

# MINIMUM FIDUCIARY REQUIREMENTS FOR A NONPROFIT BOARD MEMBER

## FORT WORTH CHAPTER TEXAS SOCIETY OF CPAS

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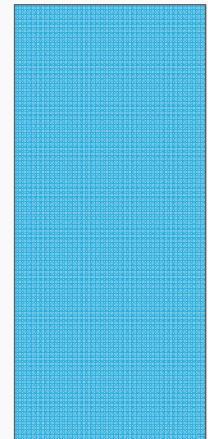
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# GOVERNANCE

## WHO IS WATCHING:

Attorney General, IRS, Watchdog  
Groups,  
Public (your donors/future donors)



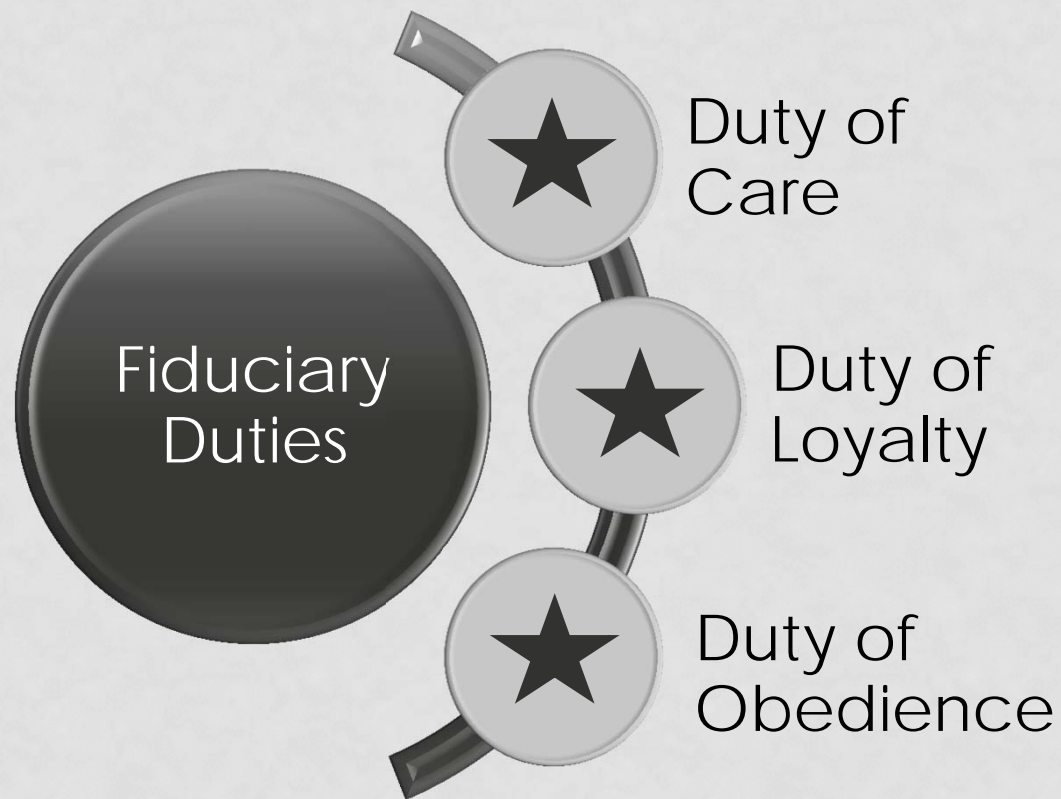
# Governance is No Joke!

Directors/Trustees  
/Officers are  
fiduciaries with  
real  
responsibilities

Nonprofit governance  
matters

- To the community
- To the beneficiaries of the charity
- To state and federal regulators

# THE RULES:



# DUTY OF CARE - DIRECTORS

Act in good faith

Use care that a person of ordinary prudence would use in same or similar circumstances (reasonable skills)

