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Board Basics

New York State
Federation of Lake Associations

Hamilton, New York
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Presenter

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Goals for Today

1. Corporate Characteristics of Nonprofits
2. Required Filings
3. Know your Fiduciary Duties
4. New York's Not-for-Profit Corporation Law

Corporate Characteristics

- Key Documents
- Qualify for (and maintain) Tax Exemption
- Relationships with Governing Authorities
- Record-keeping Responsibilities

Key Documents

- Certificate of Incorporation
- Bylaws of the Corporation
- Conflict of Interest Policy
- Annual Conflict of Interest Disclosure Statement
- Whistleblower Policy

Organizational Documents

- Certificate of Incorporation
 - Describes Purposes
 - Includes Language Required by IRS
 - Can create certain structures
 - Membership
 - Number of Directors
- Bylaws
 - Governs Meetings and Procedures

Conflicts of Interest

- Conflict of Interest Policy – *discuss in detail later*
- Annual Disclosure Statement

Whistleblower Policy

If your nonprofit has more than 20 employees AND revenue in excess of \$1M, you must have a whistleblower policy, which:

- Establishes procedures to report violations
- Is confidential
- Appoints someone to oversee and report to Board
- No retaliation is permitted

Tax Exempt Status

- Section 501(c) of the Internal Revenue Code
 - (c)(3) – charitable, environmental
 - (c)(4) – exempt, social welfare, public good
 - (c)(7) – exempt, social club, recreational

- Organized and operated exclusively for charitable or exempt purposes



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Applying for Tax Exempt Status

- 1023 and 1023-EZ for charitable organizations
 - 1023: hefty application, \$850 filing fee
 - 1023-EZ: user friendly, \$250 filing fee
 - available to lower budget nonprofits
- 1024 for non-charitable organizations
 - Significant application, \$850 filing fee

Maintaining Tax Exempt Status

- Annual Informational Returns
 - 990-N: annual revenue < \$50K
 - 990-EZ: annual revenue < \$200K and assets < \$500K
 - 990: annual revenues > \$200K or Assets > \$500K
 - 990-PF: all private foundations
- Must continue to operate exclusively for charitable or exempt purposes



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Governing Authorities

- Department of State
- Office of the Attorney General – Charities Bureau
- Internal Revenue Service – Tax Exempt and Governmental Agencies Division

Attorney General Oversight

- Annual filing with Charities Bureau
- AG can obtain books and records
- AG can rescind or void related party transactions
- AG can sue for damages – double the profit to unrelated party
- AG has jurisdiction over all Directors, Officers, Agents and Key Employees of New York nonprofits
- Board Members and Key Persons have personal liability with respect to AG enforcement actions



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Annual Charities Bureau Filing

- General Rule – if you are charitable and solicit funds, you must file. If you are non-charitable or do not solicit funds, no need to file.
 - If formed after July 1, 2014, Certificate of Incorporation will state charitable or non-charitable.
 - If formed before July 1, 2014, Certificate of Incorporation will identify a Type:
 - Type A – Non-charitable
 - Types B and C – Charitable
 - Type D – depends on purposes
- Exemption – if you are charitable and solicit funds solely from your membership, no filing is required

Internal Revenue Service

- Audits
- Enforcement Actions:
 - private benefit
 - private inurement
- Unrelated Business Income Taxation
- Risk Losing Tax Exempt Status



Record-Keeping Responsibilities

- Minutes are the secretary's responsibility
- No need to make available to the public unless
 - Nonprofit elects to share or post
 - Nonprofit is formed based on statute
 - Subject to discovery in litigation
- Reviewed (and reported) by auditors in certain circumstances

Board and Committee Minutes

- Record the Attendees - how many and who
- Record the discussion but do not over-disclose
 - Show that procedures are respected
 - Demonstrate that board deliberated but not the details of any disagreement
 - Write cleanly, especially with respect to high risk decisions (e.g., HR issues, known disputes)
- Keep and maintain – used by auditors and for reviewing past decisions



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Officers and Directors

Officers

- Required: President and Secretary – cannot be the same
- Optional but good practice: Vice-President(s) and Treasurer
- Sometimes the Executive Director, if any

Directors

Officers and all other Directors



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Voting Requirements

- Quorum: how many directors need be present before corporation can act (typically 51%)
 - *Conflicted Directors are Included*
- Majority Vote: 51% of directors present
- Super-Majority Vote: 2/3 of directors present
 - By deliberate statement in bylaws (e.g., removal of Executive Director)
 - By statute (e.g., assets of corporation, real property)

Committees

Committees of the Board

- Executive Committee
- Finance Committee
- Governance Committee

Committees of the Corporation

- Strategic Planning
- Quality Issues
- Ad hoc (e.g., event-planning)



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Training Your Board Members

- Orientation Materials:
 - Certificate of Incorporation
 - Bylaws or Constitution
 - Names and contact information of full board, including officer designations
 - Committee structure
 - Financial snapshot
 - Industry snapshot

- Annual training on various topics of interest – legal, financial, industry



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FIDUCIARY DUTIES

- Duty of Care
- Duty of Obedience
- Duty of Loyalty

Duty of Care

Requires Board Members to:

Act in good faith with that degree of care which an ordinarily prudent person would exercise under similar circumstances, and which Director reasonably believes is in the best interest of the Corporation.

