

Boards of Directors

What you don't know can hurt you:
Responsibilities and legal liabilities for Board
Members of Charitable Organizations.

Presented by:

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In the room

Is everyone on a board of directors? Which orgs?

Please ask questions as we go.

- IRS Circular 230 Disclosure: Any advice (but none is intended) relating to federal taxes that is contained in this presentation is not intended or written to be used, and cannot be used, for the purpose of (1) avoiding penalties under the Internal Revenue Code or (2) promoting, marketing or recommending to another party any plan or arrangement addressed herein.
- The material discussed today provides a general commentary on legal and governance matters. It was provided to assist in spotting issues, but it should not be relied upon as a substitute for legal advice as to any particular situation, activity or event. It is recommended that qualified legal counsel should be retained to advise your organization on any specific questions or issues you may have.

Agenda

- Community Expectations
- Role of the Board
- General Board duties and responsibilities
- Liability issues and protections
- Common problems

The Tax Exempt Sector

- Over 1.8 million tax-exempt organizations recognized by the IRS
- Tax-exempt organizations count for more than 15% of the nation's gross domestic product (increasing)
- Charitable giving totaled a record \$557.2 billion in 2023
- More than a quarter of the adults in the United States volunteered with a nonprofit organization in 2023. Many as volunteer directors.

Increased Oversight of Tax-Exempt Organizations

- “as to tax-exempt institutions, I expect scrutiny of this sector to intensify, not diminish.”-Commissioner of Internal Revenue Service, **Mark W. Everson**.
- “I know that this sector has had its encounters with abuse and misuse. The combination of tax-exemption and the over \$3 trillion of assets held by nonprofits seems too compelling a prize to resist for some. The IRS has fought hard to protect the sector against corruption, and the diversion of tax-exemption’s public purposes to mere private benefit. *We will continue to insist that the sector be squeaky-clean, and that the high ideal of public benefit that underlies tax-exemption is honored.* – Commissioner of Internal Revenue Service, **Douglas Shulman**.
- “We’re touching a significant number of organizations and a significant cross section of different types and sizes of organizations, charities need to be aware.”
 - **Lois G. Lerner, Director of IRS Exempt Organizations office**

General Responsibilities for a Non-Profit Corporation Board of Directors

- 1) The Board has primary governance responsibility for the Organization.
- 2) The Board sets the mission, vision, strategy, and goals for the Organization.
- 3) The Board members also should bring perspective of the community to the Organization.
 - Beware of situations in which different board members are focused only on “their issue”.

General Responsibilities of a Non-Profit Corporation Board of Directors

4) Enhance the Organization's standing with the public.

- Educate the public and be a cheerleader for its programs.
- Let the public know about the success that the Organization has achieved, its importance to the college and its students.
- Also let them know about the Organization's future goals and needs.

General Responsibilities of a Non-Profit Corporation Board of Directors continued

- 5) Ensure that the Organization's programs are consistent with its mission.
- The Board must continually determine effectiveness of its programs.
 - Recognize that prudent planning requires a careful review of the past actions of the Organization:
 - What were the past goals?
 - Were they met? If not, what must be changed?

General Responsibilities of a Non-Profit Corporation Board of Directors continued

6) The Board is responsible for setting policy and the procedure for management to carry out the objectives of the Organization.

- Board members must actively participate in the planning process and assist management in implementing and monitoring programs, mission and goals.
- Board members must oversee the financial records of the Organization to ensure that the Organization has adequate resources to perform its mission or to meet the goals that have been established.

General Responsibilities of a Non-Profit Corporation Board of Directors continued

7) The Board of Directors selects and oversees the Executive Director for the Organization.

- Oversight can be difficult when the Executive Director is an employee of a related or affiliated organization.
- Appropriate agreements regarding oversight and direction must be in place between the related organizations to avoid any employment law problems.

8) The Board is responsible for the legal and ethical integrity of the Organization and must establish and enforce policies to maintain legal and financial oversight.

Board Member Legal Responsibilities

- Duty of care
- Duty of loyalty
 - Duty of obedience

Duty of Care

- Good Faith judgment that the decision is in the best interests of the charity.
- Courts use the “Reasonably Prudent Person” standard for evaluation of decisions.

Duty of Care

The Duty of Care requires that a director:

- (a) be informed;
- (b) participate in the decision making process; and
- (c) exercise due care when making a decision.