Make decisions reasonably believed to be in the best interest of the corporation

- Reasonableness based on objective facts available to the decision maker



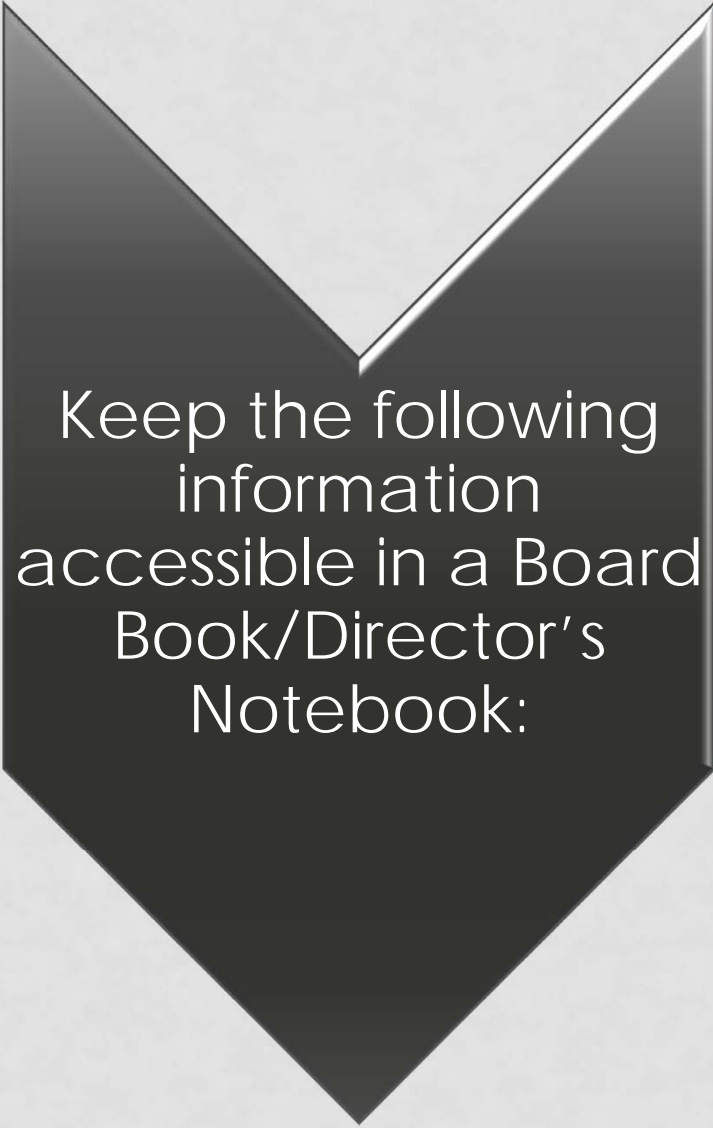
# DUTY OF CARE: BUSINESS JUDGMENT RULE AND DIRECTORS

Directors of nonprofit corporations are not liable where they exercise their business judgment in making decisions on behalf of organization.

Parameters not clearly defined (compare for profit context)

Statutory law governing nonprofit corporations simply refers to the duty of care

Essentially means directors are not liable for simple negligence absent fraud, illegality or a disabling conflict of interest



Keep the following  
information  
accessible in a Board  
Book/Director's  
Notebook:

- Articles of Incorporation/Certificate of Formation
- Bylaws
- Conflict of Interest Policy
- Minutes for the previous year
- Most recent audit/review
- Budget and most recent financials

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**A Director  
Should  
Seek to  
Do the  
Following:**

Familiarize herself with material aspects of the organization

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Faithfully attend meetings

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Read materials and prepare for meetings

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Ask questions before, during and after meetings

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Exercise independent judgment

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Rely on appropriate sources of information

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Review minutes of the board

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Seek to stay informed as to legal obligations and good governance

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# DUTY OF LOYALTY

Exercise an "extreme measure of candor, unselfishness and good faith"

Don't usurp corporate opportunities

Transactions with organization must be fair to the organization

Maintain appropriate confidentiality



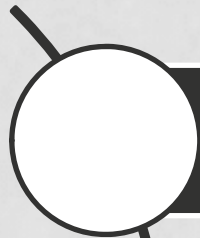
## Corporate Opportunity

- Prohibits a director from usurping corporate opportunities (i.e. opportunities in which the corporation has a legitimate interest or expectancy and the financial resources to exploit)
- Where closely related to corporate operations, must disclose (timely)
- Defenses where no disclosure:
  - Not same line of business
  - Corporation abandoned opportunity
  - Corporation lacked financial resources to pursue the opportunity

# CORPORATE OPPORTUNITY

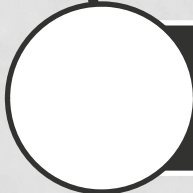
- \* Before a director engages in a transaction which he or she reasonably should know may be of interest to the corporation, the director should disclose the transaction to the board in sufficient detail (all material facts) and adequate time to enable the board to act or decline to act with regard to such transaction.

