversight of any work of such adviser retained by the Committee, and the

Organization will provide appropriate funding (as determined by the Committee) for the payment of reasonable compensation to any such adviser.⁴

IV. COMMITTEE MEETINGS

The Committee shall meet on a regularly scheduled basis, at least [two] times per year and additionally as circumstances dictate.

The Committee shall establish its own schedule of meetings. The Committee may also act by unanimous written consent of its members.

Notice of meetings shall be given to all Committee members, or may be waived, in the same manner as required for meetings of the Board. Any one or more members of the Committee may participate in a meeting of the Committee by means of a conference telephone or similar communications equipment or by electronic video screen communication as long as all persons participating in the meeting can speak to and hear each other at the same time and each member can participate in all matters before the Committee, including, without limitation, the ability to propose, object to, and vote upon a specific action to be taken by the Committee. Participation by such means shall constitute presence in person at a meeting. A majority of the members of the Committee shall constitute a quorum for a meeting and the affirmative vote of a majority of members present at a meeting at which a quorum is present shall constitute the action of the Committee. The Committee shall otherwise establish its own rules of procedure.

V. KEY RESPONSIBILITIES

The following responsibilities are set forth as a guide for fulfilling the Committee's purposes in such manner as the Committee determines is appropriate:

1. Understand the Board's investment goals, risk tolerance level, and spending plans in order to develop an investment strategy to meet these goals;
2. Oversee the implementation of and compliance with, periodically review, and revise as appropriate the Organization's investment policy including but not limited to:
 - a. hiring and terminating investment managers;
 - b. regularly reviewing investment performance results;
 - c. setting investment objectives;
 - d. establishing performance objectives and benchmarks;
 - e. devising the asset allocation strategy;
 - f. portfolio rebalancing; and
 - g. restricting investments, as necessary;

3. Oversee the prudent management of the Organization's funds in compliance with applicable law, and specifically shall:
 - a. incur only investment fees and costs that are appropriate and reasonable in relation to the assets, the purposes of the Organization and the skills available to the Organization;⁵
 - b. consider the following factors when managing and investing the Organization's funds: general economic conditions; inflation or deflation; tax consequences; expected total return from income and appreciation; other resources of the Organization; the needs of the Organization to make distributions and to preserve capital; an asset's special relationship or special value, if any, to the charitable purposes of the Organization; the role that each investment or course of action plays within the overall investment portfolio of the Organization;⁶
 - c. make individual investment decisions not in isolation but rather in the context of the entire portfolio and as a part of an overall investment strategy having risk and return objectives reasonably suited to the Organization;⁷
 - d. diversify the Organization's investment portfolio unless the Committee reasonably determines that, because of special circumstances, the Organization is better served without diversification (in which case the Committee shall review the decision not to diversify as frequently as circumstances require, but at least annually)⁸; and
 - e. promptly make and carry out decisions concerning the retention or disposition of investments, or to rebalance a portfolio, in order to bring the portfolio into compliance with the Organization's purposes, investment policy, distribution requirements and legal requirements;⁹
4. Review and advise investment managers on a regular basis regarding the form, content and frequency of financial information necessary for the Organization to fulfill its responsibilities;
5. Direct management and investment managers, where necessary, to undertake longer-term financial planning to evaluate future financial needs;
6. Receive and review on a quarterly basis investment performance statements and financial statements (statement of financial position, income statement and operating statement) relating to the then current year-to-date as well as key financial benchmarks the Committee deems relevant from time to time. These investment performance statements and financial statements may be accompanied by a narrative highlighting any financial issues and, where necessary, actions related thereto;
7. Review annually an operating budget proposal by management for the next fiscal year to be approved by the Board;
8. Approve the financing of capital projects for approval by the Board where material or otherwise appropriate;
9. Review, approve, and generally oversee the Organization's participation in any joint ventures or similar arrangements. If the Organization does propose to enter into a joint venture, the Committee will approve a joint venture policy and maintain the proper documentation establishing the overriding exempt purpose of the joint venture;

10. Report regularly to the Board on Committee findings, recommendations, and any other matters the Committee deems appropriate or the Board requests, and maintain minutes or other records of Committee meetings and activities;¹⁰ and
11. Undertake such other responsibilities as the Board may delegate or assign to the Committee from time to time.

ENDNOTES

¹ The New York Not-For-Profit Corporation Law (the “NPCL”) requires that authority delegated to committees of the board be set forth in the certificate of incorporation, bylaws or resolutions of the board. *See* NPCL § 712(a). The NPCL also provides that an organization may delegate management and investment functions to its committees, officers, or employees. *See* NPCL § 554(f).

² The NPCL requires that committees designated by the board consist of three or more directors; however, there is no such requirement applicable to other committees of the organization. *See* NPCL § 712(a).

³ The NPCL requires that members of the investment committee that have special skills or expertise have a duty to use those skills or expertise in managing and investing the organization’s funds. *See* NPCL § 552(e)(6).

⁴ The NPCL requires that in managing and investing an institutional fund, an organization may incur only costs that are appropriate and reasonable in relation to the assets, the purposes of the organization and the skills available to the organization. *See* NPCL § 552(c)(1). An organization may delegate to an external agent the management and investment of an institutional fund to the extent that an organization could prudently delegate under the circumstances. *See* NPCL § 554.

⁵ The NPCL requires that an organization may incur only costs that are appropriate and reasonable in relation to the assets, the purposes of the organization and the skills available to the organization. *See* NPCL § 552(c)(1).

⁶ The NPCL requires that in managing and investing an institutional fund, the following factors, if relevant, must be considered: (a) general economic conditions; (b) the possible effect of inflation or deflation; (c) the expected tax consequences, if any, of investment decisions or strategies; (d) the role that each investment or course of action plays within the overall investment portfolio of the fund; (e) the expected total return from income and the appreciation of investments; (f) other resources of the organization; (g) the needs of the organization and the fund to make distributions and to preserve capital; and (h) an asset’s special relationship or special value, if any, to the purposes of the organization. *See* NPCL § 552(e)(1).

⁷ The NPCL requires that management and investment decisions about an individual asset must be made not in isolation, but rather in the context of the institutional fund’s portfolio of investments as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the fund and to the organization. *See* NPCL § 552(e)(2).

⁸ The NPCL requires that an organization diversify the investments of an institutional fund unless the organization prudently determines that, because of special circumstances, the purposes of the fund are better served without diversification. An organization is required to review a decision not to diversify as frequently as circumstances require, but at least annually. *See* NPCL § 552(e)(4).

⁹ The NPCL requires that, within a reasonable time after receiving property, an organization shall make and carry out decisions concerning the retention or disposition of the property or to rebalance a portfolio, in order to bring the institutional fund into compliance with the purposes, terms and distribution requirements of the organization as necessary to meet other circumstances of the organization and the requirements of Article 5-a of the NPCL. *See* NPCL § 552(e)(5).

¹⁰ IRS Form 990 requires disclosure of whether the organization contemporaneously documents, by any means permitted by state law, the meetings held by the board and any committee authorized to act on behalf of the board. The related instructions provide that “[d]ocumentation permitted by state law can include approved minutes, email, or similar writings that explain the action taken, when it was taken, and who made the decision. For this purpose, *contemporaneous* means by the later of (1) the next meeting of the governing body or committee (such as approving the minutes of the prior meeting) or (2) 60 days after the date of the meeting or written action.” *See* Form 990, Part VI, Lines 8a-b and related instructions. Additionally, for appropriations for expenditures or accumulations of endowment funds, the NPCL requires that the committee keep a

contemporaneous record describing the consideration given to various enumerated factors and keep a record of the action taken. *See* NPCL § 553.

Not-For-Profit Practice Group

Sample Strategic Planning Committee Charter

The board of a not-for-profit organization may wish to establish a strategic planning committee in order to periodically assess the performance of its mission and strategic plan; however, it is not required by law to do so.

Whether a not-for profit organization would find it valuable to establish a strategic planning committee will depend on the financial resources and complexity of the organization. One size does not fit all – governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions of the charter that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate depending upon the circumstances.

Not-For-Profit Practice Group

[NAME OF NOT-FOR-PROFIT-ORGANIZATION]

Strategic Planning Committee Charter

I. PURPOSES

The Strategic Planning Committee (the “Committee”) is appointed by the Board of Directors (the “Board”) of _____ (the “Organization”) to develop and monitor performance against the Organization’s mission and strategic plan.¹

II. COMMITTEE MEMBERSHIP

Composition. The Committee shall consist of [the chair of each of the committees of the Board], as well as officers and additional directors selected by the Board.² Except as otherwise directed by the Board, a director or officer selected as a Committee member shall continue to be a member for as long as he or she remains a director or officer or until his or her earlier resignation or removal from the Committee. Any member may be removed from the Committee by the Board, with or without cause, at any time.

Chair. The Chair of the Committee shall be appointed from among the Committee members by, and serve at the pleasure of, the Board, shall preside at meetings of the Committee and shall have authority to convene meetings, set agendas for meetings and determine the Committee’s information needs, except as otherwise provided by the Board or the Committee. In the absence of the Chair at a duly convened meeting, the Committee shall select a temporary substitute from among its members to serve as chair of the meeting.

III. COMMITTEE MEETINGS

The Committee shall meet on a regularly scheduled basis, at least [two] times per year and additionally as circumstances dictate.

The Committee shall establish its own schedule of meetings. The Committee may also act by unanimous written consent of its members.

Notice of meetings shall be given to all Committee members, or may be waived, in the same manner as required for meetings of the Board. Any one or more members of the Committee may participate in a meeting of the Committee by means of a conference telephone or similar communications equipment or by electronic video screen communication as long as all persons participating in the meeting can speak to and hear each other at the same time and each member can participate in all matters before the Committee, including, without limitation, the ability to propose, object to, and vote upon a specific action to be taken by the Committee. Participation by such means shall constitute presence in person at a meeting. A majority of the members of the Committee shall constitute a quorum for a meeting and the affirmative vote of a majority of members present at a meeting at which

a quorum is present shall constitute the action of the Committee. The Committee shall otherwise establish its own rules of procedure.

IV. KEY RESPONSIBILITIES

The following responsibilities are set forth as a guide for fulfilling the Committee's purposes in such manner as the Committee determines is appropriate:

1. Assess annually the Organization's success in achieving long-term funding and any program-related goals, as articulated in the Organization's mission and strategic plan adopted by the Board;
2. Review the mission and recommend to the Board amendments as the Committee deems appropriate;
3. Review the strategic plan and recommend to the Board modifications as the Committee deems appropriate, prior to the budget being developed for the next fiscal year;
4. Report regularly to the Board on Committee findings, recommendations and any other matters the Committee deems appropriate or the Board requests, and maintain minutes or other records of Committee meetings and activities;³ and
5. Undertake such other responsibilities as the Board may delegate or assign to the Committee from time to time.

ENDNOTES

¹ The New York Not-For-Profit Corporation Law (the “NPCL”) requires that authority delegated to committees of the board be set forth in the certificate of incorporation, bylaws or resolutions of the board. *See* NPCL § 712(a). The Non-Profit Revitalization Act of 2013, which amends the NPCL, provides that “committees of the corporation” (as opposed to committees of the board) have no authority to bind the board. *See* NPCL § 712(e).

² The NPCL requires that committees designated by the board consist of three or more directors; however, there is no such requirement applicable to other committees of the organization. *See* NPCL § 712(a).

³ IRS Form 990 requires disclosure of whether the organization contemporaneously documents, by any means permitted by state law, the meetings held by the board and any committee authorized to act on behalf of the board. The related instructions provide that “[d]ocumentation permitted by state law can include approved minutes, email, or similar writings that explain the action taken, when it was taken, and who made the decision. For this purpose, *contemporaneous* means by the later of (1) the next meeting of the governing body or committee (such as approving the minutes of the prior meeting) or (2) 60 days after the date of the meeting or written action.” *See* Form 990, Part VI, Lines 8a-b and related instructions. Additionally, for appropriations for expenditures or accumulations of endowment funds, the NPCL requires that the committee keep a contemporaneous record describing the consideration given to various enumerated factors and keep a record of the action taken. *See* NPCL § 553.

Not-For-Profit Practice Group

Sample Development Committee Charter

The board of a not-for-profit organization may wish to establish a development committee in order to assist with its fundraising and recruitment efforts; however, it is not required by law to do so.

Whether a not-for profit organization would find it valuable to establish a development committee will depend on the financial resources and complexity of the organization. One size does not fit all – governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions of the charter that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate depending upon the circumstances.

Not-For-Profit Practice Group

[NAME OF NOT-FOR-PROFIT-ORGANIZATION]

Development Committee Charter

I. PURPOSES

The Development Committee (the “Committee”) is appointed by the Board of Directors (the “Board”) of _____ (the “Organization”) to raise financial and other resources for the Organization by: (1) assisting Board members in their own fundraising efforts; (2) recruiting potential donors; and (3) assisting staff in planning fundraising events.¹

II. COMMITTEE MEMBERSHIP

Composition. The Committee shall consist of three or more members selected by the Board.² Except as otherwise directed by the Board, a director, officer or employee selected as a Committee member shall continue to be a member for as long as he or she remains a director, officer or employee or until his or her earlier resignation or removal from the Committee. Any member may be removed from the Committee by the Board, with or without cause, at any time.

Chair. The Chair of the Committee shall be appointed from among the Committee members by, and serve at the pleasure of, the Board, shall preside at meetings of the Committee and shall have authority to convene meetings, set agendas for meetings, and determine the Committee’s information needs, except as otherwise provided by the Board or the Committee. In the absence of the Chair at a duly convened meeting, the Committee shall select a temporary substitute from among its members to serve as chair of the meeting.

III. COMMITTEE MEETINGS

The Committee shall meet on a regularly scheduled basis, at least [two] times per year and additionally as circumstances dictate.

The Committee shall establish its own schedule of meetings. The Committee may also act by unanimous written consent of its members.

Notice of meetings shall be given to all Committee members, or may be waived, in the same manner as required for meetings of the Board. Any one or more members of the Committee may participate in a meeting of the Committee by means of a conference telephone or similar communications equipment or by electronic video screen communication as long as all persons participating in the meeting can speak to and hear each other at the same time and each member can participate in all matters before the Committee, including, without limitation, the ability to propose, object to, and vote upon a specific action to be taken by the Committee. Participation by such means shall constitute presence in person at a meeting. A majority of the members of the Committee shall constitute a quorum for a meeting and the affirmative vote of a majority of members present at a meeting at which

a quorum is present shall constitute the action of the Committee. The Committee shall otherwise establish its own rules of procedure.

IV. KEY RESPONSIBILITIES

The following responsibilities are set forth as a guide for fulfilling the Committee's purposes in such manner as the Committee determines is appropriate:

1. Assist and encourage Board members to reach out to potential donors [and make personally meaningful contributions of their own];
2. Endeavor to recruit new institutional donors;
3. Assist staff in planning and developing fundraising-related events, including benefits and other events designed to maintain existing donors and recruit new donors;
4. Report regularly to the Board on Committee findings, recommendations and any other matters the Committee deems appropriate or the Board requests, and maintain minutes or other records of Committee meetings and activities;³ and
5. Undertake such other responsibilities as the Board may delegate or assign to the Committee from time to time.

ENDNOTES

¹ The New York Not-For-Profit Corporation Law (the “NPCL”) requires that authority delegated to committees of the board be set forth in the certificate of incorporation, bylaws or resolutions of the board. *See* NPCL § 712(a). The Non-Profit Revitalization Act of 2013, which amends the NPCL, provides that “committees of the corporation” (as opposed to committees of the board) have no authority to bind the board. *See* NPCL § 712(e).

² The NPCL requires that committees designated by the board consist of three or more directors; however, there is no such requirement applicable to other committees of the organization. *See* NPCL § 712(a).

³ IRS Form 990 requires disclosure of whether the organization contemporaneously documents, by any means permitted by state law, the meetings held by the board and any committee authorized to act on behalf of the board. The related instructions provide that “[d]ocumentation permitted by state law can include approved minutes, email, or similar writings that explain the action taken, when it was taken, and who made the decision. For this purpose, *contemporaneous* means by the later of (1) the next meeting of the governing body or committee (such as approving the minutes of the prior meeting) or (2) 60 days after the date of the meeting or written action.” *See* Form 990, Part VI, Lines 8a-b and related instructions. Additionally, for appropriations for expenditures or accumulations of endowment funds, the NPCL requires that the committee keep a contemporaneous record describing the consideration given to various enumerated factors and keep a record of the action taken. *See* NPCL § 553.

Not-For-Profit Practice Group

Sample Public Relations Committee Charter

The board of a not-for-profit organization may wish to establish a public relations committee in order to assist with the development and realization of its communications strategies; however, it is not required by law to do so.

Whether a not-for profit organization would find it valuable to establish a public relations committee will depend on the financial resources and complexity of the organization. One size does not fit all – governance structures and processes should reflect and be tailored to meet the needs and circumstances of the particular organization.

