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## FIDUCIARY DUTIES OF NONPROFIT BOARD MEMBERS

Becoming a board member of a nonprofit organization carries with it certain legal obligations that are not excused by the argument, “I’m only a volunteer.” These obligations include the fiduciary duties of (1) care, (2) loyalty, (3) compliance, and (4) to maintain accounts. Board members must carry out these duties with the same degree of care that would be used by a reasonable, prudent person in the same position. A board member who breaches these duties can be subject to civil or criminal penalties, especially if the member has personally benefitted from their action or inaction. Nonprofit board members should therefore treat their positions with the same diligence that they would give to their own affairs or being on the board of a for-profit corporation.

### A. Duty of Care

**Definition:** A director must discharge their duties in good faith with the care that an ordinarily prudent person in a like position would use under similar circumstances. (Ohio Revised Code § 1702.30(B)).

**Plain English:** Be informed and involved, actively participate in discussions and meetings, ask questions, rely on dependable sources of information, hold staff and other board members accountable.

### **Action Steps to Help Fulfill the Duty of Care:**

- 1.) Regularly attend board and committee meetings.
- 2.) Take minutes of board and committee meetings.
- 3.) Prepare for board meetings by reading reports received before the meeting.
- 4.) Ask questions and get enough information necessary to make informed decisions.
- 5.) Use your own judgment, rather than rubber-stamping staff or board officer requests.

- 6.) Review the performance of the executive director at least annually and establish a consistent procedure for doing so.
- 7.) Use committees to gather the most qualified board members to handle specific areas of oversight. Committees then report to full board, which makes decisions relying, in part, on committee recommendations.
- 8.) Retain competent help, including a qualified executive director and outside experts (nonprofit consultants, lawyers, accountants, appraisers).
- 9.) Require that existing board members be voted on to continue for another term.
- 10.) Consider setting term limits to avoid tunnel vision and to allow fresh perspectives to be brought on the board.
- 11.) Have a board governance committee which evaluates board members and nominates new ones. The committee should analyze which skill sets are needed and lacking on the board and should also seek candidates from diverse backgrounds.
- 12.) Always cast a vote at board meetings. Directors who are present at board or committee meetings are presumed to have voted for a decision passed at the meeting if they do not have a recorded “no” vote. (Ohio Revised Code Section 1702.55(C)).

**Sarbanes-Oxley Act (2002):** Federal law passed to strengthen standards for governance of publicly-traded companies. Two provisions specifically apply to nonprofits:

- 1.) Document retention policies: Prohibits destroying, altering or falsifying documents to prevent their use or discovery in official proceedings or to obstruct a federal investigation. Nonprofits are criminally liable for violations of the Act.
  - a) Create a document retention policy that mandates the length of time that paper and electronic records must be kept or destroyed. Keep in mind that the law or your funders will require certain types of documents to be retained for specific periods of time.
  - b) Never destroy documents that you suspect or know to be relevant to pending or threatened litigation or government investigations.

2.) Whistleblower protections: Non-profits should establish procedures for receiving, investigating, and taking appropriate action regarding fraud or other compliance issues. It is illegal for a corporation to punish, in any manner, an employee who reports suspected illegal activity. Reporting of unethical activity should also be protected.

a) Whistleblower policy should provide that whistleblowers should not be fired, demoted, or receive negative treatment merely for being a whistleblower.

b.) The identity of whistleblowers should be kept confidential by setting up an anonymous hotline or complaint box.

c.) Whistleblower policy should specify an officer to receive and investigate complaints and to report illegal activities to the proper outside authorities.

d.) Establish a formal review policy for all employees and document reasons for changes to employees' positions to protect against future allegations of retaliation.

## B. Duty of Loyalty

**Definition:** A director must discharge their duties in a manner the director reasonably believes to be in or not opposed to the best interests of the corporation. (Ohio Revised Code § 1702.30(B)).

**Plain English:** Directors must put the interests of the organization over their own interests or the interests of family members and other businesses or organizations that they might be involved in.

### **Action Steps to Help Fulfill the Duty of Loyalty:**

1.) Have a written conflict of interest policy requiring directors to disclose their involvement with other organizations and businesses.

