

APABA Colorado

Nonprofit Boards and Directors

Roles and Responsibilities

April 24, 2019

1

Nonprofit Organizations

- Tax exempt organizations, primarily religious, charitable, and educational organizations, date back to US Revenue Act of 1894
- Tax deductions provided for in Revenue Act of 1917
- 1950's legislation limited tax exemptions to non-profit earnings and expenditures
- Private foundations defined in 1969
- Minimal changes to basic structures since 1969

April 24, 2019

2

What is a Nonprofit Corporation

Generally, nonprofits:

- Have a mission focusing on benefitting society,
- Are owned publicly, with no shareholders or individual owners of the assets, and
- Use income only for public mission and activities, and never distribute income to any owner.

April 24, 2019

3

Types of Nonprofit Corporations

- **501(c)(3) – Charitable Organizations**
 - Food banks, museums, art groups, amateur sports, colleges, low-income housing organizations, and animal welfare organizations, **bar foundations**
- 501(c)(4) - Civic League, Social Welfare or Employee Association
- 501(c)(6) - Trade or Professional Association (**APABA**, CBA)
- 501(c)(7) - Social or Recreational Club
- 501(c)(8) and (c)(10) - Fraternal Societies (service clubs, lineage clubs, or secret societies)
- **501(c)(27)** - State Sponsored Workers' Compensation Reinsurance Organization
- 501(d) - Religious and Apostolic Associations

April 24, 2019

4

Nonprofit Corporations

According to the **Independent Sector** (2016 data):

- Number of Colorado Nonprofit Org's (all types): **25,560**
- 501(c)(3) Public Charities (incl. some religious orgs): **17,901**
- 501(c)(3) Private and Public Foundations: **1,662**
- Other 501(c) Nonprofit: **5,997**

(Civic Leagues, Chambers of Commerce, Veteran's Org's, etc.)

April 24, 2019

5

Impact of Nonprofits

Economic Impact of Colorado's Nonprofit Sector

- Employs **142,000** - almost 8% of the state's workforce
- Generates more than **\$32.1 billion** in annual revenues
 - Cf. Colorado gross domestic product in 2018 of \$345 billion
- Holds assets of **\$73.2 billion**
- Colorado foundations annually **give over \$705 million**

April 24, 2019

6

Impact of Nonprofits

Employment by Nonprofit Service Area

- Religious, Grant making, and Civic Associations - 36%
- Arts, Entertainment, and Recreation - 21%
- Social Assistance - 16%
- Health Care and Hospitals - 9%
- Education 8%

April 24, 2019

7

Impact of Nonprofits

Largest foundations (Denver Bus. Journal, 2017)

1. Colorado Health Foundation
\$2.59B assets / \$85.31M grants in 2017
2. Daniels Fund
\$1.54B assets / \$31.87M grants
3. Denver Foundation
\$842M assets / \$66M grants

April 24, 2019

8

Impact of Nonprofits

Largest Nonprofit Businesses (2014):

Catholic Health Initiatives & CHI Colorado (Centura)
Portercare Adventist Health System
Children's Hospital
Compassion International
SCL Health
UCHealth
University of Denver
St Joseph Hospital

April 24, 2019

9

Lawyers and Nonprofit Board Service

- Required documents
 - Interpretation of articles, bylaws, and policies
 - Conflicts, document retention, whistle blower
- Risk assessment
 - Legal claims, regulatory compliance
- Processes
 - Minutes, documenting actions, executive compensation

April 24, 2019

10

Overview

- Roles of Nonprofit Board member
- Focus on Fiduciary responsibilities
- Conflicts of Interest
- Liability
- Indemnification
- Upholding Duty of Care

April 24, 2019

11

Available Resources

Colorado Secretary of State
Nonprofit Board Member Course

<https://www.sos.state.co.us/pubs/charities/boardTraining.html>

April 24, 2019

12

Colorado Secretary of State Nonprofit Board Member Course



April 24, 2019

13

Additional Resource

Colorado Nonprofit Ass'n
Principles and Practices
for Nonprofit Excellence in
Colorado

<https://www.coloradononprofits.org/resources/principles-practices>

April 24, 2019

14

Roles of Board Member

3 Roles of the Nonprofit Board Member:

- Fiduciary
- Strategic
- Generative

--Richard Chait, *Governance as Leadership* (2005)