Please note that various factors unique to a not-for-profit organization (including, among others, organizational structure, activities, life-cycle stage, funding mechanisms, and applicable requirements of local, regional or national law) may affect the provisions of the charter that should be addressed. Accordingly, while this sample includes standards and provisions that may be generally appropriate for some not-for-profit organizations, different and additional provisions may be appropriate depending upon the circumstances.

Not-For-Profit Practice Group

[NAME OF NOT-FOR-PROFIT-ORGANIZATION]

Public Relations Committee Charter

I. PURPOSES

The Public Relations Committee (the “Committee”) is appointed by the Board of Directors (the “Board”) of _____ (the “Organization”) to increase the profile of and awareness about the activities of the Organization towards target audiences such as potential donors and volunteers, and in the community generally.¹

II. COMMITTEE MEMBERSHIP

Composition. The Committee shall consist of three or more members selected by the Board.² Except as otherwise directed by the Board, a director, officer or employee selected as a Committee member shall continue to be a member for as long as he or she remains a director, officer or employee or until his or her earlier resignation or removal from the Committee. Any member may be removed from the Committee by the Board, with or without cause, at any time.

Chair. The Chair of the Committee shall be appointed from among the Committee members by, and serve at the pleasure of, the Board, shall preside at meetings of the Committee and shall have authority to convene meetings, set agendas for meetings, and determine the Committee’s information needs, except as otherwise provided by the Board or the Committee. In the absence of the Chair at a duly convened meeting, the Committee shall select a temporary substitute from among its members to serve as chair of the meeting.

III. COMMITTEE MEETINGS

The Committee shall meet on a regularly scheduled basis, at least [two] times per year and additionally as circumstances dictate.

The Committee shall establish its own schedule of meetings. The Committee may also act by unanimous written consent of its members.

Notice of meetings shall be given to all Committee members, or may be waived, in the same manner as required for meetings of the Board. Any one or more members of the Committee may participate in a meeting of the Committee by means of a conference telephone or similar communications equipment or by electronic video screen communication as long as all persons participating in the meeting can speak to and hear each other at the same time and each member can participate in all matters before the Committee, including, without limitation, the ability to propose, object to and vote upon a specific action to be taken by the Committee. Participation by such means shall constitute presence in person at a meeting. A majority of the members of the Committee shall constitute a quorum for a meeting and the affirmative vote of a majority of members present at a meeting at which a quorum is present shall constitute the action of the Committee. The Committee shall otherwise establish its own rules of procedure.

IV. KEY RESPONSIBILITIES

The following responsibilities are set forth as a guide for fulfilling the Committee's purposes in such manner as the Committee determines is appropriate:

1. Develop relationships with organizations and individuals external to the Organization, including media outlets, public relations firms and advertising agencies where appropriate, to increase awareness of the Organization, especially in donor and volunteer communities;
2. Report regularly to the Board on Committee findings, recommendations and any other matters the Committee deems appropriate or the Board requests, and maintain minutes or other records of Committee meetings and activities;³ and
3. Undertake such other responsibilities as the Board may delegate or assign to the Committee from time to time.

ENDNOTES

¹ The New York Not-For-Profit Corporation Law (the “NPCL”) requires that authority delegated to committees of the board be set forth in the certificate of incorporation, bylaws or resolutions of the board. *See* NPCL § 712(a). The Non-Profit Revitalization Act of 2013, which amends the NPCL, provides that “committees of the corporation” (as opposed to committees of the board) have no authority to bind the board. *See* NPCL § 712(e).

² The NPCL requires that committees designated by the board consist of three or more directors; however, there is no such requirement applicable to other committees of the organization. *See* NPCL § 712(a).

³ IRS Form 990 requires disclosure of whether the organization contemporaneously documents, by any means permitted by state law, the meetings held by the board and any committee authorized to act on behalf of the board. The related instructions provide that “[d]ocumentation permitted by state law can include approved minutes, email, or similar writings that explain the action taken, when it was taken, and who made the decision. For this purpose, *contemporaneous* means by the later of (1) the next meeting of the governing body or committee (such as approving the minutes of the prior meeting) or (2) 60 days after the date of the meeting or written action.” *See* Form 990, Part VI, Lines 8a-b and related instructions. Additionally, for appropriations for expenditures or accumulations of endowment funds, the NPCL requires that the committee keep a contemporaneous record describing the consideration given to various enumerated factors and keep a record of the action taken. *See* NPCL § 553.

Not-For-Profit Practice Group

Sample Not-For-Profit Board and Board Committee Self-Evaluation Form

Practice Note: This questionnaire is intended to assist in obtaining the viewpoints of directors regarding the structure and functioning of the board of directors (the “Board”) in order to assist the Board in its continuous efforts to improve its and its Committees’ effectiveness in governing the not-for-profit organization (the “Organization”). The questionnaire can be used in several ways: it can be distributed to directors for them to complete and return (anonymously if need be) to a Board Committee or Committee Chair or other person who then collates and reports back to the Board; it can be used as a guide for interviews of directors; or it can be used to facilitate a discussion by the Board directly. However it is used, evaluation is most effective if the full Board has an opportunity for candid and open discussion about any concerns raised or suggestions for areas of improvement.

Please rate the statements that follow on a scale of 1 to 5, with 1 indicating that there is room for improvement and 5 indicating an area of considerable strength for the Board. A score of 3 indicates neutrality, no opinion or no knowledge on the matter.

I. BOARD SIZE AND COMPOSITION

1. The Board has an appropriate number of directors. 1 2 3 4 5

2. The current Board composition reflects an appropriate mix of skills, experiences, backgrounds and diversity in relation to the needs of the Organization. 1 2 3 4 5

3. The Board makes appropriate use of the skills and experience of its members. 1 2 3 4 5

4. Please circle the three most important skills or attributes that directors should possess:
 - (a) business experience
 - (b) financial acumen
 - (c) ability to think strategically
 - (d) investment experience
 - (e) expertise in relation to governance
 - (f) fundraising skill and experience
 - (g) access to a network of donors

- (h) passion with respect to the Organization's mission
- (i) commitment to volunteerism
- (j) industry experience
- (k) understanding of ethical issues
- (l) understanding of political issues and engagement in the political process
- (m) ability to make a financial contribution
- (n) other (please specify): _____

Comments and suggestions:

II. BOARD EFFECTIVENESS AND AGENDA

- | | | | | | | |
|----|--|----------|----------|----------|----------|----------|
| 1. | Directors come to meetings prepared and ready to engage in discussion. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| 2. | Directors are attentive at and contribute to the discussion at Board meetings. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| 3. | Each director contributes effectively to the work of the Board. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| 4. | The Board considers and promotes the Organization's mission in its operations and decision-making. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| 5. | The Board devotes sufficient attention to: | | | | | |
| | (a) fundraising and other funding issues | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| | (b) whether the Organization is being properly managed | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| | (c) financial statements and processes | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| | (d) annual operating and capital plans and budget | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| | (e) long-term strategic plans and associated risks | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |

(f)	the Organization's governance framework and standards of conduct	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
(g)	periodic review of major projects	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
(h)	oversight of risk management systems, processes and activities (including vis-à-vis data privacy and cybersecurity, as applicable)	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
(i)	assessment of the Organization's performance against its strategic goals and plans	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
(j)	executive compensation decisions	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
(k)	management development and succession	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
6.	The Board is well-informed about the Organization's operations and financial condition.	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
7.	The Board regularly monitors performance against the Organization's strategic and business plans.	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
8.	The Board provides appropriate oversight relating to internal controls and compliance with applicable laws and regulations.	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
9.	The Board understands and assesses major risks relating to performance, and reviews (and adopts or causes to be adopted, as needed) measures to address and manage such risks.	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
10.	The Board is appropriately engaged in evaluating the performance of the [Executive Director/President] and determining his or her compensation.	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
11.	The Board appropriately communicates its goals, expectations, and concerns to the [Executive Director/President], and the [Executive Director/President] is responsive to such communications.	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
12.	The Board provides clear and well-understood policy direction to management and employees/volunteers.	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>

- | | | | | | | |
|-----|--|----------|----------|----------|----------|----------|
| 13. | The Board understands and respects that its role is to provide oversight and direction, and it does not unduly intrude into the day-to-day operations of the Organization. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| | | | | | | |
| 14. | Directors have sufficient access to officers and other members of the management team outside of Board meetings. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| | | | | | | |
| 15. | The Board has sufficient access to external advisors when needed. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| | | | | | | |
| 16. | The Board has adopted appropriate corporate governance and ethics policies and procedures. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| | | | | | | |
| 17. | Directors disclose personal interests in matters under review, and abstain from voting where appropriate, in accordance with the Organization's Conflict of Interest and Related Party Transaction Policy (as applicable). | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| | | | | | | |
| 18. | The Board effectively oversees the Organization's (i) Conflict of Interest and Related Party Transaction Policy and (ii) Whistleblower Policy (as applicable).. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| | | | | | | |
| 19. | Each director participates in the Organization's fundraising activities. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| | | | | | | |
| 20. | [The current expectation concerning director personal financial contributions is appropriate.] | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |

Comments and suggestions:

III. BOARD INFORMATION, MEETINGS AND LEADERSHIP

- | | | | | | | |
|----|--|----------|----------|----------|----------|----------|
| 1. | The Board holds an appropriate number of meetings. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
|----|--|----------|----------|----------|----------|----------|

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|-----|---|----------|----------|----------|----------|----------|
| 2. | Board meetings are of an appropriate length to cover the business to be conducted and enable directors to meet their responsibilities. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| 3. | Directors receive timely and accurate minutes, advance written agendas, meeting notices and other information in sufficient time to allow them to prepare for meetings. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| 4. | Directors receive clear, concise and relevant background materials to prepare in advance for meetings. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| 5. | Information provided to directors is brief but detailed enough to provide the desired information, and is analytic as well as informative. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| 6. | Meetings are conducted in a manner that fosters open communication, meaningful participation and timely resolution of issues. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| 7. | Board meeting time is appropriately allocated between Board discussion and management presentations or other speakers. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| 8. | Management presentations to the Board are of appropriate quality, length, and relevance. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| 9. | Directors have sufficient input into shaping the Board's agenda and priorities. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| 10. | The Board's leadership is effective. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |
| 11. | Executive sessions of the Board (without the Executive Director or other employees present) are held periodically. | <i>1</i> | <i>2</i> | <i>3</i> | <i>4</i> | <i>5</i> |

Comments and suggestions:

IV. BOARD COMMITTEES

1.	The current Committee structure, charters and composition assist the Board in the execution of its responsibilities and contribute to its efficiency and effectiveness.	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
2.	The Board and relevant Committees review (and update as needed) the charter of each Committee periodically.	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
3.	The Board's method for determining Committee composition and chairmanship is appropriate.	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
4.	The Committees communicate their activities, findings and recommendations to the full Board. In particular: <hr/> <hr/>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
5.	[The Audit Committee is effective in fulfilling its responsibilities.]	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
6.	[The Nominating and Governance Committee is effective in fulfilling its responsibilities.]	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
7.	[The Compensation Committee is effective in fulfilling its responsibilities.]	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
8.	[The Executive Committee is effective in fulfilling its responsibilities.]	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
9.	[The Finance and Investment Committee is effective in fulfilling its responsibilities.]	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
10.	[The Planning Committee is effective in fulfilling its responsibilities.]	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
11.	[The Development Committee is effective in fulfilling its responsibilities.]	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
12.	[The Public Relations Committee is effective in fulfilling its responsibilities.]	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>

13. [The [●] Committee is effective in fulfilling its responsibilities.] *1 2 3 4 5*

14. A committee that the Board shall consider creating is: _____.

Comments and suggestions:

Not-For-Profit Practice Group

Issues and Concerns for Directors of Troubled Not-For-Profit Organizations: Recognizing and Facing the Challenges

I. FIDUCIARY DUTIES

All directors owe certain fiduciary duties to their organizations, whether the organizations are for-profit or not-for-profit. For example, directors owe a duty of care, which requires them to be informed, attend board meetings, exercise independent judgment and act in good faith. Directors also owe a duty of loyalty, which requires them to act in the best interests of the corporation by avoiding conflicts of interest, observing confidentiality obligations and not abusing corporate opportunities for personal gain. See **Tab 3** for more information on fiduciary duties. In general, the directors of a solvent organization owe their duties to the organization and, in the context of a for-profit corporation, its shareholders, but not to creditors.¹ When an organization is insolvent, however, most courts recognize that fiduciary duties are owed to, or at least can be enforced by, creditors.² When an organization is merely in the “zone of insolvency,” a murky area that occurs when the organization cannot generate and/or “obtain enough cash to pay for its projected obligations and fund its business requirements for working capital and capital expenditures with a reasonable cushion to cover the variability of its business needs over time,”³ the law varies from jurisdiction to jurisdiction as to whether directors’ fiduciary duties expand to creditors.⁴

In the for-profit context, the fact that duties are owed to creditors upon insolvency typically means that directors should maximize the value of the corporation for its creditors and other parties in interest. In the not-for-profit context, however, a director also has a duty of obedience to the organization’s charitable mission.⁵ The challenge for a director of a New York not-for-profit organization that is insolvent or in the “zone of insolvency” is to balance the interests of the organization’s creditors against the interest of preserving and adhering to the organization’s charitable mission. Whereas many for-profit corporations are able to rely on their own operations to sustain them in times of crisis, many not-for-profit corporations rely on donations. Directors of not-for-profits need to be mindful of their organizations’ commitments and expenses when the organization’s solvency depends on future fundraising and donations.

Abandonment of an organization’s charitable mission is a last resort.⁶ Thus, in evaluating a proposed sale of the assets of a not-for-profit corporation, the Attorney General or a court will consider whether the sale will promote the interests of the organization.⁷ If a not-for-profit animal rescue organization proposes to sell its assets to a greyhound racing business, for example, a court may be unwilling to sanction the sale. Accordingly, directors of a troubled not-for-profit organization should be aware that they must keep the organization’s charitable mission at the forefront of their concerns when making decisions about the organization’s fate.

The consequences of breaching a fiduciary duty owed to a not-for-profit corporation are just as severe as the consequences for breaching a duty owed to a for-profit corporation. These consequences include personal liability, as well as the negative impact the breach will have on employees and on those who rely on the charitable purpose of the organization.

II. DEALING WITH CREDITORS

When a not-for-profit organization runs into trouble, often the first parties it will hear from are its creditors. Generally, creditors do not share concerns about an organization's charitable mission and may threaten various remedies to force a not-for-profit organization to pay its debts. Because not-for-profit organizations do not always have operations that generate cash, such organizations have limited sources of funds with which to satisfy their creditors. Borrowing money to repay creditors may not be an option for a troubled not-for-profit and, even if it is, the organization ultimately will have to generate the funds to repay its loans. Moreover, many donations and grants are restricted and cannot be used to repay lenders and creditors or finance general operations. The Attorney General or the courts may impose restrictions on an organization's ability to sell its real estate or even substantially all of its assets to pay its creditors if they see such sales as a threat to the organization's charitable mission.⁸ Thus, when a not-for-profit organization encounters financial difficulties, dealing with its creditors may prove to be complicated.

2.1 Accessing Charitable Donations to Pay Creditors

State law determines whether a not-for-profit organization will be able to access private donations to repay its creditors. This is so even if the not-for-profit organization is in bankruptcy.⁹ Under New York law, for example, a not-for-profit organization is bound to observe the restrictions donors place on their contributions.¹⁰ Notably, these restrictions also apply to interest or appreciation on donated funds if the gift instrument expressly specifies the donor's intent that the organization may not spend any accrued appreciation.¹¹

New York law requires the board of a not-for-profit corporation to cause the corporation to keep accurate accounts of directed donations separate and apart from other accounts.¹² New York law also requires the organization's treasurer to make an annual report to the organization's members (or board, as applicable) regarding the use of restricted assets and the income derived from them.¹³ Misuse of restricted funds (or failure to comply with restrictions) may give rise to personal liability for the directors, officers, or key employees¹⁴ or to an action for an order requiring return of the funds to the donor.¹⁵

Organizations may attempt to obtain releases of donor restrictions by (i) obtaining the donor's consent in a record,¹⁶ or (ii) applying to the supreme court (or the surrogate's court if the gift was by will), if "the restriction has become impracticable or wasteful, it impairs the management or investment of the fund, or if, because of circumstances not anticipated by the donor, a modification of [the] restriction will further the purposes of the fund."¹⁷ In evaluating whether to authorize a release of a donor restriction, a court must determine whether (i) the gift was charitable in nature, (ii) the language of the gift instrument indicates the donor intended a general, rather than specific, charitable intent, and (iii) the purpose for which the gift was created has failed.¹⁸ Even if a restriction is released, however, the released funds must be used for the charitable purposes of the corporation rather than general operating expenses.¹⁹

Similarly, under New York law, charitable gifts may not be considered property of a bankruptcy estate for distribution to creditors upon dissolution.²⁰ One New York court rejected the argument that payment of a charitable organization's debts is a proper charitable object.²¹ In so deciding, the court noted that donors who make general gifts to charitable organizations intended to further "the charitable purpose for which the entity was formed as set forth in its charter. In the case of hospital corporations, such purpose is deemed to be the actual and continued provision of acute patient care services rather than the satisfaction of creditors' claims."²²

A bankruptcy court in Massachusetts, however, issued a contrary decision allowing not-for-profit debtors to use restricted gifts to repay their creditors.²³ The court went as far as to hold that the debtor, which was liquidating

and had permanently discontinued its charitable operations, could still receive bequests intended for charitable purposes and apply them to satisfy the claims of its creditors. On appeal, however, the United States Court of Appeals for the First Circuit noted that it disagreed with the bankruptcy court's extension of the definition of "charitable purposes" to payment of creditors where the organization had discontinued its charitable operations.²⁴ The First Circuit's decision turned on the timing of the gift.²⁵ The court found that, because the bequest in question had vested when the hospital was still operating, the hospital could use the proceeds to pay its creditors for debts incurred while the organization was still operating.²⁶ Accordingly, the court affirmed the bankruptcy court's decision allowing the organization to use the bequest to pay its creditors' claims.

