

## *The Legal Duties of the Nonprofit Board and Its Members<sup>1</sup>*

In the United States and many other nations, the board of directors of a nonprofit corporation has the ultimate responsibility and accountability for the conduct and performance of the organization. Boards regularly delegate the work of the organization to executives, staff, and volunteers, yet they cannot delegate or reassign their responsibility for that work. Nonprofit corporations are entities authorized by a state to be formed for the purpose of engaging in some form of public service, and the law requires that each such corporation must have a governing body that oversees and ultimately is legally accountable for the organization. Acting as a collective, this governing body has both the authority and the accountability for the work of the organization.

From a legal perspective, the nonprofit board and its members, individually, have three fundamental duties.

**Duty of Care**, which is taking the care and exercising the judgment that any reasonable and prudent person would exhibit in the process of making informed decisions, including acting in good faith consistent with what you as a member of the board truly believe is in the best interest of the organization. The law recognizes and accepts that board members may not always be correct in their choices or decisions, but it holds them accountable for being attentive, diligent, and thoughtful in considering and acting on a policy, course of action, or other decision. Active preparation for and participation in board meetings where important decisions are to be made is an integral element of the duty of care.

**Duty of Loyalty**, which calls upon the board and its members to consider and act in good faith to advance the interests of the organization. In other words, board members will not authorize or engage in transactions except those in which the best possible outcomes or terms for the organization can be achieved. This standard constrains a board member from participating in board discussions and decisions when they as an individual have a conflict of interest (i.e., their personal interests conflict with organizational interests, or they serve multiple organizations whose interest conflict).

**Duty of Obedience**, which requires obedience to the organization's mission, bylaws, and policies, as well as honoring the terms and conditions of other standards of appropriate behavior such as laws, rules, and regulations.

Board members are obligated to honor these standards with regard to all decisions and actions of the board, and those who do not may be subject to civil and even criminal sanctions (including sanctions imposed by the Internal Revenue Service of the U.S. government in cases of inappropriate personal benefit).

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<sup>1</sup> As with any general discussion of legal matters, we must present an important warning and disclaimer. This document is intended only to offer general information and its contents do not constitute legal advice. Boards and members with specific legal questions and concerns should consult legal counsel and the relevant regulatory authorities for definitive information and answers. A document site such as this can only help begin to consider the issues that the conscientious board and its members will need to explore in order to serve effectively in their roles. Please also recognize that this document focuses on nonprofit organizations in the United States. Laws and legal expectations vary from state to state, even though a large number of states in the United States have adopted nonprofit corporation laws that are based on the same model statute, and nonprofit laws vary even more substantially from nation to nation. It makes a significant difference where the organization was formed and incorporated, and where it operates its programs and services.

### ***The “Fiduciary Responsibility” of Boards***

Boards and board members often are reminded that they have a "fiduciary responsibility" to the organization and, ultimately, to the larger community within which they serve. At its core, "fiduciary responsibility" is the responsibility to treat the resources of the organization as a trust, and the responsible board will ensure that these resources are utilized in a reasonable, appropriate and legally accountable manner. While the phrase often is used to refer especially to financial resources, it applies to the stewardship of all of the assets and resources of the organization.

In general, the appropriate exercise of fiduciary responsibility includes:

- a) Adoption of a set of policies to govern the acquisition and use of financial and other resources;
- b) Establishment, on a regular basis (usually annual), of a budget that allocates financial resources to the programs and activities that will accomplish the organization's mission, vision and goals and outcomes (preferably, in alignment with a strategic plan);
- c) Development and implementation of an ongoing system for monitoring and holding staff and volunteers accountable for their performance with regard to these policies and budgets;
- d) Development and implementation of an ongoing system to monitor, assess, and report on the overall fiscal condition and financial performance of the organization; and
- e) Implementation of an independent external review process (such as an independent audit) on a regular basis (usually annual), to assess the organization's fiscal condition and health, including the effectiveness of its systems and policies for the protection and appropriate use of financial resources.

### **The Legal Roles and Responsibilities of the Member of a Typical Nonprofit Board**

Your legal responsibilities as a member of the board of a nonprofit flow directly from the responsibilities of the board as a whole. You, individually, are accountable for honoring the same three fiduciary duties as is the entire board: you individually must exhibit due care, the duty of loyalty, and the duty of obedience on behalf of the organization on whose board you serve (as described earlier). This standard of personal conduct requires active and informed preparation and participation in the conduct of board business, including raising questions and issues that would reasonably be raised by any prudent person. Of course, a board member who does not attend meetings or who attends but does not participate or know what is under consideration does not meet these standards. At best, such members are not helping the organization; at worst they are endangering the organization and the interests of the people it serves. Such members also are at risk of personal civil liability and "intermediate sanctions" should certain kinds of inappropriate organizational or board behavior occur.

It is every board member's responsibility to do their best to help ensure that the board as a whole is performing its legal responsibilities, and individual board members can be held liable as individuals for inappropriate organizational acts. Among the circumstances under which board members have been held personally liable are:

- When the organization has not paid certain taxes, especially payroll taxes.
- The board enters into inappropriate arrangements or contracts with a board member, particularly including conflicts of interest.
- The board has violated employment laws or contracts (a common example: the handling of the termination of an executive director).
- The board has failed to take reasonable steps to protect others from harm in a situation they knew or should have known was potentially dangerous (for example, in addressing dangerous

facilities conditions, or in failing to address inappropriate individual behaviors of staff such as harassment or sexual misconduct).