# INTERESTED TRANSACTIONS

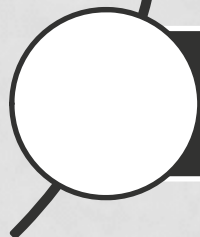


Not inherently unethical or a violation of law

- **Note:** Loans to directors are a statutory violation



Key is disclosure and how the director and board then deal with a disclosed conflict (i.e. upon disclosure the board should provide a disinterested review of the matter)



Decision makers should consider adopting a conflict of interest policy

# INTERESTED TRANSACTIONS

An officer or director is interested if he:

Makes a personal profit from the transaction with the corporation

Buys or sells assets of the corporation

Transacts business in the officer's or director's capacity with a second corporation of which the officer or director has a significant financial interest

Transacts corporate business in the officer's or director's capacity with a member of his family



# DEALING WITH DISCLOSED CONFLICT

Interested transactions are presumed unfair on the part of the decision maker, fraudulent on the corporation and generally voidable.

## "Safe Harbor"

- Interested decision maker discloses material facts
- Majority of the disinterested directors, in good faith and the exercise of ordinary care, authorize the transaction

# CONFLICT OF INTEREST POLICY

If an organization chooses to adopt a policy (and all should), the policy should consider the following:

1. Identification of the class of individuals covered by the policy;
2. Definition of "actual" and "potential" conflicts of interest;
3. Articulation of the duty of disclosure of officers and directors;
4. Appropriate "trigger" mechanisms to help identify potential conflicts;
5. Annual, episodic disclosure obligations of individuals covered by the policy;
6. Written conflicts disclosure questionnaires;
7. of disclosed potential conflicts by a committee of disinterested directors with outside counsel's input;
8. The applicability of the corporate opportunity doctrine to the board;
9. Disclosure obligations regarding outside board service of officers and directors; and
10. Disclosure obligations regarding outside business activities of senior executive leadership.

## Duty of Obedience

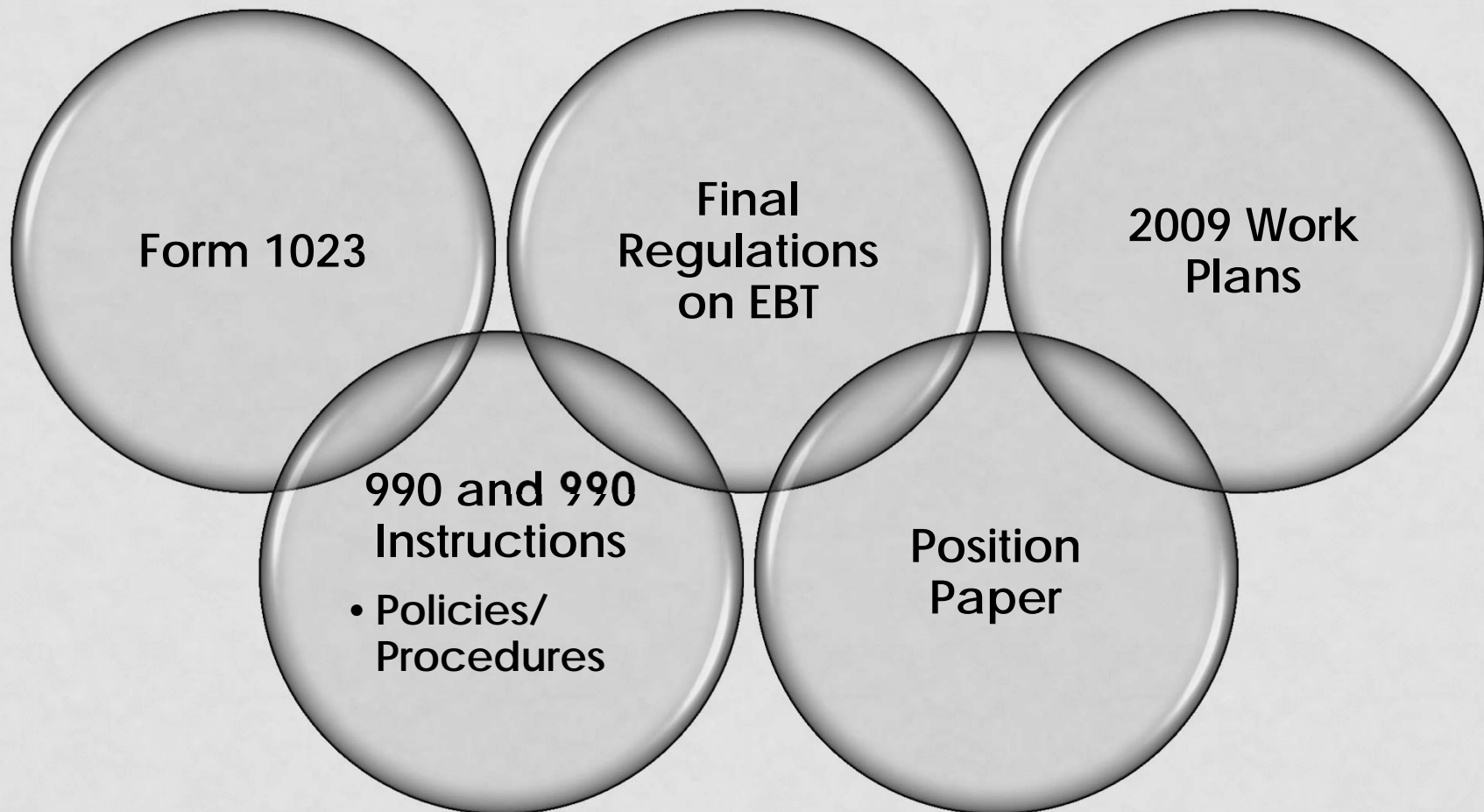
- Remain faithful to and pursue the goals of the organization
- Follow the governing documents of the organization, laws applicable to the organization (including reporting and regulatory requirements), and restrictions imposed by donors
- Ensure charitable assets are not diverted to non-charitable uses
- Liability requires personal participation or actual knowledge of the wrongful act