The United States District Court for the District of Columbia also affirmed a similar bankruptcy court decision.²⁷ However, the court's decision was based on the District of Columbia not-for-profit corporation law, which provided that a dissolving not-for-profit corporation must first satisfy its liabilities to creditors before any charitable gifts are returned or distributed to other charitable institutions. However, the D.C. statute at issue has since been superseded.²⁸ Now, when a not-for-profit is dissolved under D.C. law, "[p]roperty held in trust or otherwise dedicated to a charitable purpose shall not be diverted from its purpose by the dissolution of [the not-for-profit] corporation unless and until the corporation obtains an order of the" court.²⁹

2.2 Soliciting Additional Donations

As discussed above, troubled organizations may not be able to tap into restricted funds to pay creditors. Troubled organizations, however, may decide to go public with their troubles in an attempt to bring in new donations to pay creditors. Depending upon the organization and the circumstances, public awareness of the organization's financial troubles may stimulate or impede fundraising. If the organization decides to seek additional donations during a period of financial trouble, donors may be more inclined to restrict donations or seek assurances that their contributions will be used for charitable purposes rather than to pay creditors. Because New York courts will not infer that donors intended their gifts to be used to pay creditors, financially troubled New York organizations who solicit donations may want to consider setting up special unrestricted funds or creating a pledge form that explicitly allows the organization to use the gift in support of operations and/or restructuring.

2.3 Compelling Donors to Pay Their Pledges

Troubled organizations may also seek to bring in money by enforcing outstanding pledges for charitable contributions. Under New York case law, pledges are generally enforceable.³⁰ A pledge can create a unilateral contract between the pledgor and pledgee. The pledgor can be compelled to complete performance on the pledge if there was consideration for the pledge, such as creation of a named scholarship on the pledgor's behalf, or if the pledgee acted in substantial reliance on the pledge. Such reliance may include using a pledge agreement as collateral to obtain funds necessary to carry out the organization's charitable mission and make good on the promises the organization made to the donor in return for the pledge.

As discussed above, however, if the organization is seeking to compel payment on pledges or bequests for the purpose of paying its creditors, this analysis may change. Moreover, even if an organization may be able to compel payment on pledges, the organization should consider whether doing so would cause public relations problems whose costs would outweigh the benefits of receiving the pledges.

2.4 Member Contributions

Creditors may also seek payment from members of not-for-profit corporations. Such members will only be liable to the extent of (i) any unpaid portion of lawfully imposed initiation fees, membership dues, or assessments or (ii)

any other debts the members owe to the organization.³¹ Notably, however, a creditor may only bring an action to apply such liability to a debt of the corporation if, *inter alia*, the corporation is adjudged bankrupt or the creditor obtains a final judgment against the corporation that is unsatisfied.³²

2.5 Accessing Government Grants to Pay Creditors

A number of courts have held that federal grants remain the property of the federal government unless and until expended in accordance with the terms of the grant.³³ These courts arrived at their holdings by evaluating the specific restrictions placed by the government on each organization's use of grant funds.³⁴ According to one court, where a grant specifically provides that its proceeds may be used to pay a grantee's creditors, then such grant will be considered property of the grantee's bankruptcy estate.³⁵ But because many federal grants impose such "pervasive restrictions" on the identity of the grantee and the administration of the funds, the grantee cannot be considered to have a property interest in the grant.³⁶ Accordingly, such grants generally are not considered property of the bankruptcy estate.³⁷ Notably, even if an organization is able to treat the proceeds of government grants as property of the estate, the organization may have trouble securing future grants.

2.6 Selling Assets to Pay Creditors

Troubled not-for-profit organizations may decide to sell off assets in order to repay creditors. Although this seems straightforward, many states require board and/or court approval of significant asset sales. In New York, for example, a not-for-profit organization generally must secure the approval of two-thirds of its board before selling all or substantially all of its assets.³⁸ In addition, in New York, charitable corporations must seek approval from the court or the Attorney General before selling all or substantially all of their assets.³⁹ The court or Attorney General may require the assets to be distributed to organizations involved in substantially similar activities.⁴⁰ Moreover, because the Bankruptcy Code requires sales of property of a not-for-profit debtor's estate to be conducted in accordance with applicable nonbankruptcy law, not-for-profit organizations that file for bankruptcy protection will not be able to avoid state law provisions governing the sales.⁴¹ They may, however, be able to substitute what may be a more expeditious bankruptcy court approval for the requirement of obtaining state court approval.

The Bankruptcy Code also may affect sales of donor lists and other personally identifiable information. Section 363(b)(1) of the Bankruptcy Code provides that if the debtor "in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless" the sale is consistent with the privacy policy or a consumer privacy ombudsman is appointed and the court approves the sale.⁴² Even though this provision is not explicitly directed at not-for-profit corporations, not-for-profit organizations should be aware of the potential impact on a not-for-profit debtor's sale of donor lists where the debtor had previously indicated to its donors that their personally identifiable information would be kept private.

If a not-for-profit enters into any real estate transactions, it should be sure it complies with any special approval requirements imposed by the applicable not-for-profit statute. For example, in New York, a not-for-profit corporation may not purchase or dispose of real property where such property would, upon its purchase, constitute all or substantially all of the assets of the corporation, unless authorized by two-thirds of the entire board of directors (or a majority of the board if the corporation has more than 20 board members).⁴³ The statute does not address the consequences of the failure to comply with this provision, although, given the "strong-arm" powers of a debtor in possession or trustee in bankruptcy, lessors and counterparties to real estate transactions may face an

attempt to unwind any transaction for which the statutory approval was not obtained. It is also not clear what liability directors and officers could face for failing to comply with this provision.

III. DIRECTOR AND OFFICER LIABILITY

When an organization runs into trouble, any number of parties may seek to impose liability on the organization's directors and officers. These parties include (i) employees (*e.g.*, wrongful termination or Anti-Discrimination Act violations), (ii) outsiders (*e.g.*, vendors, other not-for-profits), (iii) the not-for-profit corporation itself (via derivative claims), (iv) other directors (for violation of fiduciary duties), (v) beneficiaries of the organization's mission, (vi) members, (vii) donors (*e.g.*, misuse of a restricted gift), (viii) state attorneys general, and (ix) other government officials (*e.g.*, IRS, Department of Labor). Directors may be held liable for any number of acts or omissions. Examples of such types of liability are provided below.

3.1 Employee Wages

Under New York law, directors and officers may be subject to criminal liability for failing to pay employee salaries as they come due.⁴⁴ In addition, directors and officers of an organization can be held personally liable if the organization fails to pay the government withholding taxes (income tax, social security, and Medicare taxes) deducted from employee wages.⁴⁵ Accordingly, if a not-for-profit organization encounters financial difficulties, the board should ensure that employee-related payments are not diverted to pay creditors.

3.2 Director Support of Prohibited Actions

Another common basis for imposing liability on not-for-profit directors is director support of actions prohibited by law. Section 719 of the New York Not-For-Profit Corporation Law (the "NPCL") makes directors jointly and severally liable for the benefit of creditors, members, or an organization's ultimate beneficiaries to the extent of any injury caused by the director's voting for or support of prohibited actions.⁴⁶ Examples of such prohibited actions include (i) self-dealing, (ii) redemption or payment of interest on capital certificates, subvention certificates, or bonds contrary to not-for-profit corporation law, and (iii) distribution of assets after dissolution of the corporation (a) in violation of New York's requirement that a not-for-profit corporation's assets be distributed to entities engaged in substantially similar activities or (b) without paying or adequately providing for all known liabilities of the corporation (excluding untimely claims). If a director is found to have discharged his or her duties to the organization pursuant to Section 717 of the NPCL, however, the director will not be held liable for supporting the prohibited action.⁴⁷ Section 717 requires directors and officers to discharge their duties "in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions."⁴⁸ Notably, Section 717 allows directors (and officers) to rely on information or reports prepared by officers or employees of the organization, counsel or other professional advisors, or a committee of the board, provided such directors (i) believe such committee or individuals are competent and reliable, and (ii) do not have knowledge that would make such reliance unwarranted.⁴⁹

3.3 Director Misconduct

Directors, officers, or key employees may be subject to liability for neglect or violation of their duties in managing corporate assets or for knowingly supporting or effecting unlawful conveyances of corporate assets.⁵⁰ Specifically, Section 720(a) of the NPCL provides:

- (a) An action may be brought against one or more directors, officers, or key employees of a corporation to procure a judgment for the following relief:
 - (1) To compel the defendant to account for his official conduct in the following cases:
 - (A) The neglect of, or failure to perform, or other violation of his duties in the management and disposition of corporate assets committed to his charge.
 - (B) The acquisition by himself, transfer to others, loss or waste of corporate assets due to any neglect of, or failure to perform, or other violation of his duties.
 - (2) To set aside an unlawful conveyance, assignment or transfer of corporate assets, where the transferee knew of its unlawfulness.
 - (3) To enjoin a proposed unlawful conveyance, assignment or transfer of corporate assets, where there are reasonable grounds for belief that it will be made.⁵¹

Section 720 applies to, *inter alia*, wrongful transfers of corporate assets by not-for-profit directors, officers, or key employees to themselves and unauthorized use of corporate funds for personal expenses.⁵²

Actions for misconduct may be brought by the state attorney general, the corporation itself, other directors, officers, a state law receiver, a bankruptcy trustee, judgment creditors, members (as a derivative action), or, if the organization's bylaws permit, by a party who contributed at least \$1,000 to the organization.⁵³

3.4 Excess Benefits and Compensation

Not-for-profit directors who receive or approve excess benefits are subject to liability under both state and federal law. Under New York law, not-for-profit corporations may elect or appoint officers and fix the reasonable compensation of directors and officers.⁵⁴ Although New York law provides little guidance to not-for-profit boards for setting director compensation,⁵⁵ the not-for-profit corporation statute generally requires a vote of the majority of the entire board to set officer compensation.⁵⁶ In one high profile case, the New York Court of Appeals considered a complaint for excessive compensation against the former chairman of the New York Stock Exchange. One of the counts of the complaint included a claim for violation of Section 715(f), which requires approval of the majority of the board to fix an officer's salary if not done in or pursuant to the bylaws.⁵⁷ The Court of Appeals dismissed the claim because it found that it would impose liability on directors without any proof that they were at fault. According to the Court, this was contrary to the general design of the not-for-profit corporation statute, which provides directors with a "business judgment" defense if they can show that they acted in good faith.⁵⁸ The decision suggests that proper authorization procedures may help protect directors against liability, while at the same time, technical violations of the statute will not automatically result in liability where the directors acted in good faith.

In addition to incurring liability for excess compensation under state law, not-for-profit directors may be subject to liability under federal tax law for excess benefits. The IRS may impose "intermediate sanctions" on not-for-

profit directors who receive or approve excess benefits. Intermediate sanctions are excise taxes of 25% on the amount of the excess benefit.⁵⁹ Even if an offending director pays the 25% tax, failure to return the excess benefit, with interest, may result in the imposition of an additional excise tax of 200% of the benefit.⁶⁰

In determining whether a benefit is excessive, the IRS will look to the market and to the compensation allowed at similar organizations.⁶¹ There is a rebuttable presumption that compensation is not excessive if it satisfies the following test: (i) it was approved in advance by an authorized body—such as a compensation committee—of individuals, none of whom had a conflict of interest with regard to the compensation decision at issue, (ii) the authorizing body relied on comparable data to set compensation (*i.e.*, compensation of similar individuals at comparable organizations), and (iii) the decision was adequately documented.⁶² Accordingly, not-for-profit directors should insist that their organizations implement compensation approval systems that will satisfy this test.

3.5 Limitations on Liability

Except with respect to director misconduct and director support of prohibited actions as described above and except with respect to actions brought by the attorney general or a beneficiary of a charitable trust, directors who do not receive compensation for their services cannot be held liable to any entity other than the corporation itself unless such directors were grossly negligent or intended to cause harm.⁶³ For more detail on protections available to not-for-profit volunteers, please refer to **Tab 3**.

Under New York law, except as otherwise provided in the applicable gift instrument, a not-for-profit corporation's board may delegate to its committees, officers or employees, the authority to act in place of the governing board in investment or reinvestment of institutional funds.⁶⁴ No director (whether for-profit or not) will be held liable for investment and reinvestment of institutional funds by, and for the other acts or omissions of, persons to whom authority is so delegated or with whom contracts are so made.⁶⁵ As such, directors who receive compensation for their services should strongly consider encouraging their boards to reasonably delegate investment authority to investment professionals.

3.6 Indemnification

The NPCL includes detailed indemnification provisions and also provides for contribution from other directors and/or recovery from other parties who knowingly received unauthorized distributions.⁶⁶ There are two types of indemnification under the NPCL: mandatory and permissive. A not-for-profit corporation may extend indemnification beyond restrictions of mandatory or permissive indemnification by including a provision in the corporation's bylaws or certificate, passing a board resolution, or entering into a separate agreement. However, indemnification of a director is not permissible under any circumstance if the director acted in bad faith, was deliberately and materially dishonest, or procured some illegal gain.⁶⁷

1. **Mandatory Indemnification.** Under New York law, not-for-profit corporations are required to indemnify their directors for expenses (including costs and attorney's fees) incurred in successfully defending a civil or criminal proceeding, whether brought by the corporation as a derivative suit or by a third party.⁶⁸ Although a director does not have to secure a victory on the merits of the litigation to be eligible for indemnification, mandatory indemnification is not available to a director who settles.⁶⁹ If a director is only partially successful in his or her defense, the corporation is still required to indemnify the director proportionately.⁷⁰ If a not-for-profit corporation fails to comply with its mandatory indemnification obligations, a director may apply to the court to order such indemnification.⁷¹

2. *Permissive Indemnification.* New York law also allows not-for-profit corporations to indemnify their directors even if directors (i) are unsuccessful in defending actions against them or (ii) decide to settle.⁷² Permissive indemnification is only allowed, however, if a director acted in good faith and reasonably believed that he or she was acting in the best interests of the corporation.⁷³ Additionally, if a director was involved in a criminal proceeding, he or she must have had no reasonable cause to believe that his or her conduct was unlawful.⁷⁴

Directors may be indemnified for settlement costs and reasonable expenses, including attorney fees and the costs of appeal, in both derivative suits and third-party actions, but directors may not be indemnified for judgments and fines in derivative suits. If a corporation declines to exercise permissive indemnification, but a director has met the conditions allowing permissive indemnification, then the director can petition the court to order the corporation to provide indemnification.⁷⁵

New York law sets forth three alternative procedures for corporations to follow when determining whether to indemnify directors who were unsuccessful in defending against third-party litigation or directors named as defendants in derivative actions.⁷⁶ These alternatives also apply to corporate approval of indemnification of ongoing expenses.⁷⁷ The alternatives are (i) authorization by a quorum of disinterested directors finding that the director in question has satisfied the standards for permissive indemnification (*i.e.*, acted in good faith, reasonably believed he or she was acting in the best interests of the corporation, and, in the case of a criminal proceeding, had no reasonable cause to believe his or her conduct was unlawful),⁷⁸ (ii) authorization by a quorum of disinterested directors who have relied on the opinion of an independent legal advisor that the director in question has satisfied the standards for permissive indemnification,⁷⁹ or (iii) authorization by a quorum of disinterested directors who have based their decision on the approval of the membership of the corporation (if the corporation has members) that the director in question has satisfied the standards for permissive indemnification.⁸⁰

3. *Director and Officer Insurance.* Under New York law, not-for-profit corporations may maintain directors and officers insurance (“D&O Insurance”) to indemnify the corporation or directors and officers as described above.⁸¹ If a court finds that a director has committed acts of deliberate and active dishonesty or the director has personally gained an illegal profit or advantage, the D&O Insurance may not be used to cover indemnification costs, but it may be used to cover defense costs.⁸² D&O Insurance may not be used to indemnify parties for punitive damages.