April 24, 2019

15

Roles of Board Members

Fiduciary

- Select, support and evaluate **Chief Executive**
- Ensure adequate **financial resources**
- Provide **financial oversight**, including protection of assets
- Ensure legal and ethical **integrity**

April 24, 2019

16

Roles of Board Members

Strategic

- Determine **mission** and purpose
- Ensure effective **planning**
- Monitor and strengthen programs and services
- Build a competent **Board**
- Enhance the Organization's Public Standing

April 24, 2019

17

Roles of Board Members

Generative

Lead the Organization into the future

April 24, 2019

18



Focus on Fiduciary Responsibilities:

- Legal requirements
- Fundamental responsibilities
- Standards by which risk assessed

April 24, 2019

19

Colorado Law

Colorado Revised Nonprofit Corporation Act (2016)

§ 7-128-401. General standards of conduct for directors and officers

- (1) Each director shall discharge the director's duties as a director, including the director's duties as a member of a committee of the board, and each officer with discretionary authority shall discharge the officer's duties under that authority:
 - (a) In **good faith**;
 - (b) With the care an ordinarily **prudent person** in a like position would exercise under similar circumstances; and
 - (c) In a manner the director or officer reasonably believes to be in the **best interests** of the nonprofit corporation.

See also, § 15-1-1103, Standards for Managing and Investing Institutional Funds

April 24, 2019

20

Fiduciary Responsibilities

Common law responsibilities

- When serving on a board, you have a **fiduciary responsibility** to the nonprofit, which includes legal duties and obligations.
- “**Fiduciary**” relationship: Where one person has an **affirmative duty** to act for the **benefit of other persons** in all matters falling within the scope of the relationship between the parties.

--Restatement (Third) of the Law of Trusts,
§ 170 cmt. B (1996)

Fiduciary Responsibilities

Common Law Fiduciary Duties:

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

Duty of Care

- The duty of care requires directors to devote the **necessary amount of time and attention** to the affairs of the nonprofit so they will be able to make **reasonable and informed** decisions.
- In other words, "a director has the duty or obligation to be informed, ask questions, participate in deliberations, and exercise judgement."

April 24, 2019

23

Duty of Loyalty

- The duty of loyalty means putting the **organization's interests** ahead of any private interests.
- In other words, the director, or a party related to a director, may not profit to the detriment of the organization.

April 24, 2019

24

Duty of Obedience

- The duty of obedience means a duty to carry out the **purposes of the organization** and to **obey all applicable laws** - local, state, and federal.
- The **purposes of the organization** are defined in the articles of incorporation, its bylaws, mission statements, and any other governing documents.
- Sometimes this duty is expressed as a separate and distinct duty, and sometimes it is treated as encompassed under the duties of care and/or loyalty.

April 24, 2019

25

CRNA

§ 7-128-401. General standards of conduct for directors and officers

- (1) Each director shall discharge the director's duties as a director, including the director's duties as a member of a committee of the board, and each officer with discretionary authority shall discharge the officer's duties under that authority:
 - (a) In **good faith**;
 - (b) With the care an ordinarily **prudent person** in a like position would exercise under similar circumstances; and
 - (c) In a manner the director or officer reasonably believes to be in the **best interests** of the nonprofit corporation.

See also, § 15-1-1103,
Standards for Managing and Investing Institutional Funds

April 24, 2019

26

Good Faith

- “Good faith” - honesty of intention, openness, and fair dealing.
- If a suit was brought claiming breach of fiduciary duty, a court would evaluate whether a director or officer acted in good faith; it would consider her state of mind and try to determine whether the director or officer was acting **honestly and with faithfulness to his duties or obligations**, or whether she was trying to take advantage of the corporation.

April 24, 2019

27

Ordinary and Prudent Person

“With the care of an ordinarily prudent person” - The balance of the potential risks and rewards when making their decisions.

They do not have to guarantee results, and they are allowed to make errors of judgment or mistakes, as long as they **act with common sense and use informed judgment**.

In order to do so, directors and officers need to stay **adequately informed** about the nonprofit’s affairs, so they understand when issues need their attention.

April 24, 2019

28

Best Interest of the Organization

“In the best interests of the nonprofit corporation” - Subjective belief that director is acting in the best interests of the nonprofit corporation, as long as that belief was **objectively reasonable**.

Placing **interests of the nonprofit before the director’s own interest** or those of another.