2.) Don't get involved in a transaction that harms the organization.

3.) Don't get involved in a transaction that competes with the organization's interests.

4.) Don't make decisions for the organization based upon your own personal gain.

- 5.) Whenever possible, avoid entering into business relationships between board members, board members' families or businesses and the organization.
- 6.) If a business relationship is being considered between the organization and a board member or board members' families or businesses, require written disclosure of the conflict by the board member and that they abstain from voting on the business transaction. Other board members must then impartially vote on whether the transaction is in the best interest of the organization.
- 7.) Avoid diverting opportunities available to the organization for personal gain.
- 8.) Keep strategic planning discussions and other sensitive matters of the organization confidential.

C. Duty of Compliance

**Definition:** Directors have a duty to be faithful to the organization's mission and to follow the organizations' bylaws and other governing documents, as well as laws related to nonprofits.

**Action Steps to Help Fulfill the Duty of Compliance:**

- 1.) Annually review the organization's bylaws, mission, and major policies.
- 2.) Have a committee to review compliance with the organization's policies.
- 3.) If your local agency is accountable to a national organization, be sure that your own governing documents and procedures comply with the national organization's requirements.
- 4.) Be familiar with state and federal laws applying to nonprofits.
- 5.) Develop a strategic plan to set the nonprofit's goals, address weakness, and recognize strengths. The strategic plan should set the framework for board meeting agendas and set priorities for committees.

D. Duty to Manage Accounts

**Definition:** Directors have a duty to ensure the nonprofit's financial stability and accountability.

**Action Steps to Help Fulfill the Duty to Manage Accounts:**

- 1.) Keep board minutes of all decisions concerning expenses and investments, including some detail of the discussions that took place to show that the decision-making was informed.
- 2.) Develop a financial management policy that designates what expenditure decisions can be made by the agency or executive committee of officers and what expenditure decisions must be made by the full board.
- 3.) Create an annual budget that clearly provides a blueprint for agency spending and intended sources of income. The Treasurer's regular financial reports provided to the board should track how expenditures and income compare to budgeted projections. The budget should be revised during the year, if necessary.
- 4.) Employ a bookkeeper in addition to your Treasurer to keep accurate financial records that are regularly provided to and approved by the full board.
- 5.) Establish an impartial bidding process for large projects or expenses and seek the best prices on everyday items.
- 6.) Have a finance committee overseen by the Treasurer that prepares the budget in conjunction with the executive director and that makes recommendations on investments.
- 7.) Seek multiple expert opinions on investment decisions and have them voted on by the full board.
- 8.) Set fundraising goals in conjunction with the executive director and monitor the performance of the agency and board members in achieving those goals.
- 9.) Ensure that monies donated for designated specific purposes are segregated from other funds in financial reports.
- 10.) Conduct an annual audit with an independent auditor.
- 11.) Complete the IRS's 990 Form, required for tax-exempt organizations, and make it available for public inspection.

## E. Directors' Personal Liability

Directors of nonprofits can be held personally liable for breaches of fiduciary duties in **derivative suits** filed on behalf of the organization by (1) fellow board members, (2) the State Attorney General, (3) members, or (4) beneficiaries of the organization's activities. Derivative suits must claim that a director's breach of fiduciary duty resulted in (1) actual damages to the organization, or a (2) waste of association assets where funds were used for improper purposes.

Directors may also be liable in **third-party suits** where a third-party (i.e. agency employee) claims that a director has directly participated in a tortious activity, such as libel, slander, or fraud. Directors can also be held personally liable for statutory violations that they have participated in or were responsible for, such as civil rights violations, as well as criminal activities that they are responsible for. Voting for an illegal act or statutory violation can lead to personal liability.