Modern D&O Insurance policies include three different components.⁸³ “Side A” coverage insures past, present, and future directors and officers in their respective capacities as individual insureds (including defense costs) against any insured loss arising from a claim for any actual or alleged wrongful act. “Side B” coverage insures the corporation for amounts it pays out to indemnify its directors and officers. “Side C” coverage insures the corporation against any loss arising from a claim against it for any actual or alleged wrongful act of the corporation. The causes of action covered by a D&O Insurance policy depend on its terms.

Courts generally engage in fact-intensive inquiries to determine whether the proceeds of an organization’s D&O Insurance policy are property of the debtor organization’s estate and thus subject to bankruptcy’s automatic stay, or whether they belong to directors and officers personally.⁸⁴ Courts have not decided the issue uniformly.⁸⁵ If such proceeds are found to be

property of the estate, a director seeking access to them would have to petition the bankruptcy court to lift the automatic stay.

Many modern D&O Insurance policies contain “insured vs. insured” exclusions. Conceived as a protection against collusive lawsuits, insured vs. insured exclusions prevent recovery against a policy where a lawsuit is brought by, or on behalf of, an insured party (for example, the organization) against another insured party (for example, a director). Most insured vs. insured exclusions, however, do not apply when the lawsuit is being brought derivatively, without the aid or assistance of an insured party.

4. *Removal of Directors.* Generally, directors of not-for-profit corporations may be removed for cause by a vote of members or directors, as long as a quorum of a majority of directors is present at the applicable meeting, and provided that (i) if the organization has cumulative voting, the number of votes cast against removing a director would not be enough to elect the director at an election of the entire board and (ii) in organizations in which directors are elected by classes or groups of an organization (*e.g.*, holders of bonds), then a director so elected may only be removed by vote of such class or group.⁸⁶ A director may also be removed for cause upon an action brought by the state attorney general or 10% of the corporation’s members requesting removal for cause.⁸⁷ A court may bar from reelection any director so removed.⁸⁸ A director may be removed without cause by a vote of an organization’s members if the organization’s certificate of incorporation or bylaws so permit.⁸⁹
5. *Resignation of Directors.* Generally, a director has the right to resign from a board and will not incur additional liability by doing so,⁹⁰ but resigning from the board will not absolve the director of liability for prior bad acts.⁹¹ Moreover, after resigning, the former director will retain certain fiduciary duties, such as confidentiality. Notably, however, some courts have held that a director cannot resign if doing so would harm the corporation or leave the interests of the corporation in jeopardy.⁹²

IV. WHAT TO DO IF YOUR ORGANIZATION ENCOUNTERS DIFFICULTIES

One of the most common problems for any organization that runs into trouble is denial. Not-for-profit organizations are no different, and, in fact, because not-for-profit organizations generally do not have the same onerous public reporting obligations that for-profit corporations do, the realization that an organization may be getting into financial trouble may be even more delayed. Further delay may aggravate the problem. Accordingly, not-for-profit directors who encounter trouble should act quickly to determine what course of action to take. Refer to **Tab 19** for a checklist of items to consider when a not-for-profit organization begins to experience financial difficulties. Among other things, the board of directors should determine whether special financial, restructuring, and/or legal advisors are needed and, if so, retain them.⁹³

Boards should also begin to consider whether the trouble is serious enough to warrant restructuring or going out of business altogether. If an organization decides to restructure, it may be able to effectuate the restructuring out of court. Sometimes, however, the organization will need the protections and powers that a court proceeding affords, whether under state law or under the federal Bankruptcy Code. The not-for-profit organization, with the assistance of its advisors, should review the federal and state law options available to it and determine, in light of all the circumstances, which option best addresses the needs and problems of the organization. Some of the reorganization and liquidation options available to not-for-profit organizations are summarized below. See also **Tab 18**.

4.1 Restructuring Options

1. *Out-of-Court Restructuring.* Organizations may renegotiate their debt obligations out of court. Out-of-court restructurings may be accomplished in conjunction with new financing secured on the basis of the corporation's goodwill and/or the threat of bankruptcy. An out-of-court restructuring may be beneficial because it may help a not-for-profit avoid the stigma of bankruptcy and certain other disadvantages of chapter 11. Out-of-court restructurings also demonstrate creditor confidence and involve fewer parties than bankruptcy cases. On the other hand, negotiating separately with every creditor constituency (as compared with a bankruptcy case in which all creditors are brought into the same forum) may be time consuming. In an out-of-court restructuring, it is often difficult to demonstrate to creditors that you are treating them fairly and that one creditor is not being treated less favorably than others. In addition, the powers available to a debtor in bankruptcy (*e.g.*, automatic stay, the ability to "cram down" on a dissenting class, and inducements available for postpetition financing) are not available in out-of-court restructurings. Without these powers, there is a potential for hold-outs and there is no guarantee that parties will come to a consensus regarding the restructuring.
2. *Chapter 11 Cases.* Chapter 11 of the Bankruptcy Code typically contemplates the continuation and financial and operational rehabilitation of a debtor's business, but an organization may also liquidate under chapter 11. A reorganization under chapter 11 permits an organization to continue its business operations in bankruptcy while a plan of reorganization is negotiated, confirmed, and consummated. The plan of reorganization describes how the debtor's liabilities will be addressed and discharged and lays out the debtor's plan for emerging from chapter 11 (typically as a viable enterprise). Among other things, a not-for-profit debtor will have to show that its plan for addressing liabilities is feasible under Section 1129 of the Bankruptcy Code, *i.e.*, not likely to be followed by liquidation. Unlike for-profit enterprises that utilize sales history to project future revenue, courts are hesitant to rely on previous donations as evidence of future fundraising ability when determining a plan's feasibility under Section 1129.⁹⁴ Courts reason that raising funds during or immediately after a bankruptcy case will be more difficult as donors are hesitant to give for the purpose of satisfying creditors.⁹⁵

Although chapter 11 is a relatively costly process and may pose a significant distraction to management, there are many advantages to reorganizing under chapter 11.⁹⁶ Foremost among these advantages is the "fresh start" to which a chapter 11 debtor is entitled. This fresh start results from the discharge of all of the debtor's debts under the Bankruptcy Code.⁹⁷ In addition, the bankruptcy court provides a single forum for resolving all issues concerning the debtor. This gives the debtor a certain amount of leverage and, as such, may enable the debtor to obtain better trade terms than it would in an out-of-court restructuring.

In addition, the Bankruptcy Code provides for an automatic stay of all actions against the property of the debtor's estate. Although the automatic stay is interpreted broadly and is designed to give a debtor a "breathing spell" from its creditors so it can focus on reorganizing, there are some limitations to the automatic stay.⁹⁸ Moreover, even where such limitations are not applicable, creditors may petition the bankruptcy court for relief from the stay. Nonetheless, the automatic stay is a valuable tool for debtors and is not available outside of bankruptcy.

Other tools available in bankruptcy include inducements to prospective financiers to assist debtors in securing financing during the course of their bankruptcy cases,⁹⁹ the power to assume,

assign, and reject executory contracts and unexpired nonresidential real property leases,¹⁰⁰ and the ability to sell assets free and clear of liens (subject to court approval).¹⁰¹ Chapter 11 debtors may also resort to “cramdown.” Cramdown involves confirming a chapter 11 plan over the dissent of a class or classes of creditors provided at least one class of creditors that is impaired by the plan accepts the plan and the court finds the plan does not discriminate unfairly and is fair and equitable.¹⁰² Specifically, to meet the criteria for cramdown, a chapter 11 plan may not violate bankruptcy’s “absolute priority rule,” which prevents junior interests from receiving distributions before senior interests have been paid in full.¹⁰³ In the for-profit context, this means, *inter alia*, that equity (and other junior classes) may not receive a distribution unless senior interests, *i.e.*, creditors, are paid in full. In the not-for-profit context, on the other hand, there is some question as to whether the absolute priority rule would prevent retention of control by members or controlling entities of the not-for-profit organization if creditors are not paid in full.¹⁰⁴ Courts have found that the absolute priority rule does not extend to members or controlling entities of non-profit organizations who are not receiving distributions.¹⁰⁵

In spite of all of these tools, a chapter 11 case certainly has disadvantages. First, the stigma of bankruptcy may negatively affect operations and impair fundraising (although for some organizations, bankruptcy may have the opposite effect and generate support and donations from the community). Moreover, a bankruptcy filing may give rise to increased scrutiny of the organization. Directors and officers may also be subject to more scrutiny after a bankruptcy filing. In addition, upon request of a party in interest, a bankruptcy court may appoint an examiner to examine the affairs of a debtor.¹⁰⁶ A court may also appoint a trustee to run the debtor’s estate in the event of fraud or gross mismanagement, or if the court determines the appointment of a trustee is in the best interests of the debtor’s constituents. When a court appoints a trustee, the management of the debtor loses control of the organization. Appointment of a trustee is relatively rare, however, especially in cases without fraud.

Chapter 11 can also be costly. Not only must the debtor retain professionals, but it also pays for the fees and expenses of professionals engaged by the creditors’ committee. One issue from the not-for-profit debtor’s perspective is whether a board member can also act as counsel for the debtor in its chapter 11 case. In this context, two issues arise: (i) whether the board member’s engagement as counsel results in a conflict of interest, and (ii) whether the services as counsel overlap with the board member’s regular board duties. In one bankruptcy court decision, the court answered both of these questions in the negative and approved the board member’s fee application.¹⁰⁷

The Bankruptcy Code also requires that the use, sale, or lease of such property must be in accordance with applicable nonbankruptcy law, and such use, sale, or lease may not be inconsistent with any relief granted under certain specified provisions of Section 362 of the Bankruptcy Code concerning the applicability of the automatic stay.¹⁰⁸

In addition, section 541(f) of the Bankruptcy Code provides that any property of a not-for-profit debtor’s estate may be transferred to an entity that is not such a corporation, but only under the same conditions that would apply if the debtor was not in bankruptcy. Similarly, section 1129(a)(16) provides that transfers of property under a not-for-profit debtor’s chapter 11 plan must be made in accordance with applicable nonbankruptcy law governing transfers of the property of not-for-profit corporations. Because most states have laws prohibiting not-for-profits from transferring their property to organizations that are not engaged in substantially similar

activities as the debtor, not-for-profit debtors will not be able to use bankruptcy law to circumvent state law transfer restrictions. To the extent, however, that state law permits such a transfer so long as the not-for-profit organization (typically, on notice to the state attorney general's office) obtains a court order permitting such transfer, approval of the Bankruptcy Court may be a more expeditious means of obtaining such relief.

3. *Involuntary Chapter 11 Cases.* Although the Bankruptcy Code does allow creditors of for-profit corporations to commence involuntary chapter 11 proceedings against them, creditors may not commence involuntary bankruptcy proceedings against not-for-profit corporations.¹⁰⁹ In addition, a court may not convert a voluntary chapter 11 case to a chapter 7 (liquidation) case unless the debtor so requests.¹¹⁰ A court may, however, dismiss the case altogether if cause exists for conversion.¹¹¹
4. *Prepackaged and Prenegotiated Chapter 11 Cases.* In a prepackaged chapter 11 case, the debtor negotiates a plan of reorganization with creditors before filing for bankruptcy. As a result, debtors in prepackaged chapter 11 cases typically emerge from bankruptcy more quickly than debtors in traditional chapter 11 cases. "Prepacks" may offer not-for-profits the best of both worlds. Because they are typically shorter than traditional chapter 11 cases, prepacks resemble out-of-court restructurings but allow debtors the use of many of the tools and advantages of chapter 11.

In addition to their relative speed, prepacks may also be preferable to ordinary chapter 11 cases because a prepack debtor will have obtained a favorable vote on its plan of reorganization before entering chapter 11. As such, a true prepackaged chapter 11 case is often less contentious than ordinary chapter 11 cases.

For a typical not-for-profit organization, however, a prepackaged chapter 11 case may be difficult to accomplish. In a bankruptcy case, entities whose claims are being affected (impaired) by a chapter 11 plan are entitled to vote to accept or reject the plan. The nature and extent of trade claims against a potential debtor can change on a daily basis. Thus, it is virtually impossible to conduct a prepetition solicitation of a class consisting of trade claims, as would be necessary if a prepackaged plan proposed to affect them. As a result, most true prepackaged cases are only used where the debtor wants to use the bankruptcy process to restructure one or more classes of claims (such as bank debt, publicly traded debt, or even tort claims), but might not be able to get the 100% approval that would be required under applicable non-bankruptcy law for such restructuring. The typical prepackaged plan provides for payment in full of trade claims so the debtor does not have to solicit the votes of trade creditors. This makes it difficult, though, for the debtor to use other powers of the Bankruptcy Code, such as the ability to reject contracts and leases, to its full advantage. Thus, where an operational – as opposed to a financial – restructuring is needed, it may not be possible to accomplish such restructuring through the means of a prepackaged plan.

Where a potential debtor does wish to alter rights of general, unsecured creditors and has the basic structure of an agreement for the restructuring that is supported by its major constituencies, it may pursue a "prenegotiated" plan. In this situation, the potential debtor negotiates the terms of the plan with its principal constituents (and, therefore, has a degree of confidence that they ultimately will vote to accept the plan), but the potential debtor has not conducted a formal solicitation of votes on the plan. The debtor commences its chapter 11 case and then follows the

same process as in a traditional chapter 11 case. The only real difference is that, having ironed out the terms of its restructuring prior to commencing its chapter 11 case, the debtor is likely to be able to emerge from chapter 11 more quickly than a traditional chapter 11 debtor.

4.2 Liquidation or Dissolution¹¹²

1. *Chapter 7 Cases.* Chapter 7 of the Bankruptcy Code contemplates an expeditious, orderly liquidation of all of the debtor's property. Under chapter 7, the debtor does not continue as an ongoing business enterprise. Instead, a trustee is appointed to take over the management of the debtor and convert the debtor's assets and properties to cash. The proceeds are then distributed to creditors in accordance with the priorities established in the Bankruptcy Code. Liquidation under chapter 7 has many advantages over dissolution under state law. For example, chapter 7 proceedings are generally relatively quick and inexpensive. In addition, many of the tools available in chapter 11 are available to a chapter 7 trustee, such as the automatic stay and the power to sell assets free and clear of liens. The disadvantages of chapter 7 include appointment of a trustee, who effectively replaces management and the board of directors of the debtor, and additional scrutiny on the organization's prepetition dealings. In addition, no discharge of prebankruptcy debts is available for a debtor that liquidates, rather than reorganizes.
2. *Non-Judicial State Law Dissolution.* Under New York law, non-judicial dissolution procedures differ depending upon the type of not-for-profit corporation¹¹³ and the amount of assets and liabilities the corporation has.¹¹⁴ If the corporation has no assets other than a reserve fund of \$25,000 or less to be used to pay (i) the costs of winding up the organization's affairs such as attorneys' and accountants' fees and (ii) liabilities less than \$10,000, then the corporation can use a streamlined procedure for dissolution.¹¹⁵

If, on the other hand, the corporation has assets and/or liabilities in excess of those described in the previous paragraph, the board must engage in a slightly stricter and more time consuming process.¹¹⁶ Pursuant to this process, among other requirements, the organization must seek approval of its Plan of Distribution from the Attorney General or the supreme court.¹¹⁷ The Plan of Distribution is the document that sets forth how the dissolving entity's assets will be distributed, first, to its creditors and then to organizations engaged in substantially similar activities.

Non-judicial dissolution is generally slower and more complex than liquidation under chapter 7 of the Bankruptcy Code. In addition, the attorney general typically becomes an integral component of the dissolution process. As such, the sale of a dissolving not-for-profit's assets is subject to review by the attorney general and may give rise to personal liability for directors if any of the sales are deemed to be inappropriate, *e.g.*, to organizations not engaged in substantially similar activities.¹¹⁸ Accordingly, non-judicial dissolution under state law may not compare favorably to liquidation under the Bankruptcy Code.

3. *Judicial State Law Dissolution.* New York law also provides for judicial dissolution, which is similar to non-judicial dissolution but involves more court oversight over the process.¹¹⁹ Judicial dissolution may be initiated by the attorney general in the case of fraud or related misconduct.¹²⁰ Generally, however, judicial dissolution in the liquidation context is initiated by an organization's board.¹²¹ In such a situation, a majority of the directors may present a petition for judicial

dissolution where the assets of a not-for-profit corporation are insufficient to discharge its liabilities or where dissolution will benefit the corporation's members.¹²²

4. *Receivership.* Receivership under state law involves court appointment of a receiver to run the not-for-profit corporation in order to pay off its debts.¹²³ In some ways a receivership is very similar to chapter 11, but receivership is typically thought of as a creditor remedy because the debtor loses control of the company. Receiverships may or may not result in the dissolution of the corporation. In New York, receivership law is largely considered obsolete.
5. *Assignment for the Benefit of Creditors.* Another rarely used wind down method under New York law is an assignment for the benefit of creditors. In an assignment for the benefit of creditors, a corporation assigns all of its nonexempt property to an assignee (typically a lawyer) who then liquidates the property (sometimes under court supervision) and distributes the proceeds pro rata to creditors.¹²⁴

ENDNOTES

¹ See *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, C.A.*, 930 A.2d 92, 99 (Del. 2007).