April 24, 2019

29

Compare Common Law to Colorado Revised Nonprofit Corporation Act

- The **duty of care** has been incorporated fully into CRNCA, CRS 7-128-401.
- The **duty of loyalty** relates to **“best interests of corporation.”**
 - Aspects of the duty have been incorporated in the statutory rules on conflicting interest transactions.
 - Statutes and case law important in defining the duties of care and loyalty of a director or officer of a nonprofit corporation.
 - **Trustees are not trustees**
- The **duty of obedience** is not expressly addressed in the Colorado statutes or case law. Directors and officers carefully **carry out the organization's purpose** and **obey applicable law**, as failure to do so could implicate the duties of care and/or loyalty.

April 24, 2019

30

Compare UPMIFA (Uniform Prudent Management of Institutional Funds Act)

CRS Sec.15-1-1103, Standards for Managing and Investing Institutional Funds

- (a) Subject to the **intent of a donor** expressed in a gift instrument, an institution, in managing and investing an institutional fund, shall consider the **charitable purposes of the institution** and the **purposes of the institutional fund**.

- (b) In addition to complying with the **duty of loyalty** imposed by law other than this part 11, each person responsible for managing and investing an institutional fund shall manage and invest the institutional fund in **good faith** and with the **care an ordinarily prudent person** in a like position would exercise under similar circumstances.

April 24, 2019

31

Conflicts of Interest

Most Important Policies for Nonprofits:

- Conflict of Interest
- Ethics / Whistleblower
 - Compensation
- Document Retention

April 24, 2019

32

Conflicts of Interest and Intermediate Sanctions

- Conflicts of Interest - CRS 7-128-501
 - **Conflict of interest transaction** means a contract, transaction, or other financial relationship between:
 - The nonprofit corporation and one of its **directors**;
 - The nonprofit corporation and a **party related to a director**; or
 - The nonprofit corporation and an entity in which a director of the nonprofit is a **director or officer**, or has a **financial interest**.

April 24, 2019

33

Conflicts of Interest

- The **mere existence** of a conflict is not prohibited, and CRNCA provides that a conflict of interest transaction if:
 - The director **discloses** the material facts as to the conflict of interest to the board or committee delegated to review conflicts (or voting members, if applicable), and the transaction is **approved** by appropriate affirmative vote, or
 - The transaction is **fair** to the nonprofit corporation.

April 24, 2019

34

Intermediate Sanctions

- For 501(c)(3) public charities, the IRS code can impose penalties called **intermediate sanctions** on “**excess benefit transactions**” with insiders or related persons (e.g., excessive compensation to an officer, or a “sweetheart” sale to a director’s company)
- In severe cases **tax-exempt status can be revoked**.

--Treas. Reg. 2.501(c)(3)-1(f).

April 24, 2019

35

Nonprofit corporation and director liability

April 24, 2019

36

Most Common Nonprofit Lawsuits

- **Contact Disputes**
 - Butterfly Pavilion (breach of contract)
- **Employment Law Claims**
 - University of Denver (equal pay)
- **Tort Claims**
 - Colorado Academy (negligent hiring)

April 24, 2019

37

Lawsuits against Nonprofits

- Woman sued Los Angeles nonprofit that provides **transitional living for pregnant teens**, alleging she was sexually abused, claiming \$5M damages
- Florida **private school** sued by student alleging he was hazed and assaulted.
- Florida **college fraternity** sued by an individual who was shot while attending a fraternity party.
- Lawsuit filed against Greenville SC **homeowners association directors (not HOA)**, for failure to enforce HOA covenants. Over \$50,000 in legal fees. By suing only directors, HOA and directors in adverse positions.
- Lawsuit alleging wrongful termination of long serving executive director filed against Washington State **Bar Association's Board of Governors**.

April 24, 2019

38

Insurance

- General Liability
- Property Insurance
- Auto Liability
- Workers Compensation
- Directors and Officers Insurance
- Errors and Omissions Insurance
- Cyber Liability

April 24, 2019

39

Limitations on Liability

1. Volunteer Protection Act of 1997, 42 USC 14501-05 and CRS 13-21-115.5 – Volunteer Service Act –uncompensated volunteers **immunity for acts of negligence** within the **scope of volunteer duties**, except where **willful, criminal, or gross negligence**.
2. CRS 13-21-115.7 – **Uncompensated** nonprofit directors **immune from civil liability** for actions taken in performance of duties, except for were **willful and wanton** acts or omissions
3. CRS 13-21-116 – Volunteers and nonprofit directors **do not assume a duty of care and not held liable** when performing uncompensated services for others, where acts performed in **good faith** (volunteers), and not **wanton and willful** (directors).