# WHO HAS STANDING TO ENFORCE THE DUTIES?

## Nonprofit Corporations:

- Organization (directors, officers and/or members may have standing to bring derivative claim)
- Texas Attorney General
- Donors in very narrow circumstances (must retain a special interest in the donated gift)
- **Note: Venue for breach of fiduciary duty claims brought by the OAG lies in Travis County**

# GOVERNANCE AND THE IRS





# PART VI – GOVERNANCE, MANAGEMENT AND DISCLOSURES

- Who is an **independent member** of the governing body?
- Regulations define independent for *rebuttable presumption* purposes.
- 3-prong test
  - Compensation as an employee
  - Compensation as an independent contractor
  - Schedule L Transactions Test
- Reasonable efforts to obtain – *questionnaire*



# PART VI – GOVERNANCE, MANAGEMENT AND DISCLOSURES

- **Independent Board Members**

- *A member of the governing body is considered “independent” only if all three of the following circumstances applied at all times during the organization’s tax year:*

1. Member was not compensated as an officer or other employee of the organization or of a related organization (see Schedule R instructions), except as provided in the religious exception discussed below.
2. Member did not receive total compensation or other payments exceeding \$10,000 during the organization’s tax year from the organization or from related organizations as an independent contractor, other than reimbursement of expenses under an accountable plan or reasonable compensation for services provided in the capacity as a member of the governing body. 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.
3. Neither 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 in Schedule L for the organization’s tax year, or in a transaction with a related organization of a type and amount that would be reportable on Schedule L required to be filed by the related organization.

# PART VI – GOVERNANCE, MANAGEMENT AND DISCLOSURES

Did any ODTKE  
have a family  
relationship or  
business  
relationship with  
any other ODTKE?

