



third edition

legal
responsibilities
of nonprofit boards

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INTRODUCTION | REASONABLENESS AND PRUDENCE

When you join the board of a nonprofit organization, you take on a set of responsibilities and duties defined by law. Along with attention to programs, finances, and fundraising, nonprofit board members should understand the regulatory environment in which their organizations operate. Fundamental legal principles and complex tax laws govern the work of nonprofit boards and individual board members.

Nonprofit organizations and their boards do not function in a vacuum. They are important players in the country's societal, economic, and legal framework and must adapt to — and sometimes act as the impetus for — environmental or ecosystem change. Other times, they may fulfill obligations and expectations common in the for-profit and government sectors.

For example, the Sarbanes-Oxley Act of 2002, passed by the U.S. Congress in the aftermath of corporate and accounting firm scandals, raised the standards of scrutiny in the private sector for matters such as auditor independence, corporate responsibility, financial disclosure, and conflicts of interest. Aspects of this heightened concern for accountability were carried over into the nonprofit sector, more by practice than by legal requirements. This phenomenon is amply reflected in the annual information return that larger tax-exempt organizations file with the IRS (Form 990).

Thus, a nonprofit board is faced with two seemingly contradictory mandates: advancing the good work of the organization and deciding the extent of its accountability to the public. This tension makes board service both rewarding and difficult.

Fulfilling Fiduciary Responsibilities

Fundamental to the legal aspects of board membership is the concept of fiduciary responsibility. The control of a nonprofit organization is usually vested in its governing board of directors, sometimes termed the board of trustees. The members of this board, charged with exercising responsibility over the organization and its resources, are considered fiduciaries. This concept of fiduciary responsibility extends to the accountability assumed by board members to advance their organization's mission and oversee its resources.

Fiduciaries are held to a standard known as the test of reasonableness and prudence. This centuries-old test is based in English common law and the standards developed concerning governance of charitable trusts. In contemporary terms, this standard means that board members are expected to regard and treat the nonprofit organization's assets and other resources with the same care with which they would treat their own resources.

Because the board is ultimately responsible for a nonprofit organization's activities, it often becomes the prime target when problems arise. The general argument often made against boards in these circumstances — and the one board members should guard against — is guilt by omission. This situation arises when board members have been passive or otherwise inactive in overseeing the organization's activities and, consequently, may have failed to adhere to the standards of fiduciary responsibility. To protect against these charges, board members must demonstrate that they appropriately discharged the requisite duties. Ignorance is not an acceptable excuse when a legal problem demands the board's attention.

Getting Sound Advice

Charged with oversight, board members inevitably struggle with the limitations created by their part-time involvement and their volunteer status. No board member can know everything. Boards must rely, to various extents, on independent professionals whom the organization may retain.

Acknowledging that sound legal advice requires legal counsel, most organizations use lawyers — some more extensively than others. An organization may have an ongoing relationship with one or more lawyers, who may be in private practice or employed by the organization. The lawyer may serve as a volunteer or be compensated at full or reduced rates for services rendered. In any case, board members should have access to the organization's lawyer, within reason (legal fees can mount if access is not monitored and limited).

Ideally, a nonprofit organization will have a lawyer present (other than one serving on the board) at every meeting of the board and each of the organization's committees. In this way, a legal issue can be spotted promptly and perhaps resolved. This ideal is not likely to be achieved, however, if only because of the expense. Some organizations have a lawyer available by telephone should a question involving a legal matter arise. Some have their lawyer review drafts of board meeting minutes and annual IRS information returns. Others invite a lawyer to appear at a meeting for board education. A few organizations conduct a periodic legal audit. In most cases, however, the lawyer involved in a board issue will evaluate that issue outside the context

of a board meeting and work on strategy with the board chair, a committee, or the chief executive.

Lawyers as Board Members

Many organizations consider it important to have individuals with legal expertise on the board. But the matter of lawyers serving on the board is tricky business. Like other board members, lawyers serve primarily as fiduciaries and are tasked with bringing different perspectives to deliberations and exercising vigilance. Although they will certainly speak up in the face of legal issues that come before the board (to the extent those issues are within their range of expertise), board members with legal experience are not a substitute for inside or outside legal counsel. This becomes particularly clear when an opinion on the propriety of a board action is required. Asking a lawyer who serves as a board member to give the opinion puts that lawyer in the awkward position of passing judgment on their own actions.

Keep in mind that most lawyers concentrate on particular areas, so a lawyer on the board is not necessarily competent to advise on nonprofit law. Having a lawyer on the board — even one who specializes in nonprofit law — does not absolve other board members from being aware of their own responsibilities and duties under the law.

Finally, lawyers on nonprofit boards who provide legal opinions grapple with the fact that the arrangement is inherently a conflict of interest, in that the lawyer is both client and advisor. For that reason, some lawyers avoid serving on the boards of their nonprofit clients.

Let's Get Started

An understanding of basic nonprofit concepts and rules can go a long way toward helping board members fulfill their fiduciary responsibilities. It is rare for a board member to incur personal liability in this context, but it can happen. Ask these questions early in your service:

- What kind of oversight and policy judgments am I expected to provide and make?
- In that regard, what organizational documents should I be familiar with?
- When and how can I be found personally liable?
- How can I avoid, or at least minimize, personal liability?

This book provides a starting point for answering these and other questions. While it offers an overall understanding of the legal landscape an individual

navigates as a member of a nonprofit board, this book does not and cannot substitute for the legal counsel that professionals provide.

Chapter 1 discusses the concept of fiduciary responsibility and the collective duties of care, loyalty, and obedience. Chapter 2 delves into the different forms that nonprofit organizations can take and summarizes various aspects of the law that board members should generally know. Chapter 3 outlines contemporary views on nonprofit governance and the policies and procedures that nonprofit boards should consider. Chapter 4 summarizes the strategies for protecting board members from personal liability. The Conclusion offers some important items to remember when trying to minimize liability.

Discussion questions for board members appear at the end of each chapter. These questions are designed to prompt board dialogue, either during a board retreat or at regular times set aside on the board meeting agenda. This book also offers a glossary of legal terms and concepts that apply to nonprofit organizations.