Montana Statute regarding Duty of Care

35-2-416. General standards for directors. (1) A director shall discharge the duties as a director, including the director's duties as a member of a committee:

(a) in good faith;

(b) with the care an ordinarily prudent person in a similar position would exercise under similar circumstances; and

(c) in a manner the director reasonably believes to be in the best interests of the corporation.

Montana Statute regarding Duty of Care (things that help)

- 35-2-416. General standards for directors. (2) In discharging the duties, **a director is entitled to rely** on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by:
 - (a) one or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the matters presented;
 - (b) attorneys, public accountants, or other persons with regard to matters that the director reasonably believes are within the person's professional or expert competence;
 - (c) a committee of the board of which the director is not a member, as to matters within its jurisdiction, if the director reasonably believes the committee merits confidence; or
 - (d) in the case of religious corporations, religious authorities, ministers, priests, rabbis, or other persons whose position or duties in the religious organization the director believes justify reliance and confidence and whom the director believes to be reliable and competent in the matters presented.

Best Practices to meet the Duty of Care.

1. The Board should have regularly scheduled meetings.
2. Board members should be prepared for board meetings and receive complete board packets in advance of the meeting.
3. The Board members should receive and review monthly or quarterly reports regarding the operation of the Organization.
4. The Board should follow set rules of procedure when making decisions.
5. Board members must regularly attend meetings. The Board should establish minimum attendance requirements for Board members.
6. Board members should not participate in decisions if they are not fully informed.

Your Turn

- What current policies do your organizations have that assist you in meeting your duty of care?
- What subjects do you believe may require additional board policies?

Duty of Loyalty

- Board members must make decisions in good faith and in the best interest of the charity.
- While making decisions on behalf of the organization, you must have undivided loyalty to the organization's mission and well being.
- Director cannot use his/her position to further other conflicting interests.
- Have a conflict of interest policy. Sign it annually with disclosures of conflicts. Follow the 'smell test'

Duty of Obedience

- Requires that a Director devote herself to ensuring that the Organization operates to further its **stated purpose**.
- All decisions made by the Board must be both in the best interests of the Organization *and* further the Organization's stated mission.
 - If Board is considering an activity outside of current mission, then Board must act to expand the mission of the organization and may need to amend its organizational documents
 - Consider UBIT

Potential liability for violation of Director Duties

- Main threat for Directors is Violation for Section 4958 for “Excess Benefit Sanctions”.
 - So long as conflict of interest policy is followed and the compensation isn’t unreasonable, then the directors should be protected.
- Violation of Duty of Care can give rise to claims against directors in actions against the Organization.
- Violation of Duty of Loyalty could result in actions by the Organization against the Director.
- Largest threat for violations (or perceived violations) of these duties is the loss of faith in the Organization by its donors, supporters and the community. Claims of conflict of interest transactions can devastate the ability for the organization to raise the funds it needs to meet its mission.

Indemnity for Directors

- General protections for volunteer directors and officers
 - **27-1-732 MCA** provides that directors, officers, or volunteers of a nonprofit corporation are not individually liable for any action or omission made in the course and scope of their official capacity, except for willful and wanton misconduct.
 - This is a remedy statute. Therefore, there is no protection for a director being named as a defendant in a lawsuit.
 - **35-2-448**, MCA provides for both mandatory and permissible indemnification for directors and officers; however, it is only good if the Organization has the resources to pay the indemnification costs.
- Must check D&O policy of the Organization and professional liability policy of any directors that are professionals (i.e. lawyers, accountants, engineers, etc) to determine if there are exclusions in professional liability coverage.

Common Legal Issues that I See with Charities

- Articles of Incorporation, Bylaws and Practice of Organization are not consistent.
- Bylaws provisions are cut/pasted from other types of organizations that are not appropriate to a charities operations.
 - i.e. public benefit language for mutual benefit org.
 - Charitable language in trade association or social welfare organization.
- People familiar with for-profit law and practice assume that it is the same for the Montana Nonprofit Corporation Act.
 - Proxy votes
 - Notice requirements
 - Records privacy rights
 - Electronic votes or meetings not consistent with statute
- Directors are not aware of new federal/state restrictions placed on nonprofits.
 - PPA of 2006, Governance initiatives, 990 revisions.
 - New filing requirements for small organizations.
- Failing to register to solicit funds in other states.
- Directors are not aware of public support test to prevent organization from private Organization status.
- Charities are not properly documenting fiscal sponsorship arrangements.

Presenter Contact Information



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