Ordinary course of  
business exception

Privileged  
relationship  
exception

- Attorney and client
- Medical professional and patient
- Clergy and communicant

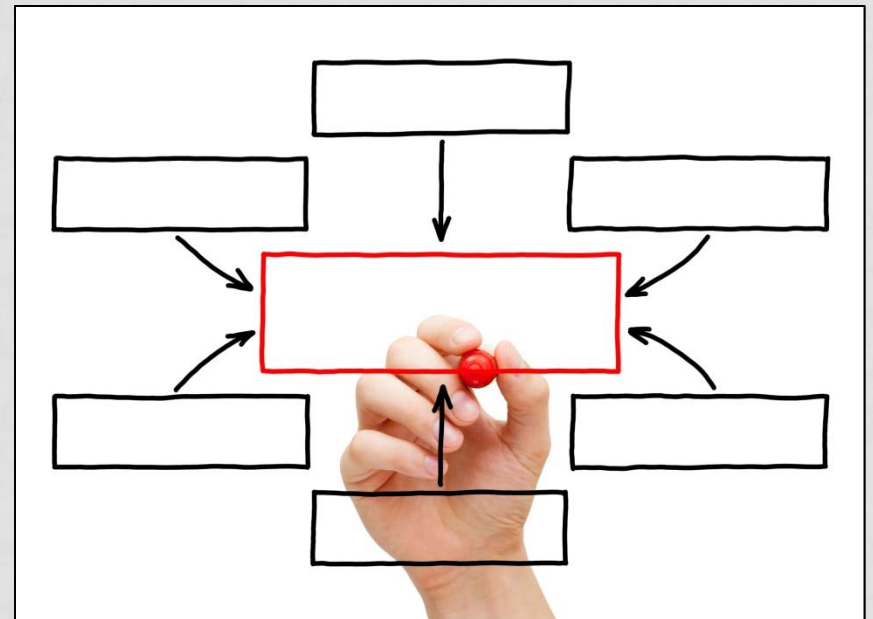
\$10,000 threshold  
for reporting

Reasonable efforts  
to obtain -  
questionnaire

- With name, title, date, and signature of each person sent any time during year

# PART VI – GOVERNANCE, MANAGEMENT AND DISCLOSURES

- Contemporaneous Documentation
  - Does the organization **contemporaneously** document meetings of the governing body and related committees through preparation of minutes and other similar documentation?
    - Contemporaneously means within 60 days of meeting or at the next meeting whichever is later.
    - If no, explain in Schedule O circumstances, process, or changes to be made going forward.





# PART VI: GOVERNANCE POLICIES

## Conflict of Interest/Annual Disclosures

- Adopting a conflict of interest policy helps ensure that officers and directors disclose their interests.
- Adopting a conflict of interest policy is not a state or federal law requirement.

## Some transactions are simply not allowed:

- loans to directors and (subject to certain exceptions) officers (prohibited under Texas law; TBOC § 22.225)
- Directors who vote for or assent to the making of any such loan in violation of the statutory prohibition are jointly and severally liable to the corporation for the amount of such loan until the loan is fully repaid.



# PART VI: GOVERNANCE POLICIES



## Whistleblower Policy

- encourages staff to come forward with credible information on illegal practices or violations of adopted policies of the organization;
- specifies protection from retaliation; and
- identifies staff, board members, or outside parties to whom such information can be reported.

# PART VI: GOVERNANCE POLICIES

- ❖ Unlike most SOX provisions, the whistleblower protection provisions of SOX apply to nonprofit corporations.
- ❖ Even if the claims are without merit, the organization may not “discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment” if the employee reports suspected fraud.
- ❖ SOX makes it a crime to knowingly and intentionally retaliate against such an employee.
- ❖ Criminal sanctions include, for individuals, fines up to \$250,000 and/or imprisonment of up to 10 years, and for organizations, fines up to \$500,000

# PART VI: GOVERNANCE POLICIES

## Document Retention and Destruction Policy

- identifies the record retention responsibilities of staff, board members, and outsiders for maintaining and documenting the storage and destruction of the organization's documents and records.

## A Document Retention and Destruction Policy

- should include guidelines for handling electronic files
- should cover backup procedures, archiving of documents, and regular check-ups of the reliability of the system.

Again, unlike most SOX provisions, the document preservation provisions of SOX apply to nonprofit corporations and carry significant criminal penalties.

# OTHER POLICIES



**Joint Venture Policy**



**Policy on  
Chapters,  
Affiliates, and  
Branches**



**Gift Acceptance  
Policy**



**Expense  
Reimbursement  
Policy**



**Executive  
Compensation  
Policy**



**Political Activity  
Policy**



**990 to the Board  
Policy**



**Code of Conduct**



# ADOPTING GOVERNANCE POLICIES



*One Size Doesn't Fit All  
But You Need to Put on Some Clothes*



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The information set forth herein is solely for purposes of discussion and to guide practitioners in their thinking regarding the issues addressed herein.

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