### **Protections against personal liability for nonprofit directors may include:**

- 1.) Ohio Revised Code: A director is liable in damages for any act that the director takes or fails to take as director only if it is proved, by clear and convincing evidence, in a court with jurisdiction that the act or omission of the director was one undertaken with a deliberate intent to cause injury to the corporation or was undertaken with a reckless disregard for the best interests of the corporation. (Ohio Revised Code Section 1702.30(E)(1)). This does not protect a director against liability for violations of criminal law, civil rights laws, and certain other duties in Ohio Revised Code Section 1702.55.
- 2.) Federal Volunteer Protection Act of 1997: A volunteer is not liable for an act or omission (1) done within the scope of their duties if (2) there is no willful or criminal misconduct, gross negligence, reckless misconduct, or a conscious, flagrant indifference to the rights or safety of the harmed individual. This does not limit a director's liability to the organization, only third-parties, and is not applicable to vehicle accidents, most crimes and civil rights laws.
- 3.) Indemnification: The nonprofit may indemnify its directors in its bylaws. Indemnification provisions should only indemnify directors who (1) have acted in good faith; (2) received no improper benefit; (3) did not have reasonable cause to believe the conduct was unlawful; and (4) reasonably believed the conduct was in the best interests of the organization.
- 4.) Directors and Officers Liability Insurance: Protection limited to actions within the scope of directors' duties and excludes willful misconduct. Some homeowner's insurance policies provide coverage.



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## FIDUCIARY DUTY SCENARIOS

What fiduciary duties are at issue and how would you handle each situation if you were board President?

- 1.) A director on the board of “We Are the World We Are the Children” learns about a one-time \$100,000 grant being offered to any agency working with at-risk youth. After bringing the grant to the attention of his organization’s Executive Director, the board member also tells his jogging partner, who happens to serve on the board of “What’s the Matter With Kids These Days?” The second agency applies for the grant first and gets it.
- 2.) The governing board of “Procrastinators Anonymous” is required by its bylaws to meet at least bi-monthly. No board meeting took place in November and the board’s committee chairs are all reporting that they have no pressing business to vote on in December. The board President’s daughter’s birthday is the same day as the scheduled December board meeting.
- 3.) The chair of the Finance Committee for “Enron Survivors, Inc.” gets a hot tip that Facebook stock is going to be publicly traded soon and is convinced that the nonprofit should invest \$20,000 from its endowment fund into Facebook. The Finance Committee and board members are notorious for not wanting to challenge each other’s opinions.
- 4.) After the Executive Director of the local chapter of “Jobs for the Underqualified” retires, a board member suggests that a recently fired client of theirs would be perfect to fill the position. Another candidate who has worked at the national organization’s human resources department for many years, but who has no prior executive director experience, is strongly recommended by the national organization.
- 5.) A well-meaning board member of “Peace Through Playstation” offers the organization a personal loan to buy videogame systems to donate to the schools for kids to play the group’s free software that deletes weapons from the hands of videogame characters. Another board member says that her uncle owns the cheapest electronics store in town and would be happy to give the agency a great deal on a shipment of second-hand gaming systems that came in last week.

- 6.) The Treasurer for “The Society Against Lawyers and Other Worrywarts” is also currently serving as board Secretary, chairing two fundraiser committees, writing the first draft of the nonprofit’s budget, and performing the nonprofits’ annual audit each year. It was recently discovered that a technology grant received for upgrading the organization’s computers was deposited into the general checking account and has been used to pay staff salaries.
- 7.) “Stay Off of My Lawn” is a nonprofit organization whose mission is to provide pet owners in a tri-county area with free baggies and pooper scoopers to pick up their animals’ waste when taking them for walks. The members of the organization’s marketing committee are all from one county and want the organization to direct all of its marketing budget to that county, where they feel that the pet waste problem is especially out of hand. They are threatening to leave the board and establish their own competing organization in their home county if their recommendation is not approved.
- 8.) A staff member of “Jocks for Geeks,” which forms mentoring matches between high school athletes who need tutoring and honor students who need dating advice, privately meets with the board President to complain that the agency is not doing background checks, interviews, or following other required procedures for making their matches. The employee asks that her comments not be shared with the Executive Director.
- 9.) The President of the Board of “Growing Up on the Wrong Side of the Tracks,” an agency that builds housing for low-income families in affluent communities, learns about affordable office space in the suburbs that would be just the right size for either the agency, which is now located downtown, or the President’s own business. The agency has just formed a committee to study the feasibility of moving to a more spacious location.