² Under Delaware law, the fiduciary duties are not owed directly to the creditors of an insolvent corporation, but creditors of the insolvent corporation are able to enforce the directors' duties to the corporation. The Delaware Supreme Court in *Gheewalla* clarified that while creditors of an insolvent Delaware corporation do not have direct claims against directors for breaches of fiduciary duties, creditors have standing to pursue such breaches derivatively on behalf of the corporation. See *id.* at 101–02. This is because creditors of an insolvent corporation “take the place of the shareholders as the residual beneficiaries of any increase in value,” and “the corporation’s insolvency makes the creditors the principal constituency injured by any fiduciary breaches that diminish the firm’s value.” *Id.* (internal citations omitted).

In contrast, under New York law, it appears fairly well-settled that the directors of an insolvent corporation owe fiduciary duties to creditors. This premise arises from a 1953 New York Court of Appeals case that is still cited as good law. *N.Y. Credit Men’s Adjustment Bureau, Inc. v. Weiss*, 110 N.E.2d 397, 398 (N.Y. 1953) (“If the corporation was insolvent at that time it is clear that defendants, as officers and directors thereof, were to be considered as though trustees of the property for the corporate creditor-beneficiaries.”); see also *Clarkson Co. v. Shaheen*, 660 F.2d 506, 512 (2d Cir. 1981), *cert. denied*, 455 U.S. 990 (1982) (citing *Weiss* in holding that directors of an insolvent New York corporation owe fiduciary duties to creditors, and creditors can sue to enforce those duties); *Hughes v. BCI Int’l Holdings*, 452 F. Supp. 2d 290 (S.D.N.Y. 2006) (holding that creditors had standing to assert a breach of fiduciary claim against the director of an insolvent New York corporation, because even though “[a]n officer or director does not owe a fiduciary duty to the creditors of a solvent corporation, the fact of insolvency causes such a duty to arise.”) (internal citations omitted); *C3 Media & Mktg. Grp., LLC v. Firstgate Internet, Inc.*, 419 F. Supp. 2d 419, 431 (S.D.N.Y. 2005) (same; dismissing claim by creditor against director for fraudulent inducement because the director made the statement prior to the company’s insolvency and did not therefore, at the time he made the statement, owe the creditor a fiduciary duty); *Econ. Dev. Growth Enter. Corp. v. McDermott*, 478 B.R. 123, 128 (N.D.N.Y. 2012) (citing *Hughes* in holding that directors of an insolvent corporation owe a fiduciary duty to preserve the assets of the corporation for the benefit of creditors); *Post-Confirmation Comm. of Unsecured Creditors v. Feld Grp., Inc. (In re I Successor Corp.)*, 321 B.R. 640, 659 (Bankr. S.D.N.Y. 2005) (“Once a corporation becomes insolvent, the fiduciary duties of corporate officers and directors also extend to creditors.”) (internal citations omitted); *Kittay v. Atl. Bank of N.Y. (In re Global Serv. Grp. LLC)*, 316 B.R. 451 (Bankr. S.D.N.Y. 2004) (Under New York law, “[o]nce insolvency enures, the fiduciary duties of corporate officers and directors also extend to creditors. As a result, the officers and directors owe duties to multiple constituencies whose interests may diverge. At this point, they have an obligation to the community of interest that sustained the corporation, to exercise judgment in an informed, good faith effort to maximize the corporation’s long-term wealth creating capacity”) (internal citations omitted); *Secs. Investor Prot. Corp. v. Stratton Oakmont, Inc.*, 234 B.R. 293, 334 n.27 (Bankr. S.D.N.Y. 1999) (“Under the New York law, a director’s fiduciary duty runs to creditors when the corporation becomes insolvent.”); cf. *Brenner v. Philips, Appel & Walden, Inc.*, 1997 WL 33471053, at *6 (S.D.N.Y. 1997) (“Under New York law, directors of an insolvent corporation have a duty not to divest the corporation of assets without affording creditors an opportunity to present and enforce their claims.”); *In re Mid-State Raceway, Inc.*, 323 B.R. 40, 58 (Bankr. N.D.N.Y. 2005) (“In the bankruptcy context, the directors owe duties not only to the corporation and its shareholders, they also owe a duty of good faith to the creditors.”).

The theory under which directors of insolvent New York corporations are found to have fiduciary duties to creditors is sometimes referred to as the “trust fund” doctrine. See, e.g., *Credit Agricole Indoseuz v. Rossiyskiy Kredit Bank*, 729 N.E.2d 683, 688 (N.Y. 2000) (By virtue of the trust fund doctrine, “the officers and directors of an insolvent corporation are said to hold the remaining corporate assets in trust for the benefit of its creditors.”); *Heimbinder v. Berkovitz*, 175 Misc. 2d 808, 816 (N.Y. Sup. Ct. 1998) (The fiduciary duty that corporate directors and officers owe to creditors derives “from the principle that the corporate assets constitute a trust fund for the benefit of creditors.”); *Roos v. Aloï*, 127 Misc. 2d 864, 868 (N.Y. Sup. Ct. 1985) (“As to the right of creditors, the courts of this state have, under certain circumstances, adopted the ‘trust fund’ theory. Under this theory, the assets of a corporation, in certain situations, constitute a trust fund for the benefit of creditors.”); see also *RSL Commc’ns PLC v. Bildirici*, 649 F. Supp. 2d 184, 202 (S.D.N.Y. 2009), *aff’d*, 412 Fed. App’x 337 (2d Cir. 2011), *cert. denied*, 132 S. Ct. 97 (2011) (“[T]he duty that directors owe to the creditors of an insolvent corporation

under New York law is defined primarily by the ‘trust fund doctrine.’”). Generally, however, “the application of the trust fund doctrine in New York has been for the purpose of imposing liability on corporate directors or transferees for wrongful dissipation of assets of an insolvent corporation, in actions later brought by court-appointed receivers, trustees in bankruptcy or judgment creditors,” rather than as a general source of fiduciary duties. *Credit Agricole*, 729 N.E.2d at 688. Moreover, a creditor’s remedy’s thereunder are “limited to reaching the asset which would have been available to satisfy his or her judgment if there had been no conveyance.” *Heimbinder*, 175 Misc. 2d at 816. Furthermore, the trust fund doctrine does not automatically create an actual lien or other equitable interest in corporate assets and may not be used by a general creditor to obtain a preliminary injunction in aid of a money judgment not yet obtained. *Credit Agricole*, 729 N.E.2d at 688.

The recognition by New York courts of broad director duties likely stems from the fact that even outside the context of insolvency, New York statutory law permits directors of a for-profit corporation to consider interests beyond those of the shareholders, including creditors. See N.Y. BUS. CORP. LAW § 717(b) (“In taking action, a director shall be entitled to consider, without limitation (1) both the long-term and the short-term interests of the corporation and its shareholders and (2) the effects that the corporation’s actions may have in the short-term or in the long-term upon any of the following: . . . (iv) the corporation’s customers and creditors.”). Interestingly, the New York Not-for-Profit Corporation Law does not have a completely analogous provision; it only provides that the board, subject to any specific limitations set forth in the applicable gift instrument, must take into account “(A) general economic conditions; (B) the possible effect of inflation or deflation; (C) the expected tax consequences, if any, of investment decisions or strategies; (D) the role that each investment or course of action plays within the overall investment portfolio of the fund; (E) the expected total return from income and the appreciation of investments; (F) other resources of the institution; (G) the needs of the institution and the fund to make distributions and to preserve capital; and (H) an asset’s special relationship or special value, if any, to the purposes of the institution,” when delegating investment management of institutional funds. See NPCL § 552(e). While this provision does not explicitly permit consideration of the not-for-profit corporation’s creditors, New York statutory law explicitly allows creditors to sue directors for certain actions that caused harm to the creditors in both the for-profit and not-for-profit spheres. See N.Y. BUS. CORP. LAW § 719(a) (“Directors of a corporation who vote for or concur in any of the following corporate actions shall be jointly and severally liable to the corporation for the benefit of its creditors or shareholders, to the extent of any injury suffered by such persons, respectively, as a result of such action” in various specified circumstances, including in the declaration of dividends, the purchase of shares, dissolution, and the making of loan to directors); NPCL § 719(a) (“Directors of a corporation who vote for or concur in any of the following corporate actions shall be jointly and severally liable to the corporation for the benefit of its creditors or members or the ultimate beneficiaries of its activities, to the extent of any injury suffered by such persons, respectively, as a result of such action,” in certain specified circumstances, including the unauthorized distribution of the corporation’s cash or property to members, directors or officers, certain redemptions, dissolution, or the making of loans to directors.). Finally, New York statutory law explicitly provides judgment creditors, receivers, and bankruptcy trustees the right to sue a director or officer “in the right of the corporation” for such director’s or officer’s wrongful conduct or violation of general duties. See *id.* § 720; N.Y. BUS. CORP. LAW § 720.

³ See *Pereira v. Cogan*, 294 B.R. 449, 521 (S.D.N.Y. 2003), *cert. denied*, 126 S. Ct. 2286 (2006) (applying Delaware law), *rev’d on other grounds*, *Pereira v. Farace*, 413 F.3d 330 (2d Cir. 2005).

⁴ Specifically, some courts have stated that the fiduciary duties of an organization’s directors expand to creditors even if the organization is not yet insolvent, if it is in the zone of insolvency. See, e.g., *Schnelling v. Crawford (In re James River Coal Co.)*, 360 B.R. 139, 170 (Bankr. E.D. Va. 2007) (applying Virginia law and stating that “[o]nce a corporation enters the zone of insolvency, the fiduciary duties owed by Directors extend also to the corporation’s creditors”). Under Delaware law, however, directors of a corporation in the zone of insolvency do not owe fiduciary duties to creditors, and it does not appear that creditors of such a corporation can even assert claims for breaches of fiduciary duty derivatively. Clearing up confusion from lower court opinions that suggested otherwise, the Delaware Supreme Court held definitively that directors of a solvent Delaware corporation operating in the zone of insolvency do not owe fiduciary duties to creditors and creditors may not assert direct claims for breaches of fiduciary duty against those directors. See *Gheewalla*, 930 A.2d at 101. Although the *Gheewalla* court did not say so explicitly, the thrust of its opinion appears to be that creditors of a corporation operating in the zone of insolvency cannot even bring claims derivatively on behalf of the corporation. *Id.* (“When a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to

discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation *for the benefit of its shareholder owners.*") (emphasis added).

No New York court has considered whether to adopt the Delaware court's reasoning in *Gheewalla*, and New York caselaw regarding directors' duties while an organization is operating in the zone of insolvency is scant. In *RSL Communications*, the United States District Court for the Southern District of New York concluded that "there is no support under New York law" for imposing upon directors an unlimited fiduciary duty of care with respect to the organization's creditors. *RSL Commc'ns PLC*, 649 F. Supp. 2d 184, 207 (S.D.N.Y. 2009). The *RSL Communications* court declined, however, to decide whether New York law would find that the trust fund doctrine applies while an organization is in the zone of insolvency and noted that the duties imposed by the trust fund doctrine are more "narrow" than a general fiduciary duty of care. *Id.* at 203 n.10. At least one New York court indicated that the trust fund doctrine does apply when a corporation is on the brink of insolvency though not yet technically insolvent. *See Weiss*, 110 N.E.2d at 398 ("If the corporation was then technically solvent but insolvency was approaching and was then only a few days away, defendants, as officers and directors, were, in effect, the trustees by statute for the creditors by virtue of section 60 of the General Corporation Law which obligated them to protect the trust res for the creditors and to account for waste in not obtaining full value for the res, if there was any waste by reason of their conduct."). Section 60 of the General Corporation Law, cited in *Weiss*, is the predecessor statute to N.Y. BUS. CORP. LAW § 720. *Purves v. ICM Artists, Ltd.*, 119 B.R. 407, 411 n.7 (S.D.N.Y. 1990). Prior to the *RSL Communications* decision, several federal district courts stated that New York law may impose upon an organization's directors fiduciary duties to its creditors while in the zone of insolvency. *See Stratton Oakmont, Inc.*, 234 B.R. at 334 n.27 (stating that no New York case holds that a board's fiduciary duties do not begin to run to creditors as soon as the corporation approaches insolvency); *Hallinan v. Republic Bank & Trust Co.*, 2007 WL 39302, at *8, n.29 (S.D.N.Y. 2007) (appearing to apply New York law and noting in dicta that "once a corporation enters the zone of insolvency, the directors owe fiduciary duties to the corporations' [sic] creditors, in addition to its shareholders) (internal citations omitted); *Fed. Nat'l Mortg. Assoc. v. Olympia Mortg. Corp.*, 2006 WL 2802092, at *6 (E.D.N.Y. 2006) (upholding claim against officers and directors for breach of fiduciary duty based on a theory that when a corporation enters the zone of insolvency, the officers and directors owe fiduciary duties to the corporation's creditors; the defendants, however, did not dispute that proposition but argued for the claim to be dismissed on other grounds); *Kittay v. Flutie N.Y. Corp. (In re Flutie N.Y. Corp.)*, 310 B.R. 31, 57 (Bankr. S.D.N.Y. 2004) ("Michael Flutie, much as a director of a corporation that is in the zone or vicinity of insolvency, owes a fiduciary duty not only to [the corporation] and any shareholders, but also to its creditors.") (applying New York law but citing cases applying Delaware law); *cf. Clarkson Co.*, 660 F.2d at 512 (rejecting proposition that directors only owe duties to creditors when "liquidation is imminent and foreseeable" or "it is clear that the corporation is no longer a going concern") (internal citations omitted). It should be noted that the *Flutie* court's reliance on pre-*Gheewalla* Delaware cases renders that decision of questionable persuasiveness. The issues of whether and to what extent directors of New York organizations owe fiduciary duties to the organization's creditors while it is operating in the zone of insolvency thus remain open questions. It is clear, at least, that, as is the case under Delaware law, creditors of New York corporations operating in the zone of insolvency have standing to sue the directors derivatively for breaches of fiduciary duties. *See In re I Successor Corp.*, 321 B.R. at 659 ("[C]laims based on the breach of fiduciary duty to creditors when a company is in the zone of insolvency are derivative of claims of breach of fiduciary duty to the company itself.").

⁵ The rationale for this duty is that donations to nonprofit organizations are made on the assumption and reliance that the charitable purposes of the organization will be fulfilled and the donations will not be used for other purposes. *Trs. of Rutgers Coll. v. Richman*, 125 A.2d 10 (N.J. Ch. 1956).

⁶ *See, e.g., Manhattan Eye, Ear & Throat Hosp. v. Spitzer*, 715 N.Y.S.2d 575, 595 (Sup. Ct. 1999) ("Embarkation upon a course of conduct which turns it away from the charity's central and well-understood mission should be a carefully chosen option of last resort. Otherwise a board facing difficult financial straits might find a sale of assets, and 'reprioritization' of its mission, to be an attractive option, rather than taking all reasonable efforts to preserve the mission which has been the object of its stewardship."); *In re United Healthcare Sys., Inc.*, 1997 WL 176574, at *5 (D.N.J. Mar. 26, 1997) (when analyzing an articulated business reason for a sale of a charitable institution's assets, the court must consider the fact that a debtor is a charitable institution and that the board of the non-profit organization has a fiduciary obligation to maintain the acute care facility in question); *In re Brethren Care of S. Bend, Inc.*, 98 B.R. 927, 935 (Bankr. N.D. Ind. 1989) (finding that a sale that would provide continued services to the debtor's patients/residents was a good business reason for the sale of a charitable

institution's assets). *But see Dennis v. Buffalo Fine Arts Acad.*, 15 Misc. 3d 1106(A) (N.Y. Sup. Ct. Mar. 21, 2007) (limiting the holding in *Manhattan Eye, Ear, & Throat Hospital* to sales of all or substantially all of the entity's assets, and determining that the same considerations do not apply when a charitable entity disposes of only a small portion of its assets in a way that does not depart from its corporate purposes).

⁷ NPCL §§ 511, 511-a. *See also Rogers Duell ex rel Rogers v. Ying-Jen Chen*, 42 Misc. 3d 1226(A) (N.Y. Sup. Ct. Feb. 11, 2014).

⁸ NPCL §§ 511, 511-a.