### **What is a conflict of interest and what am I supposed to do about it?**

The phrase "conflict of interest" is often used to describe a problem of legal or ethical concern, yet the nature of this problem often is not well understood. Fundamentally, the issue is about organizational loyalty and fairness, and conflict of interest generally refers to a situation in which a board member (or any other significant decision maker) has interests of his or her own that are -- or likely will be -- in conflict with the best interest of the organization. These may be financial or business interests, for example, such as selling your business's services or products to the organization on whose board you sit. The issue is that you are making a profit (your own interest) instead of ensuring that, from an objective perspective, the organization is getting what is best for its needs (the organization's interest). Because each board member has a duty to place the interest of the organization foremost in any dealings with the organization, the existence of a conflict of interest is a problem.

A common misconception is that board members cannot have conflicts of interest with the organization on whose board they serve. The problem is not with the existence of a conflict -- indeed, many board members are named to a board for the very expertise or business experience that results in such conflicts -- but with how it is handled. The board member's obligation when a real or potential conflict exists is to disclose this situation to the board and then avoid participating in both the deliberations and decision making associated with the conflict situation. The board member should not be present at the time the matter is discussed to ensure that neither overt nor subtle pressure is applied (or appears to have been applied -- perceptions of conflict of interest often can be as damaging as an actual conflict).

It is essential for each organization and board to have a conflict of interest policy that makes clear the organization's expectations for such circumstances. Some place their requirements in the bylaws of the organization. These policies or bylaws usually include conduct of both board members and other senior executives and, as noted earlier, are designed to enable the organization to effectively control for and manage the problem. In some organizations, the likelihood of such conflicts existing is great enough that a part of the policy requires annual disclosure of information by members and executives that would flag the potential for such conflicts. This information is shared with leaders of the organization or, in many cases, the entire board, to help members anticipate and proactively manage what might otherwise become a serious problem.

In many parts of the world, governmental authorities are taking an increasingly active role in defining and monitoring the work and behavior of nonprofit boards and their members. In the United States, for example, the federal Internal Revenue Service (IRS) has been clear in demanding that board members of nonprofit corporations, at the least, to fulfill all legally-mandated roles and responsibilities associated with being a board member. Therefore, the IRS expects board members and boards to honor in spirit and action the responsibilities that are articulated in the earlier section on Legal Duties and to do so in a timely and forthright manner.

### **Beyond the legal obligations**

Obviously, it is important for every board member to honor their legal responsibilities, but the roles and responsibilities of the individual board member of a typical nonprofit board are more extensive than mere legal compliance. Every board should develop its own set of member expectations that addresses the needs and interests of that specific organization and what it needs from its board. However, the following are among the most typical of responsibilities or expectations that a typical nonprofit is likely to have of its board members.

In general, the typical governing board will expect its board members to:

- Participate actively:
  - Attend all meetings of the board.
  - Serve as a member of one or more of board committees or task forces.
  - Prepare in advance for meetings and other key board activities.
  - Engage in independent and critical thought in all areas of board work.
  - Attend special events and other key organizational activities as requested.
- Be knowledgeable and ensure that they understand:
  - The mission, vision, and overall work and strategic direction of the organization.
  - The bylaws and policies that guide the work of the board.
  - The board's expectations of them as a member of the board.
- Do their homework to ensure that they are appropriately informed about:
  - Issues and matters that will be the subject of board deliberation or decision making.
  - Important issues that are likely to have an impact on the success of the board and organization.
- Provide active support for the fund raising and other resource development activities of the organization, including:
  - Making a regular personal financial contribution to the organization (at a significant level, according to the member's capacity).
  - Assisting the organization in connecting with those people and organizations that may be able to assist in funding and supporting the organization.
- Serve as an ambassador and advocate on behalf of the organization, including active support for networking and the development of connections with community and other leaders.
- Provide encouragement and active support for the work of the staff and volunteers, taking care that board activities do not interfere with staff roles or functions.
- Serve with honor and integrity:
  - Help enhance the image and credibility of the organization through their work, taking care that their personal behavior reflects well on the work and reputation of the organization.
  - Honor sensitive matters in confidence and with discretion, exhibiting the best of ethical performance.
  - Honor and actively support all board decisions, once they have been made, and treat the content of board deliberations with confidence and discretion.
  - Avoid actual and perceived conflicts of interest, to the greatest degree possible, and exhibit the highest of ethical standards in all personal conduct.
  - and other unethical behavior.
- Support and actively contribute to the board's efforts to work effectively as a team:
  - Play an active and constructive role in helping the board do its work, embracing the challenges and opportunities of board work with a positive attitude and energy.
  - Bring a sense of perspective and humor to the work of the board.
  - Provide support to fellow board members, and take time to celebrate the successes and accomplishments of the organization and the board.

Effective governance is essential to nonprofit organization effectiveness, and boards of directors that engage in the work of governance are central to the success of the organizations they serve. When knowledgeable and motivated volunteers take the time to serve on boards, we all benefit. And serving as a member of a nonprofit's board of directors can be one of the most influential and enjoyable roles that any volunteer can play; the rewards of effective service accrue to both the volunteer and their community. Such service is essential to the future of our civil society.