April 24, 2019

40

Indemnification

- “[The] evolution of board member fiduciary duties has been to **increase the liability exposure of directors and officers** serving both nonprofit and for-profit institutions.”

Foxman, Directors and Officers Liability Insurance for Nonprofits,
Business Law Today, American Bar Ass'n, 9/19/18,
https://www.americanbar.org/groups/business_law/publications/blt/2009/07/05_foxman/

- CRS 7-129-102:
Authorizes nonprofit to indemnify liability of directors, if director acted in **good faith** and in the **best interest** of the nonprofit, that is, **fulfilled their fiduciary responsibility**.

April 24, 2019

41

Indemnification

- Boards should carefully consider **indemnification policies** and **directors and officers insurance** for directors, officers, employees, and volunteers.
- Individuals should review a nonprofit's **indemnification policies** and **available insurance** when deciding whether to serve on a board of directors.

April 24, 2019

42

Directors and Officers Insurance

- Volunteer Protection Act and similar statutes limited to uncompensated nonprofit directors and volunteers.
- Statutes do not provide for costs of defense.
- Directors and Officers (D&O) Liability Insurance:
 - Liability insurance covering directors and officers for claims made against them while serving on a board of directors and/or as an officer.
 - Similar to Errors and Omission (E&O) Insurance

April 24, 2019

43

Directors and Officers Insurance

D&O Insurance:

- A-Side: Payment directly to directors if claim outside of indemnification policy or not available due to insolvency
- Side B: Payment to nonprofit to cover indemnification claims and responsibilities
- Side C: Coverage of the nonprofit itself

April 24, 2019

44

Additional Insurance

Additional Insurance:

- Side A Difference in Condition (DIC)
 - Additional coverage to fill gaps in Side A, e.g. bad faith claim, exhaustion of primary policy
- Personal Umbrella policies (\$150-300/\$1M)
 - Carefully check policy for exclusions related to board service

April 24, 2019

45

Scope of Duties

All board decisions and actions are made **collectively** by the board except to the extent authorized by **articles, bylaws, and express board action**.

April 24, 2019

46

Upholding Duty of Care

Generally:

- Know the nonprofit's mission, activities, and plans.
- Know the nonprofit's articles of incorporation and its bylaws.
- Request expert advice if a decision requires information and judgment that is outside the board's experience and expertise.
- Actively engage in oversight of management.
 - Do not micromanage

April 24, 2019

47

Upholding Duty of Care

For Board Meetings:

- Attend board meetings.
- Prepare for board meetings by reading the minutes from the previous meeting, the agenda, and any additional information provided.
- Read committee reports.

April 24, 2019

48

Upholding Duty of Care

Accounting and Financials

- Require frequent financial and annual budgets reports.
- Ensure proper accounting systems and internal controls are in place to prevent fraud and embezzlement.
- Review and approve budgets.
- Review financial and investment reports.
- Consider hiring a CPA to audit or review the organization's annual financial statement.
- Ensure appropriate board review of audit and investment functions, including audit and investment committees if appropriate.

April 24, 2019

49

Upholding Duty of Care

Good Governance Practices:

- Ensure compliance with all applicable laws and review the organization's regulatory filings before they are filed.
- Register as appropriate to solicit contributions;
- Review IRS Form 990 or 990-PF;
- Ensure proper wage withholding, employment taxes, and other employment responsibilities.

April 24, 2019

50

Upholding Duty of Care

Good Governance Practices

- Control distributions of the organization's assets to directors.
 - Distributions by nonprofits are generally forbidden, with only a few exceptions, such as paying reasonable compensation to members, directors, or officers for services rendered.
- Ensure appropriate conflict of interest policy for staff, volunteers, and the board, and administer conflicts of interest appropriately.
- Foster an atmosphere that encourages employees to come forward with problems (whistleblower policy).

April 24, 2019

51

Available Resources



Colorado Secretary of State Nonprofit Board Member Course

<https://www.sos.state.co.us/pubs/charities/boardTraining.html>

April 24, 2019

52

Available Resources

Additional topics:

- Federal Volunteer Protection Act
- Form 990 and Financial Ratios
- Regulatory compliance
- Employer responsibilities (compliance generally/executive compensation)

April 24, 2019

53

Contact information:

Paul Chan
University Counsel's Office
303-871-4646
paul.chan@du.edu
www.du.edu/counsel

April 24, 2019

54