⁹ *In re Winsted Mem'l Hosp.*, 249 B.R. 588, 594 (Bankr. D. Conn. 2000) (the debtor's ability to pay creditors out of private donations "depends on whether, in the absence of the bankruptcy filing, the [debtor] would have been permitted to do so"); *see also* 11 U.S.C. § 363(d) (2010) ("The trustee may use . . . property [of the estate] only in accordance with applicable nonbankruptcy law applicable to the transfer of property by a debtor that is such a corporation or trust . . .").

¹⁰ NPCL § 513(b) (With certain exceptions, "the governing board shall apply all assets thus received to the purposes specified in the gift instrument . . . and to the payment of the reasonable and proper expenses of administration of such assets.").

¹¹ *Id.* § 553.

¹² *Id.* § 513(b).

¹³ *Id.* § 513(b).

¹⁴ *Id.* § 720(a). *See, e.g., Sergeants Benevolent Ass'n Annuity Fund v. Renck*, 796 N.Y.S.2d 77, 80 (1st Dep't 2005).

¹⁵ Generally, donors of restricted gifts who do not retain a property interest in their gifts do not have standing to sue for return of such gifts in the event donees fail to comply with the restrictions. *See, e.g., Steeneck v. Univ. of Bridgeport*, 1994 WL 463629, at *7 (Conn. Super. Ct. Aug. 18, 1994). Notably, however, one court granted a donor's request for return of its charitable gift directed toward building a school when the recipient mismanaged the school project and failed to meet the deadlines and other requirements of the gift instrument. *Dickler v. Cigna Prop. & Cas. Co.*, 1998 WL 126938, at *7 (E.D. Pa. Mar. 19, 1998); *see also Smithers v. St. Luke's-Roosevelt Hosp. Ctr.*, 723 N.Y.S.2d 426, 434 (1st Dep't 2001) (court-appointed estate administrator had standing to sue for recovery of allegedly misused restricted assets because she was enforcing her late husband's rights under his agreement with the hospital through specific performance of that agreement).

¹⁶ NPCL § 555(a).

¹⁷ *Id.* § 555(b). Section 555(b) also requires the not-for-profit institution to "notify the donor, if available, and the attorney general," and both parties "must be given an opportunity to be heard." *Id.* This provision requires that the funds be used to further the not-for-profit corporation's charitable purposes, rather than its operating expenses. *Id.* § 555(a) ("A release or modification may not allow a fund to be used for a purpose other than a charitable purpose of the institution."). In addition, section 555(c) permits a court to modify a restriction on the use or purpose of a fund that is or has become "unlawful, impracticable, impossible to achieve, or wasteful" as long as (i) the modification is "consistent with the purposes expressed in the gift instrument," (ii) the donor, if available, has been given notice of the application, and (iii) the attorney general has been notified and given an opportunity to be heard. *Id.* § 555(c). A not-for-profit corporation would be able to release or modify a restriction on the management, investment or purpose of a fund without court approval (but upon notice to the donor, if available, and 90-day notification to the attorney general) if (i) the restriction is "unlawful, impracticable, impossible to achieve, or wasteful," (ii) the fund has a total value of less than \$100,000, (iii) the fund is more than 20 years old, and (iv) the not-for-profit corporation "uses the property in a manner consistent with purposes expressed in the gift instrument." *Id.* § 555(d).

¹⁸ *In re Othmer*, 710 N.Y.S.2d 848, 851 (Sur. Ct. 2000) (stating that courts may free a charitable organization from restrictions and limitations attached to a donation where the following three conditions are satisfied: “(1) the gift or trust must be charitable in nature; (2) the language of the will or trust instrument, when read in the light of all attendant circumstances, must indicate that the donor demonstrated a general, rather than specific, charitable intent; and (3) it must be determined to the court’s satisfaction that the particular purpose for which the gift or trust was created has failed, or has become impossible or impracticable to achieve.”); *In re Edward John Noble Hosp. of Gouveneur*, 39 Misc. 3d 279 (N.Y. Sup. 2013) (applying the test for release of a donor restriction set forth in *Othmer* and modifying the terms of certain trusts to permit the principal of the trusts to be pledged as collateral, or, in the alternative, paid directly to not-for-profit hospital so that it could meet its financial commitments because the court found that the donors had a general charitable intent and the not-for-profit’s financial condition made it impracticable for it to both abide by the donors’ restrictions and satisfy the donors’ charitable intent).

¹⁹ NPCL § 555(f) (“This chapter shall not limit the application of the doctrines of cy pres and deviation.”).

²⁰ *See In re Kraetzer’s Will*, 462 N.Y.S.2d 1009, 1013 (Sur. Ct. 1983) (holding that a chapter 11 trustee of a bankrupt hospital could not distribute funds from a general gift to the hospital’s creditors because courts have uniformly held that the intention of a testator in making a general gift to a charitable corporation was the furtherance of the charitable purpose for which the entity was formed as set forth in its charter).

²¹ *Id.* at 1012 (The termination of a charitable organization’s “benevolent services causes the loss of a charity’s right to receive an absolute disposition or continued income, as the case may be, despite the prior vesting of the bequest or devise. Charitable gifts by will, being for public purposes, are impressed with a public trust imposed by the charter of each particular entity even if no express trust was created by the donor.”).

²² *Id.* at 1013 (internal citations omitted).

²³ *Boston Reg’l Med. Ctr., Inc. v. Reynolds (In re Boston Reg’l Med. Ctr., Inc.)*, 298 B.R. 1, 28 (Bankr. D. Mass. 2003) (donors to hospitals “do not contemplate that hospital personnel will apply donated monies directly to patients’ wounds. They understand full well that the hospital will use the funds to pay the employees and other creditors through whom it provides medical care to its patients.”).

²⁴ *Boston Reg’l Med. Ctr., Inc. v. Reynolds (In re Boston Reg’l Med. Ctr., Inc.)*, 410 F.3d 100, 111 (1st Cir. 2005) (“We decide only that, absent a contrary provision in the will or indenture of trust, a charitable organization that has ceased to perform any charitable work and that is incapable of redirecting new funds for charitable purposes is ineligible to receive a charitable bequest or gift.”).

²⁵ *Id.* at 114.

²⁶ *Id.*

²⁷ *Bierbower v. McCarthy*, 334 B.R. 478 (D.D.C. 2005) *appeal dismissed* 2006 WL 3086921 (D.C. Cir. Oct. 17, 2006); *cf.* NPCL § 1002-a.

²⁸ *See* D.C. CODE § 29-412.01 *et seq.*

²⁹ *Id.* § 29-412.05(c).

³⁰ *See, e.g., In re 375 Park Ave. Assocs.*, 182 B.R. 690, 694-95 (Bankr. S.D.N.Y. 1995) (citing numerous cases for the proposition that “New York courts have uniformly held that a charitable pledge constitutes a unilateral contract, that, when accepted by the charity by incurring liability in reliance thereon, becomes a binding obligation”).

³¹ NPCL § 517(b) (“A member shall be liable to the corporation only to the extent of any unpaid portion of the initiation fees, membership dues or assessments which the corporation may have lawfully imposed upon him, or for any other indebtedness owed by him to the corporation.”).

³² *Id.* § 517(b) (“No action shall be brought by any creditor of the corporation to reach and apply any such liability to any debt of the corporation until after final judgment shall have been rendered against the corporation in favor of the creditor and execution thereon returned unsatisfied, or the corporation shall have been adjudged bankrupt, or a receiver shall have been appointed with power to collect debts, and which receiver, on demand of a creditor to bring suit thereon, has refused to sue for such unpaid amount, or the corporation shall have been dissolved or ceased its activities leaving debts unpaid.”).

³³ *See, e.g., Westmoreland Human Opportunities, Inc. v. Walsh*, 246 F.3d 233, 244 (3d Cir. 2001) (“As we see it, a federal agency’s retention of pervasive restrictions on a grantee’s identity and manner of performance under a HUD-type grant program is inconsistent with the grantee’s assertion of a property interest in the grant relationship.”); *In re Joliet-Will County Cmty. Action Agency*, 847 F.2d 430, 433 (7th Cir. 1988) (“Practical considerations support characterization of these grant moneys as property of the grantors until expended in accordance with the terms of the grants.”); *U.S. Dep’t of Hous. & Urban Dev. v. K. Capolino Constr. Corp.*, No. 01 Civ 390, 2001 WL 487436, *4 (S.D.N.Y. May 7, 2001) (“In determining whether the United States has an interest in particular funds, that have been disbursed to a grantee, courts have considered whether the funds were dispensed according to conditions, whether the United States retains a reversionary interest in the funds, and whether the United States employs accountability procedures to ensure that the grants are being spent as directed.”); *Cnty Assocs. v. Novak*, 173 B.R. 824, 828 (D. Conn. 1994) (adopting the reasoning of *Joliet-Will*).

³⁴ *See Westmoreland*, 246 F.3d at 244.

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.* (“[I]f these controls are sufficiently extensive, *i.e.*, if, under the terms of the arrangement between the grantor federal agency and the grantee, the agency retains strict, pervasive, and minute oversight over the identity of the grant recipient and the manner of that recipient’s performance, the existence of such controls can demonstrate that the federal grantor agency’s interest in ensuring the effective administration of that program is weighty enough to exclude the grantee’s interest from § 541’s property definition.”).

³⁸ NPCL § 510(a)(1)-(2).

³⁹ *Id.* § 510(a)(3) (“If the corporation is . . . a charitable corporation . . . such sale, lease, exchange or other disposition shall in addition require approval of the attorney general or the supreme court.”).

⁴⁰ *See, e.g., Manhattan Eye, Ear & Throat Hosp. v. Spitzer*, 715 N.Y.S.2d at 597 (denying authorization to sell a not-for-profit hospital’s assets because sale would not promote the hospital’s charitable purpose); *In re Multiple Sclerosis Serv. Org. of N.Y., Inc.*, 505 N.Y.S.2d 841, 867 (1986) (standard for determining suitability of proposed recipient of dissolving not-for-profit’s assets under nonjudicial dissolution plan was whether the organizations were involved in substantially similar activities, not whether the recipient’s activities conformed as nearly as possible to those of the dissolving entity).

⁴¹ 11 U.S.C. § 363(d) (“The trustee may . . . sell, or lease . . . property [of the estate] . . . (1) [i]n the case of a debtor that is a corporation or trust that is not a moneyed business, commercial corporation, or trust, only in accordance with nonbankruptcy law applicable to the transfer of property by a debtor that is such a corporation or trust . . .”).

⁴² *Id.* § 363(b)(1).

⁴³ NPCL § 509. If the property to be purchased or disposed of does not constitute all or substantially all of the corporation's assets, then approval of the majority of the board is sufficient. *Id.* The term "entire board" is generally defined as "the total number of directors entitled to vote which the corporation would have if there were no vacancies." *Id.* § 102.

⁴⁴ See N.Y. LAB. LAW § 198-a; *Renzler v. D.F. White, Inc.*, 700 N.Y.S.2d 487, 488 (App. Div. 1999) ("Labor Law § 198-a provides a criminal penalty . . . against the officers and directors of a corporation.").

⁴⁵ See, e.g., *Carter v. United States*, 717 F. Supp. 188, 193 (S.D.N.Y. 1989) (holding not-for-profit directors and officers personally liable for failing to pay withholding taxes).

⁴⁶ NPCL § 719(a).

⁴⁷ *Id.* § 719(e) ("A director or officer shall not be liable under this section if, in the circumstances, he discharged his duty to the corporation under section 717 (Duty of directors and officers).").

⁴⁸ *Id.* § 717(a).

⁴⁹ *Id.* § 717(b) ("In discharging their duties, directors and officers, when acting in good faith, may rely on information, opinions, reports or statements including financial statements and other financial data, in each case prepared or presented by: (1) one or more officers or employees of the corporation, whom the director believes to be reliable and competent in the matters presented, (2) counsel, public accountants or other persons as to matters which the directors or officers believe to be within such person's professional or expert competence or (3) a committee of the board upon which they do not serve, duly designated in accordance with a provision of the certificate of incorporation or the bylaws, as to matters within its designated authority, which committee the directors or officers believe to merit confidence, so long as in so relying they shall be acting in good faith and with that degree of care specified in paragraph (a) of this section. Persons shall not be considered to be acting in good faith if they have knowledge concerning the matter in question that would cause such reliance to be unwarranted.").

⁵⁰ *Id.* § 720(a).

⁵¹ *Id.*

⁵² See, e.g., *United States v. King*, No. 2000 WL 362026, *10 (W.D.N.Y. Mar. 24, 2000).

⁵³ NPCL § 720(b).

⁵⁴ *Id.* § 202(a)(12).

⁵⁵ *Id.* § 715(d) ("Unless otherwise provided in the certificate of incorporation or the bylaws, the board shall have authority to fix the compensation of directors for services in any capacity.").

⁵⁶ *Id.* § 715(e) ("The fixing of salaries of officers, if not done in or pursuant to the bylaws, shall require the affirmative vote of a majority of the entire board unless a higher proportion is set by the certificate of incorporation or bylaws.").

⁵⁷ *Spitzer v. Grasso*, 11 N.Y.3d 64 (2008), *aff'd* 836 N.Y.S.2d 40 (1st Dep't 2007), *rev'g* *Spitzer v. Grasso*, 816 N.Y.S.2d 863 (Sup. Ct. 2006).

⁵⁸ *Id.* at 70–71 ("The plain language of these provisions reveals a legislative policy decision to provide officers and directors of not-for-profit corporations with the 'business judgment' protections afforded their for-profit counterparts. . . . By contrast, the four nonstatutory causes of action are devoid of any fault-based elements and, as such, are fundamentally inconsistent with the [statute]."). The Supreme Court had denied the motion to dismiss with respect to the Attorney General's statutory

and nonstatutory claims. The Appellate Division reversed and dismissed the nonstatutory claims on the basis that they violated the scheme put in place by legislature and thus exceeded the power of the Attorney General. The Court of Appeals affirmed. The remaining statutory claims were subsequently dismissed on the grounds that the stock exchange had ceased to be a not-for-profit corporation.

⁵⁹ I.R.C. § 4958; Lawrence M. Brauer, et al., *Intermediate Sanctions (IRC 4958) Update*, available at <https://www.irs.gov/pub/irs-tege/eotopice03.pdf>.

⁶⁰ Treas. Reg. §§ 53.4958-1(c)(1), 53.4958-1(c)(2).

⁶¹ AM. BAR ASS'N, COMM. ON NONPROFIT CORPS., *GUIDEBOOK FOR DIRECTORS OF NONPROFIT CORPORATIONS* 54, 83 (George W. Overton & Jeannie Carmedelle Frey eds., 2d ed. 2002).

⁶² Treas. Reg. § 53.4958-6.

⁶³ NPCL § 720-a (With certain exceptions, “no person serving without compensation as a director, officer or trustee of a corporation, association, organization or trust described in section 501(c)(3) of the United States internal revenue code shall be liable to any person other than such corporation, association, organization or trust based solely on his or her conduct in the execution of such office unless the conduct of such director, officer or trustee with respect to the person asserting liability constituted gross negligence or was intended to cause the resulting harm to the person asserting such liability.”).

⁶⁴ *Id.* § 514(a).

⁶⁵ *Id.* § 514(b) (“The governing board shall be relieved of all liability for the investment and reinvestment of institutional funds by, and for the other acts or omissions of, persons to whom authority is so delegated or with whom contracts are so made.”). Section 554 of the NPCL governs delegation of fund management and investment functions to external investment managers. *Id.* § 554. This section permits a not-for-profit corporation to delegate such functions to an external agent only “to the extent that an institution could prudently delegate under the circumstances” and provides that a not-for-profit corporation “shall act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances. . . in: (1) selecting, continuing or terminating an agent . . . ; (2) establishing the scope and terms of the delegation, including the payment of compensation . . . ; and (3) monitoring the agent’s performance and compliance with the scope and terms of the delegation.” *Id.* § 554(a). A not-for-profit corporation that complies with these prerequisites is protected from liability for the decisions or actions of the agent. *Id.* § 554(c).

⁶⁶ *Id.* §§ 719(d), 721–26.

⁶⁷ *Id.* § 721.

⁶⁸ *Id.* § 723(a) (“A person who has been successful, on the merits or otherwise, in the defense of a civil or criminal action or proceeding of the character described in section 722 shall be entitled to indemnification as authorized in such section.”).

⁶⁹ *Id.* §§ 722(c), 723(a); cf. *Waltuch v. Conticommodity Servs., Inc.*, 88 F.3d 87, 96 (2d Cir. 1996) (under Delaware corporate law, success “on the merits or otherwise” in the indemnification context extends to situations in which a defendant entered into a settlement gratis (*i.e.*, without having to pay anything)); *Hermelin v. K-V Pharm.*, 54 A.3d 1093, 1107 (Del. Ch. 2012) (stating that “where the *outcome* of a proceeding signals that the indemnitee has avoided an adverse result, the indemnitee has succeeded ‘on the merits or otherwise,’ and further inquiry into the ‘how’ and ‘why’ of the result is unnecessary.”) (internal citations omitted).