Act in Good Faith

- Active Participation
- Regular Attendance
- Review Materials and Minutes
- Report Corrections
- Ask Questions

Similar Circumstances

- Takes Account of Distinct Facts and Reality
- Based on Facts Available at Time of Decision

Ordinarily Prudent Person

- Generalists, no need for specialized knowledge
- Sound, practical judgment and common sense
- Does not mean that all decisions are correct
- Does not require excessive caution
- You can rely on experts and committees

Duty of Obedience

- Must act in pursuit of the Corporation's Mission
- Board may determine precisely how mission can best be fulfilled
- Cannot divert corporate resources to other purposes, even if charitable

Duty of Loyalty

Requires Board Members to:

- Exercise power in the interest of the Corporation only – not in their own interest, or that of another entity or person
- Demonstrate undivided allegiance to mission
- Manage conflicts of interest

NOT-FOR-PROFIT CORPORATION LAW

Statutory History

- Enacted on May 26, 1969, effective of September 1, 1970.
- Amended by the New York Nonprofit Revitalization Act of 2013, which took effect on July 1, 2014.
- Technical amendments enacted in October and December of 2015, and again in December 2016.

Fear of Fraud

James G. Sheehan, Chief of New York State Charities Bureau:

- “[Fraud] is a surprisingly common problem.”
- “We’ve seen organizations that have the same event occur two or three times because their control process is weak.”
- “People are committed to the mission. But sometimes the first stop is: Who’s in this business that we know. And that often is a board member. So making sure you have strong conflict of interest rules and related party rules is really important in making your decisions work.”

- “Attorney General’s Charity Chief: Fraud is ‘Surprisingly Common’”,
New York Nonprofit Media, August 6, 2015.



What is New York getting at?

Imposed specific duties on the Board to encourage more effective monitoring of the nonprofit's financial health and fraud controls.

1. Board duties may only be satisfied by the board itself or committees comprised solely of board members.
2. Audit functions may only be conducted by independent board members.
3. Conflict of Interest Procedures



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Committees

- No more standing committees or ad hoc committees
- Committees of the Board
 - Comprised solely of Board members
 - May be delegated Board responsibilities
- Committees of the Corporation
 - May include non-Board members
 - May not be delegated Board responsibilities
- Other than performing “Audit Functions”, board responsibilities means the ability to **act** on behalf of the board



Audit Functions

1. Oversee accounting and financial reporting
2. Annually retain or renew independent auditor
3. Review scope and planning of audit prior to commencement
4. Review audit results
5. Discuss with auditor material risks and weaknesses in internal controls, any restrictions on the scope of auditor's activities or access to requested information, and any significant disagreements between auditor and management, adequacy of accounting and financial reporting processes.
6. Annually consider performance and independence of independent auditor
7. Report activities to Board



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Conflicts of Interest

- Conflicts of Interest are not unlawful.
- A Conflict of Interest exists when a Director or Officer, directly or indirectly, has a **material personal interest** in a contract or transaction.

Conflicts of Interest

- Obligation to disclose real or *potential* conflict.
- Authorized committee determines whether conflict exists.
- Conflicted director may present information relating to transaction at issue.
- Conflicted director must leave for determination and vote by Board or authorized committee.

Related Party Transactions

A “Related Party Transaction” is any transaction or agreement in which a Related Party has a financial interest and in which the Corporation or an Affiliate is a party.

New Exceptions

On May 27, 2017, the following transactions will be excluded:

- De minimis
- Those that would not be customarily reviewed by boards of similar organizations and are available to others on similar terms;
- Those that benefit charitable beneficiaries and are available to other members of the same charitable class

What is a Related Party?

- Technical definition imposed by N-PCL Section 102(23).
- Check the box analysis.
- Case-by-case identification.

A Related Party is any:

- Director, officer, or member of a committee to whom the governing board has delegated powers;
- or Key Person of either the corporation or an affiliate;
- or other person who exercises such powers over the affairs of the Corporation or an Affiliate;
- Relative of any of these people;
- Entity in which any of these individuals has a 35%+ beneficial interest;
- Partnership or professional corporation in which any of these individuals owns a direct or indirect ownership interest >5%

Related Party Duties

Normal Conflict Procedure...

- Obligation to disclose real or *potential* conflict.
- Board or authorized committee determines whether conflict exists.
- Conflicted director may present information relating to transaction at issue.
- Conflicted director must leave for determination by board or authorized committee.

Related Party Duties

Plus...

1. Investigate alternatives to the proposed transaction.
2. Determine whether it is reasonably possible that a better transaction that will not give rise to a conflict can be obtained.
3. If not reasonably possible, board or authorized committee must determine by a majority vote, whether the related party transaction is...

Related Party Duties

Required Resolutions

- Best interest of the Corporation
- For the Corporation's benefit and not the related party
- Fair and reasonable

The decision to enter transaction must be based on these determinations.

Liability and Indemnification

Your volunteer service is appreciated.

- Immunity
- Directors and Officers Liability Insurance
- Indemnification

Summary

1. Corporate Characteristics of Nonprofits
2. Required Filings
3. Know your Fiduciary Duties
4. New York's Not-for-Profit Corporation Law

Disclaimer

This presentation is for informational purposes and is not intended as legal advice.