⁷⁰ NPCL §§ 722(c), 723(a).

⁷¹ *Id.* § 724(a) (“Notwithstanding the failure of a corporation to provide indemnification, and despite any contrary resolution of the board or of the members in the specific case under section 723 (Payment of indemnification other than by court award), indemnification shall be awarded by a court to the extent authorized under section 722 (Authorization for indemnification of directors and officers), and paragraph (a) of section 723.”).

⁷² *Id.* § 722(a).

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *Id.* § 724(a).

⁷⁶ *Id.* § 723.

⁷⁷ *Id.* § 723(c).

⁷⁸ *Id.* § 723(b)(1).

⁷⁹ *Id.* § 723(b)(2)(A).

⁸⁰ *Id.* § 723(b)(2)(B).

⁸¹ *Id.* § 726.

⁸² *Id.* § 726(b)(1) (“No insurance under paragraph (a) may provide for any payment, other than cost of defense, to or on behalf of any director or officer: (1) if a judgment or other final adjudication adverse to the insured director or officer establishes that his acts of active and deliberate dishonesty were material to the cause of action so adjudicated, or that he personally gained in fact a financial profit or other advantage to which he was not legally entitled.”).

⁸³ Richard M. Cieri & Michael J. Riela, *Protecting Directors and Officers of Corporations That Are Insolvent or in the Zone or Vicinity of Insolvency: Important Considerations, Practical Solutions*, 2 DEPAUL BUS. & COM. L.J. 295 (2004).

⁸⁴ See, e.g., *Gillman v. Cont’l Airlines (In re Cont’l Airlines)*, 203 F.3d 203, 217 (3d Cir. 2000) (“Other courts of appeals have disagreed as to the circumstances under which the proceeds of a D&O policy can be considered property of the estate, but the analysis has been fact-intensive in any event.”).

⁸⁵ Compare *id.* (“One cannot assume too quickly that the proceeds of this policy are property of the estate when the non-debtor D&Os, not the Continental Debtors, are the direct beneficiaries of the policy. We previously have recognized, albeit in a different context, that the proceeds from an insurance policy should be evaluated separately from the debtor’s interest in the policy itself.”) and *In re La. World Exposition, Inc.*, 832 F.2d 1391, 1401 (5th Cir. 1987); *In re Adelphia Commc’ns Corp.*, 298 B.R. 49 (S.D.N.Y. 2003) (“The problem here, however, is that the Bankruptcy Court assumed that the proceeds from the policies were assets of Adelphia’s estate and automatically subject to the stay under § 362(a)(3). As discussed above, that is not the case.”), with *Minoco Grp. of Cos. v. First State Underwriters Agency (In re Minoco Grp. of Cos.)*, 799 F.2d 517, 519 (9th Cir. 1986) (finding that D&O Insurance policy was property of the estate because “the estate [wa]s worth more with the policy than without the policy”); and *First Cent. Fin. Corp. v. Lipson (In re First Cent. Fin. Corp.)*, 238 B.R. 9, 16 (Bankr. E.D.N.Y. 1999) (“While a majority of courts consider a D&O policy estate property [citations omitted], there is an increasing view that a distinction should be drawn when considering treatment of proceeds under such policies.”); *In re W.R. Grace & Co.*, 475 B.R. 34, 80-81 (D. Del. 2012) (noting that the treatment of proceeds under an insurance policy depends on whether the proceeds are payable to the debtor or some other claimant).

⁸⁶ NPCL § 706(a), (c).

⁸⁷ *Id.* § 706(d) (“An action to procure a judgment removing a director for cause may be brought by the attorney-general or by ten percent of the members whether or not entitled to vote.”).

⁸⁸ *Id.*

⁸⁹ *Id.* § 706(b) (With certain exceptions, “if the certificate of incorporation or the by-laws so provide, any or all of the directors may be removed without cause by vote of the members.”).

⁹⁰ *Frantz Mfg. Co. v. EAC Indus.*, 501 A.2d 401, 408 (Del. 1985) (“Directors are also free to resign.”).

⁹¹ *7th Sense, Inc. v. Liu*, 631 N.Y.S.2d 835, 836 (App. Div. 1995) (lower court “properly determined that the purported resignation of defendant Victor Liu as an officer and director of corporate plaintiff 7th Sense for personal gain did not relieve him of his fiduciary obligations or liability for his acts of misappropriation”); *Dist. 65, UAW v. Harper & Row Publishers*, 576 F. Supp. 1468, 1483–84 (S.D.N.Y. 1983).

⁹² *See, e.g., Zeltner v. Henry Zeltner Brewing Co.*, 174 N.Y. 247, 252–53 (1903).

⁹³ The business judgment rule will protect directors who rely on their restructuring consultants, even if the restructuring consultants ultimately fail to deliver. *See Gottlieb v. Hicks*, 2007 WL 5312635 (C.D. Cal. Jan. 13, 2006).

⁹⁴ *In re Save Our Springs Alliance*, 632 F.3d 168, 172 (5th Cir. 2011) (“The bankruptcy court’s conclusion that past donations are not evidence of future fundraising ability is thus appropriate.”).

⁹⁵ *Id.*

⁹⁶ For more detail regarding chapter 11, see **Tab 18**.

⁹⁷ While an individual debtor is not entitled to a discharge of all of his or her prepetition debts, corporations are entitled to a full discharge unless they file plans of liquidation.

⁹⁸ *See, e.g., In re Bankr. Appeal of Allegheny Health, Educ. & Research Found.*, 252 B.R. 332 (W.D. Pa. 1999) (automatic stay did not apply to void state court injunction protecting not-for-profit organization’s charitable assets from its creditors because the state court litigation was subject to the police powers exception to the automatic stay; movants could seek injunctive relief pursuant to section 105 of the Bankruptcy Code, but existence of a viable exception to the stay would inform court’s decision of whether to enjoin a proceeding).

⁹⁹ *See* 11 U.S.C. § 364.

¹⁰⁰ The Bankruptcy Code also caps the damages claim of a landlord whose lease is rejected to approximately one year of rent. *Id.* § 502(b)(6). This can be very beneficial to debtors with long-term leases.

¹⁰¹ When assets are sold free and clear of liens, the liens attach to the proceeds of the sale. *See id.* § 363.

¹⁰² *Id.* § 1129(b).

¹⁰³ *In re Wabash Valley Power Ass’n, Inc.*, 72 F.3d 1305, 1313 (7th Cir. 1995), *cert. denied*, 519 U.S. 965 (1996) (the absolute priority rule “provides that, in order for a bankruptcy plan to be approved in the face of the refusal of an unsecured creditor to accept it (a “cramdown”), the holder of any claim or interest junior to that of the dissenter may not ‘receive or retain under the plan on account of such junior claim or interest any property.’”) (internal citation omitted).

¹⁰⁴ *Id.* at 1318-19.

¹⁰⁵ *Id.* (“The mere fact that the Members of [not-for-profit electric cooperative] are benefited by Wabash’s operation and might be disadvantaged by its demise also does not give them an ‘interest’ cognizable in bankruptcy. Employees, managers and customers, among others, always have an interest, in the broadest sense, in a corporation. The factor which distinguishes these parties from stockholders is not ‘control’ per se (managers, after all, have at least a limited control) but the ability to make use of that control to generate profits or to increase their own share of profits.”).

¹⁰⁶ A bankruptcy court is virtually required to grant an examiner for any reason if the debtor has aggregate debts in excess of \$5 million. *See* 11 U.S.C. § 1104(c). *But see In re Residential Capital, LLC*, 474 B.R. 112, 120–121 (Bankr. S.D.N.Y. 2012) (concluding that a bankruptcy court may deny appointment of an examiner in limited circumstances, even when the debtor has over \$5 million in fixed debts).

¹⁰⁷ *In re Am. Hous. Found.*, 2010 WL 3211691, at *3 (Bankr. N.D. Tex. Aug. 11, 2010).

¹⁰⁸ 11 U.S.C. § 363(d).

¹⁰⁹ *Id.* § 303(a).

¹¹⁰ *Id.* § 1112(c).

¹¹¹ *See, e.g., In re Sheehan Mem’l Hosp.*, 301 B.R. 777 (Bankr. W.D.N.Y. 2003) (because court could not convert case of not-for-profit debtor that defaulted on its ongoing obligations to chapter 7, it dismissed the case altogether).

¹¹² For a comparison of liquidation under state law or chapter 11 or chapter 7 of the Bankruptcy Code, see **Tab 18**.

¹¹³ As of July 1, 2014, there are two types of not-for-profit corporations under New York law: charitable and non-charitable corporations. NPCL § 201(b). Not-for-profit corporations formed prior to July 1, 2014 fell into one of four “types:” A, B, C, or D. Under the new section 201 of the Not-For-Profit Corporation Law, Type A corporations are deemed non-charitable corporations, while Types B, and C corporations are deemed charitable corporations. Type D corporations “formed for charitable purposes” are also deemed charitable corporations, while Type D corporations formed for any other purpose are deemed non-charitable corporations. Charitable corporations are defined as “any corporation formed, or . . . deemed to be formed, for charitable purposes.” *Id.* § 102(a)(3-a). Non-charitable corporations are defined as corporations formed under the NPCL other than charitable corporations.

¹¹⁴ *Id.* §§ 1001 *et seq.*

¹¹⁵ *Id.* § 1001(c).

¹¹⁶ *Id.* § 1001(d).

¹¹⁷ *Id.* § 1002(d)(3).

¹¹⁸ *Id.* § 719(a)(4) (directors who vote for distribution of assets after dissolution, without satisfying all known liabilities, are jointly and severally liable to the corporation to the extent of any injury suffered therefrom by creditors or members or the corporation itself).

¹¹⁹ *Id.* §§ 1101 *et seq.*

¹²⁰ *Id.* § 1101.

¹²¹ *Id.* § 1102(a).

¹²² *Id.* § 1102(a)(1)

¹²³ *See, e.g., id.* §§ 1201–18.

¹²⁴ *See, e.g., Compagnia Distribuzione Calzature, S.R.L. v. PSF Shoes Ltd.*, 613 N.Y.S.2d 931 (App. Div. 1994).

Not-For-Profit Practice Group

Warning Signs of Distress for Not-for-Profit Organizations

Not-for-profit directors should not “micro-manage” the daily activities of their organizations, but they should “micro-monitor” their organizations, keeping an eye out for warning signs of distress. Listed below are examples of several warning signs of distress for not-for-profit organizations.

I. DECLINING INCOME

Many not-for-profit organizations rely on donations and government/private grants to fund their operations so it is as important, if not more important, to monitor these external income sources as it is to watch operational revenue levels. A decline in any of the following can have a negative impact on the financial viability of the organization:

- A. Contributions
- B. Grants
- C. Dues
- D. Operational Revenue
 - 1. May be evidenced by excessive receivables outstanding for over 90 days
 - 2. May be caused by payment default by major customer

II. INCREASING OR DISPROPORTIONATELY HIGH EXPENSES

An increase in expenses can be a warning sign. Stable or disproportionately high expenses may also be a warning sign if income is decreasing or not increasing proportionately. Remember, the board may not be able to control income, but it can keep a lid on expenses.

III. CREDIT PROBLEMS

Not being able to pay debts as they come due is a bad sign and most likely signals entry into the “zone of insolvency.” (Is your not-for-profit overspending or does it have a cash flow problem? If you don’t know, then find out—not knowing can be a bad sign in and of itself.) Credit problems may be evidenced by:

- A. Excessive payables remaining unpaid for over 90 days
- B. Insufficient funds available to make deposits into trust funds such as employee withholding taxes
- C. Inability to fulfill long-term debt obligations
- D. Creditors not willing to advance credit

- E. Losing a major supplier that had performed under special credit terms
- F. Reduction in lines of credit
- G. Excessive re-negotiation of broken loan covenants

IV. ACCOUNTING ISSUES

- A. Unplanned auditor turnover
- B. Weak financial reporting, *e.g.*, financial statements are untimely, lack important detail or are too voluminous to be useful, external auditors fail to identify major financial issues, account analyses are delinquent, or basic financial controls are lacking
- C. Poor record keeping or inadequate financial records
- D. Lack of basic controls, such as perpetual inventory record keeping
- E. Significant discrepancies between actual and projected results of the prior three years

V. OPERATIONAL INEFFICIENCIES

A poorly run organization is bound for financial ruin regardless of how its financials look. Signs of operational inefficiencies include:

- A. Board micro-management
- B. Absentee board members
- C. Laissez-faire board attitudes or a stagnant board roster with long-tenured members selected by the CEO
- D. Excessive dependence on consultants
- E. High administrative overhead costs

VI. OTHER SIGNS

- A. Criminal investigations, extraordinary litigation, or other unusual events not ordinarily encountered in the industry
- B. Loss of key financial officers or key personnel
- C. Although cash management is always a concern, it may be a warning sign if cash management becomes a primary activity at the expense of traditional management functions
- D. Self-dealing by directors and/or others, excessive compensation

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Comparison of Liquidation Options

	CHAPTER 11	CHAPTER 7	STATE LAW
Complexity	<ul style="list-style-type: none"> Generally more complex and requires significant time, effort, and resources from the debtor. See <i>Appendix</i>. 	<ul style="list-style-type: none"> A court appointed trustee handles the liquidation of the estate. Management and the board of directors do not control the case. Can be relatively quick. 	<ul style="list-style-type: none"> State law dissolution can be complex and slow. There is a somewhat streamlined non-judicial dissolution process available to certain organizations that have assets and liabilities below a certain threshold, but even this process is not without its complexities. In a state law receivership, there is a complete loss of control. State receivership law is archaic and not commonly used.
Breathing Room	<ul style="list-style-type: none"> Automatic stay protects debtors from creditors. See <i>Appendix</i>. 	<ul style="list-style-type: none"> Automatic stay protects debtors from creditors. 	<ul style="list-style-type: none"> No automatic stay or analog in state law dissolution proceedings. If liquidating in a receivership, the appointment of a receiver functions like an automatic stay, but only for actions against property in the receivership. Property in the receivership will be liquidated and distributed pursuant to a court plan.

	CHAPTER 11	CHAPTER 7	STATE LAW
Contracts & Real Property Leases	<ul style="list-style-type: none"> • In chapter 11, a not-for-profit organization can deal with all of its contracts immediately rather than as they come due. • Section 502(b) of the Bankruptcy Code caps rejection damages for real property leases and certain other contracts that are rejected. • See <i>Appendix</i>. 	<ul style="list-style-type: none"> • Section 502(b) of the Bankruptcy Code caps rejection damages for real property leases and certain other contracts that are rejected. 	<ul style="list-style-type: none"> • State law dissolution does not offer special protections or powers vis-à-vis contracts and leases. • In a receivership, contracts and leases are maintained until rejected by the receiver.
Dealing with Creditors	<ul style="list-style-type: none"> • The debtor deals with individual creditors as well as statutory committees. • Because classes of creditors vote on whether to accept a plan of liquidation, approval of all creditors is not required. Furthermore, classes of creditors that do not approve of the plan may be “crammed down” if a single impaired class of creditors votes in favor of the plan. • See <i>Appendix</i>. 	<ul style="list-style-type: none"> • The chapter 7 trustee will deal with creditors. 	<ul style="list-style-type: none"> • Management deals with creditors in a state law dissolution. • If a receivership is established, the receiver deals with creditors who attempt to “prove” their claim in the court that has jurisdiction over the receivership.

	CHAPTER 11	CHAPTER 7	STATE LAW
Claims	<ul style="list-style-type: none"> Allowed claims are paid out pursuant to a plan of liquidation. See <i>Appendix</i>. 	<ul style="list-style-type: none"> Allowed claims are paid out pursuant to distributions made under the priorities specified in the Bankruptcy Code. Unless claims are subordinated under section 510 of the Bankruptcy Code (<i>i.e.</i>, by agreement or because of a creditor's inequitable conduct), priority claims are paid before unsecured claims. Claims for fines, penalties, or punitive damages and postpetition interest are only payable after all other claims are paid. 	<ul style="list-style-type: none"> If the company is dissolved under state law, any remaining assets will be distributed as part of a plan of distribution that must be approved by the court (or the attorney general, depending on the type of dissolution). Dissolution cannot be used to evade claimants and personal liability may attach for inappropriate distribution of assets. In a receivership, claims are paid out by the receiver upon liquidation of the assets.
Sources of Funds	<ul style="list-style-type: none"> A debtor may use the avoiding powers under the Bankruptcy Code to avoid certain prepetition transfers of property as preferences or voidable transactions. Under the Bankruptcy Code, assets can be sold free and clear of liens. The Bankruptcy Code provides incentives to lenders to provide financing during the course of bankruptcy. See <i>Appendix</i>. 	<ul style="list-style-type: none"> A chapter 7 trustee may use the avoiding powers under the Bankruptcy Code to avoid certain prepetition transfers of property as preferences or voidable transactions. Under the Bankruptcy Code, assets can be sold free and clear of liens. Debtor, absent court approval, will not continue to operate, so financing is typically not an issue. 	<ul style="list-style-type: none"> Prepetition transfers may be avoided under state fraudulent transfer law, but preferential transfers can only be avoided in bankruptcy. Assets can be sold free and clear of liens through specific action by the court in a receivership.
Employee Wages	<ul style="list-style-type: none"> Employee wages are given payment priority under the Bankruptcy Code. 	<ul style="list-style-type: none"> Employee wages are given payment priority under the Bankruptcy Code. 	<ul style="list-style-type: none"> Employees need to be paid before dissolution. In a receivership, the court may give employee wages priority.

	CHAPTER 11	CHAPTER 7	STATE LAW
Judicial and Other Oversight	<ul style="list-style-type: none"> The bankruptcy court and statutory committees. 	<ul style="list-style-type: none"> The bankruptcy court, although creditors may elect a creditors' committee under section 705 of the Bankruptcy Code. This option is rarely exercised. 	<ul style="list-style-type: none"> The state court, in a judicial dissolution, and the attorney general in a non-judicial dissolution (ultimately, court approval of a non-judicial plan of distribution is still required, unless the streamlined procedures for certain organizations that have assets and liabilities below a certain threshold are utilized). The court oversees a receivership (unless the receivership is created by an administrative agency, in which case the agency provides oversight).
Director and Officer Exposure	<ul style="list-style-type: none"> Chapter 11 plan may provide for limited releases for directors and officers. See <i>Appendix</i>. 	<ul style="list-style-type: none"> No mechanism for releasing directors and officers. Chapter 7 trustee is entitled to statutory protections. 	<ul style="list-style-type: none"> No additional protection for directors and officers. Personal liability may attach for improper distribution of assets in a state law dissolution.
Possible Loss of Control	<ul style="list-style-type: none"> For cause shown (e.g., fraud, dishonesty, incompetence, or gross mismanagement), the bankruptcy court may appoint a trustee to displace management. See <i>Appendix</i>. 	<ul style="list-style-type: none"> The debtor has no control after the chapter 7 trustee is appointed. 	<ul style="list-style-type: none"> If dissolving pursuant to state law, an organization should be able to retain control of the process, but either the court or the attorney general will play a significant role. If liquidating through a receivership, the receiver and the court control the process.

APPENDIX

ADVANTAGES & DISADVANTAGES OF CHAPTER 11

	ADVANTAGES	DISADVANTAGES
Breathing Room	<ul style="list-style-type: none"> Chapter 11 can provide a debtor with breathing room to deal with its creditors' claims. The debtor will no longer have to worry about creditors running to the court to secure judgments against it because the Bankruptcy Code provides for an automatic stay of all actions against a debtor, its property and property in its possession. 	<ul style="list-style-type: none"> The automatic stay is subject to certain limitations.
Contracts & Real Property Leases	<ul style="list-style-type: none"> In chapter 11, a not-for-profit organization can deal with all of its contracts immediately rather than as they come due. A chapter 11 case will afford a debtor with the ability to reject executory contracts and unexpired leases that are no longer advantageous. A rejection is treated as a breach of such contract or lease as of the time of the filing and rejection damages are paid in bankruptcy dollars. Contracts may also be assumed, or assumed and assigned to a third party. Section 502(b)(6) of the Bankruptcy Code caps rejection damages for real property leases that are rejected. 	<ul style="list-style-type: none"> Parties to contracts and leases that must be assumed may insist upon 100% payment of their past due amounts. Contracts not assignable outside of bankruptcy, such as intellectual property licenses, are also not assignable during bankruptcy. In certain jurisdictions, such contracts also may not be assumable.

	ADVANTAGES	DISADVANTAGES
Dealing with Creditors	<ul style="list-style-type: none"> Chapter 11 provides a single forum for dealing with all of the debtor's creditors at once. The protections of chapter 11 change the dynamics of negotiations with creditors. The debtor will not need unanimous approval of creditors to bind creditors to a plan of reorganization. In a chapter 11 case, a plan of reorganization is accepted by a class of creditors if at least 50% in number and two-thirds in amount of the creditors holding allowed claims (who actually vote) vote to accept the plan. Even if a class does not accept, the debtor will only need one impaired class of creditors voting to accept its plan of reorganization in order to confirm such plan. In other words, the debtor will have the ability to "cramdown" the unsecured creditors, even if they vote against the plan, as long as one of the secured creditor classes supports the plan. 	<ul style="list-style-type: none"> In order to protect creditors and the debtor's estate, court approval is required for most actions taken by the debtor during a bankruptcy. The court then becomes a forum for creditors to object to the debtor's course of action and the court will not approve conduct that will inequitably diminish a creditor's claim. For example, a debtor will need to obtain court approval to use cash collateral encumbered by a creditor.
Claims	<ul style="list-style-type: none"> A chapter 11 filing will bring all claims against the not-for-profit debtor to the forefront, thus enabling the debtor to achieve a true fresh start. Chapter 11 also flushes out contingent claims. A chapter 11 case provides a mechanism for treating all creditors equally and minimizes the risk of creditor holdouts seeking better treatment. 	<ul style="list-style-type: none"> May attract and motivate claimants who would have otherwise not pursued claims and claimants with contingent claims.

	ADVANTAGES	DISADVANTAGES
Sources of Funds	<ul style="list-style-type: none"> • A debtor may use the avoiding powers under the Bankruptcy Code to recover certain prepetition transfers of property as preferences or fraudulent transfers. • A chapter 11 filing could potentially lead to greater contributions from supporters of the not-for-profit organization. • The Bankruptcy Code offers incentives for financiers to provide financing during a reorganization. 	<ul style="list-style-type: none"> • It is unclear whether restricted funds, including endowments, and restricted donations may be available to satisfy creditors' claims. • Filing for bankruptcy may scare off donors.
Employee/Retiree Benefits Issues	<ul style="list-style-type: none"> • A chapter 11 case can provide a debtor with a forum for dealing with the termination of retiree benefits. The debtor can seek and obtain the bankruptcy court's blessing prior to taking any action with respect thereto. 	
Public Relations	<ul style="list-style-type: none"> • Ultimately, reorganizing may make the most business sense, despite a negative reaction from the public. A responsible reorganization will leave the reorganized not-for-profit entity more fit to pursue its mission and more deserving of public trust. 	<ul style="list-style-type: none"> • A chapter 11 filing will bring the debtor's troubles into the public eye. This could potentially impair a not-for-profit organization's ability to fundraise. On the other hand, in some situations, a chapter 11 filing could act as an impetus for donations.
Director and Officer Exposure	<ul style="list-style-type: none"> • Some chapter 11 plans of reorganization contain releases for director and officer actions taken during the course of the bankruptcy. 	<ul style="list-style-type: none"> • A chapter 11 case does not afford officers and directors with any greater protection from suit. • A chapter 11 filing may increase director and officer exposure to lawsuits by creditors.

ADVANTAGES		DISADVANTAGES
Costs of Chapter 11		<ul style="list-style-type: none"> The administrative costs of a chapter 11 case may be high. For example, the debtor is required to pay the creditors' committee's professional fees (lawyers, accountants and/or financial advisors) and the quarterly US Trustee Fees (fees range from \$250/quarter to \$10,000/quarter based on the debtor's disbursements).
Possible Loss of Control	<ul style="list-style-type: none"> The debtor usually runs the chapter 11 case. 	<ul style="list-style-type: none"> For cause shown (<i>e.g.</i>, fraud, dishonesty, incompetence or gross mismanagement), the bankruptcy court may appoint a trustee to displace management. The appointment of a trustee is atypical in a chapter 11 case.

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Checklist for Directors of Troubled Not-For-Profit Organizations

- Financial Management
 - Get a handle on the organization's cash position
 - Model quarterly cash flows
 - Analyze and assess the ability of the organization to generate enough cash to survive in the short-term
 - Evaluate whether any business areas require short-term capital to maximize long-term profit potential
 - Determine when the organization will have liquidity issues
 - Identify any areas of the organization that require immediate funding
 - Analyze liquidity and cash constraints
 - ◆ How much cash is restricted? Is the cash donor-restricted or board-restricted?
 - ◆ How can the organization free up cash (for example, via asset sales or securitization)?
 - Develop a calendar of key dates, including dates of major cash outlays, covenant dates, and cure periods
 - Review receivables to determine if current collection methods are sufficient
 - Review payables to determine "critical vendors"
 - Negotiate use of cash collateral with lenders and/or set minimum cash covenants
 - Identify alternative financing sources

- Identify vulnerabilities and determine how to keep them from becoming crises
- Formulate and communicate an action/restructuring plan:
 - How are you going to preserve the profitable operations and abort the unprofitable ones?
 - Can you resolve any operational issues outside of bankruptcy with the consent of the entities involved?
- Set goals and standards by which to judge the organization's financial situation and to evaluate performance (determine what success looks like for the organization and whether the organization is on track to achieve such success)
- Reassess the budget and determine whether to cut back operations
- Reassess loan covenants and determine whether to renegotiate
- Institute internal control procedures for:
 - Handling funds received and expended by the organization
 - Appropriate and timely financial reporting for board members and officers
 - Auditing the organization's financial statements
 - Evaluating staff and programs
 - Maintaining inventory records of real and personal property and their whereabouts
 - Implementing personnel and conflict of interest policies
 - Assuring compliance with requirements regarding restricted funds
- Board Composition (see *Tabs 1* and *5*)
 - Determine whether there are enough board members with adequate finance backgrounds and, if not, add some
 - Add management directors to the board
 - Establish special committees to address problem areas
- Review and Evaluate Advisors, Contracts and Leases, and Expenditures
 - Advisors – is it time for a new accountant and/or audit firm?
 - Contracts and leases

- What contracts and leases are necessary for the organization's continued survival?
 - Are there contracts or leases that could be eliminated?
- Capital expenditures
 - Where are the ongoing capital improvement projects?
 - Which capital expenditures are really needed?
 - Which capital expenditures can be terminated without incurring significant additional liabilities?
- Identify Key Creditor Constituencies and Potential Leverage
- Government Assistance
 - Consider whether assistance can or should be sought from state and/or local governmental authorities
- Employees
 - Determine whether the organization will be able to pay employee salaries in full and on time – failure to pay employee salaries may give rise to director liability
 - Ensure that withholding taxes are paid to the government in full and on time
 - Determine whether the organization will have to give two weeks' notice to employees it terminates
 - Communicate openly with employees
 - Watch for employee anger and productivity problems
- Develop a Communications Program
 - Consider how to maintain good relationships with donors while not misleading anyone about the organization's financial condition
 - Determine whether it makes sense to reach out to the Attorney General's office
 - Develop a communications strategy for other key constituents, including employees and donors

Right From The Start: Responsibilities Of Directors Of Not-For-Profit Corporations¹

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New York State Attorney General Eric T. Schneiderman is pleased to offer this booklet to assist current and future boards of directors 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.

Whatever their mission or size, all organizations should have policies and procedures established so that (1) boards 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.

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:

www.charitiesnys.com

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.

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 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.charitiesnys.com.
- 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.

3.1. 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.

3.2. 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 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.

3.3. 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, fundraising professionals, and other 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.

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 raising professional is extremely important. Establishing and following procedures for selection of a fund raising professional can avoid future problems. Such procedures should include:

- 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 professional 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. A reputable fund raising professionals should be happy to provide a potential client with the names, addresses and telephone numbers of some of its clients.
- Contacting some of the fundraising professional's other clients to see if those nonprofits 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 all written solicitations and scripts used by the fund raising professional, 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 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.

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:²

The Attorney General's Web site - <http://www.charitiesnys.com> - 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@ag.ny.gov or (212) 416-8401

For questions about fundraising professionals, contact:

charities.fundraising@ag.ny.gov or (518) 486-9797

Other Helpful Web Sites - links to other helpful web sites are posted on the Attorney General's web site:

www.charitiesnys.com

ENDNOTES

¹ Available at <http://www.charitiesnys.com/pdfs/Right%20From%20the%20Start%20Final.pdf>.

² 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.

Five Best Practices For Transparent Cause Marketing¹

Attorney General Eric T. Schneiderman

Charities Bureau

Across the United States companies generously support charities by promising donations from the sale of products or the use of services. These cause marketing campaigns have generated hundreds of millions of dollars in donations for charities, demonstrating that American business can do well by doing good. It is important, though, that consumers properly understand how their purchase or use of a product or service will benefit a charity. New York Attorney General Eric T. Schneiderman has developed these Best Practices to promote transparency in cause marketing and help ensure that consumers are properly informed and that charities receive what they have been promised.

1. CLEARLY DESCRIBE THE PROMOTION

Consumers should be able to easily understand *before* purchasing a product or using a service how doing so will benefit a charity. Advertisements, websites and product packaging used in the cause marketing campaign should clearly and prominently disclose:

- The name of any charity receiving a donation, as well as the mission of the organization if it is not readily apparent by the name
- The benefit the charity will receive from the purchase of a product or use of a service
- Any flat donation, any minimum amount guaranteed to the charity, or any maximum amount or other cap on the donation
- Any consumer action required in order for the donation to be made and any other restrictions on the donation
- The start and end dates of the campaign

These key details should be displayed together in a clear and prominent format and size, and in close proximity to, the text used in marketing the promotion. Disclosing information separate from the principal marketing of the campaign does not promote transparency or allow consumers to make informed decisions at the point of purchase or use.

To provide maximum transparency, consider using a “donation information” label on products or websites used in the promotion:

Donation Information

Name of Charity	ABC Cancer
Donation Amount	10 cents Per Purchase
Limitations on Donation	\$500,000 Maximum Donation
Dates of Promotion	10/1/12 through 12/31/12
More Information	<u>www.product.com</u>

2. ALLOW CONSUMERS TO EASILY DETERMINE DONATION AMOUNT

Vague terms like “profits” or “proceeds” are meaningless to consumers and prevent them from knowing how their purchase or use of a product or service will benefit a charity. Using and disclosing a fixed dollar amount—such as 50 cents for every purchase—in advertisements, marketing and product packaging will allow consumers to easily calculate their charitable donation. If it is not practicable to use a fixed dollar amount per item, use a fixed percentage of the retail purchase price.

3. BE TRANSPARENT ABOUT WHAT IS NOT APPARENT

A company’s or charity’s brand is its most valuable asset. Nothing can damage the reputation of that brand more than when consumers or donors believe they have been snookered. To maintain public trust and confidence, err on the side of caution, and disclose what might not be apparent:

- If a flat donation has been promised or paid to a charity, regardless of a consumer’s purchase or use of a product or service, be clear that consumer action will not result in a contribution to the charity
- If all or part of a donation to a charity is an in-kind contribution and not monetary, disclose the nature and amount of the in-kind contribution
- If a ribbon, color, logo or other indicia commonly associated with a charitable cause is used in a cause marketing campaign, clearly and prominently disclose whether the purchase of a product or use of a service will trigger a charitable donation
- If a purchase triggers a donation, but there is a cap on the amount to be donated to charity, do not saturate the market with products; limit the number of units distributed to a quantity that is reasonably expected to produce the maximum donation. On the other hand, if there is a minimum donation guaranteed, stock the shelves; ensure that enough products are distributed for sale so that the minimum amount can be sufficiently exceeded.

4. ENSURE TRANSPARENCY IN SOCIAL MEDIA

Increasingly, companies are partnering with charities through social media sites to promote their products and raise money for charities. Typically, companies will provide a donation if a Facebook user “likes” a company, or a Twitter user agrees to “follow” a company, or a Google+ user agrees to “+1” the company.

Companies and charities should be no less vigilant about transparency in social media cause marketing campaigns than they are in traditional product-based campaigns. Following the best practices described above, the terms of the social media campaign should be clearly and prominently disclosed as part of the campaign’s on-line marketing, including the amount that will be donated to charity per action, the name of the charity that is the beneficiary of the campaign, the dates of the campaign, and if there is a minimum or maximum amount to be donated.

Companies should also have a system in place to track donations in real-time for the duration of the campaign, to make transparent to users the progress of the campaign. When the campaign ends, it should either be discontinued entirely, or it should be clear that any subsequent actions will not result in a donation to a charity.

5. TELL THE PUBLIC HOW MUCH WAS RAISED

To further transparency, companies and charities should maintain on their websites key information about all active and recently closed cause marketing campaigns. At the conclusion of each campaign, the website should clearly disclose the amount of the charitable donation each campaign generated. Doing so will allow companies not only to showcase their generosity, but also to demonstrate their accountability to the public.

ENDNOTES

¹ Available at <http://www.charitiesnys.com/Five%20Best%20Practices%20for%20Transparent%20Cause%20Marketing.pdf>.

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