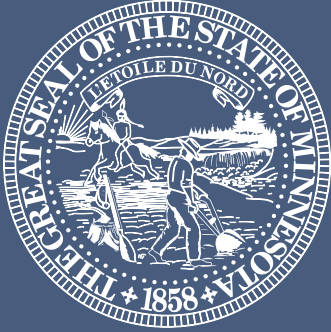


GUIDE FOR BOARD MEMBERS



FIDUCIARY DUTIES OF DIRECTORS OF CHARITABLE ORGANIZATIONS

FROM THE OFFICE OF
MINNESOTA ATTORNEY GENERAL
KEITH ELLISON

www.ag.state.mn.us

This Guide is provided by the Minnesota Attorney General's Office to assist board members with the important responsibilities they assume when elected to a nonprofit corporation's board of directors. It is only a guide and is not meant to prescribe exactly how board members must act in all situations. Each organization is different and experiences distinct circumstances and outcomes.

This guide is provided as a reference tool to assist directors in performing their duties. It does not contain all of the provisions, exceptions, limitations, and requirements of the law. For the exact requirements of the law, please refer to the source of the law itself. Many of the principles discussed in this guide are taken from the Minnesota Nonprofit Corporation Act, located in Minnesota Statutes chapter 317A.

For more assistance, there are a number of resources in Minnesota that provide information, direct assistance and materials for nonprofits, their officers, and their directors at little or no cost. A list of these resources can be obtained from the Minnesota Attorney General's Office:

Office of Minnesota Attorney General Keith Ellison

445 Minnesota Street, Suite 1400, St. Paul, MN 55101

(651) 296-3353 (Twin Cities Calling Area)

(800) 657-3787 (Outside the Twin Cities)

(800) 627-3529 (Minnesota Relay)

www.ag.state.mn.us

Fiduciary Duties of Directors of Charitable Organizations is written and published by the Minnesota Attorney General's Office.

This document is available in alternative formats to individuals with disabilities by calling (651) 296-3353 (Twin Cities Calling Area), (800) 657-3787 (Outside the Twin Cities), or through the Minnesota Relay Service at (800) 627-3529.

I.

INTRODUCTION

The Attorney General’s Office has prepared this Guide for Board Members to help directors understand their role and responsibilities as stewards of the nonprofit organizations for which they serve. Under Minnesota law, directors of Minnesota nonprofits are responsible for the management, finances, and other affairs of the corporation. This means that directors must supervise and govern the nonprofit’s efforts in carrying out its mission. This does not mean that directors are required to manage the day-to-day activities of a corporation. Rather, directors can appoint officers and employ individuals who carry out the daily tasks of running the nonprofit organization. Directors must be active, informed, and engaged, as they are considered fiduciaries—a term used for individuals who are in a position involving trust. Specifically, directors are subject to the fiduciary duties of care, loyalty, and obedience to the law, among others. Minnesota courts have long held that the law imposes the highest standard of integrity on the bearers of these fiduciary duties.

II.

TO EXERCISE THE PROPER DUTY OF CARE

The duty of care generally requires that directors discharge their duties in good faith, in a manner the director reasonably believes to be in the best interests of the nonprofit corporation, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. This means:

- 1. Active Participation.** A director must actively participate in the management and operations of the organization. This includes preparing for and attending board meetings, reading and evaluating all materials received in advance of meetings, reading meeting minutes, reviewing the performance and compensation of the Executive Director and the organization’s other officers and employees, reviewing financial documents, exercising independent judgment, asking questions to obtain information necessary to make informed decisions, and so on. Serving on a board is a significant commitment. Individuals who do not have the time to participate as required should not agree to be on a board of a nonprofit organization.
- 2. Committees.** Directors may establish committees having the authority of the board and may rely on information, opinions, or reports of these committees for certain matters. These committees are subject to the direction and control of the board, however, and committee action alone does not mean a director has properly discharged the director’s fiduciary duties. As a result, directors are still responsible for overseeing these committees and should periodically scrutinize their work.
- 3. Board Actions.** The board takes action by the affirmative vote of a majority of directors present with voting rights at a meeting. A director who is present at a meeting when an action is approved by the entire board is presumed to have agreed to the action unless: (1) the director objects to the meeting because it was

not lawfully called or convened and does not participate in the meeting; (2) the director votes against the action; or (3) the director is prohibited from voting on the action because of a conflict of interest. Proxy voting, or voting through an agent, by directors is not permitted.

4. **Minutes of Meetings.** Written minutes should be taken at every board meeting. These minutes should accurately reflect board discussions, as well as any board actions taken at meetings.
5. **Books and Records.** A director should have general knowledge of the books and records of the organization. The organization's articles, bylaws, accounting records, voting agreements, minutes, and financial statements must be made available to directors and members of the nonprofit who wish to inspect them for a proper purpose. A board should consider adopting written document retention policies to ensure documents are properly maintained and stored.
6. **Accurate Record Keeping.** A director should not only be familiar with the content of the organization's books and records, but should also assure that they are accurate. This may require the director to take steps to have regular audits conducted by an independent certified public accountant. At the very least, the director should be aware of what the financial records disclose and take appropriate action to make sure there are proper internal controls, or processes to assure reliable financial reporting and proper administration over charitable assets.
7. **Charitable Assets.** A director has the duty to protect, preserve, invest, and manage the nonprofit corporation's charitable assets and property in a fashion consistent with the purposes for which they were given and legal requirements. Instituting proper internal controls aids in the protection of the nonprofit corporation's charitable assets.
8. **Resources.** A director must assist the organization in obtaining adequate resources to enable it to further its charitable mission.
9. **Investigations.** A director has a duty to investigate warnings or reports of officer or employee theft, mismanagement, or misuse of the nonprofit's charitable assets. In some situations, a director may have to report misconduct to the appropriate authorities, such as the police or the Attorney General. When appropriate, a director should consult an attorney or other professional for assistance.

III.

TO EXERCISE THE DUTY OF LOYALTY:

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Directors have an absolute duty of complete, undivided loyalty to the organization. This means that directors should avoid using their position or the nonprofit's assets in a way which would result in monetary gain for them or a member of their family. A director should put the best interests of the organization first and avoid engaging in transactions with the organization from which the director will benefit. This means:

- 1. Conflicts of Interest.** Under Minnesota law, a conflict of interest arises when a nonprofit enters into a contract or transaction with a director, a director's family member, or another organization in which the director has a material financial interest. In limited circumstances, these types of transactions may be acceptable. If the transaction is challenged, it may be permissible if the interested director has carried the burden of establishing that the transaction was fair and reasonable to the nonprofit, that there was full disclosure of the conflict to other directors or members, and that the contract or transaction was approved by non-interested members or other directors in good faith.
- 2. Written Policy.** Boards should establish a written policy on avoiding conflicts of interest. This policy should include written procedures for determining potential conflicts of interest and identify a course of action for when such conflicts arise.
- 3. Loans.** It is rarely proper for a nonprofit corporation to provide a loan or guarantee to a director or the director's family members. Such transactions raise ethical questions and typically subject the nonprofit corporation and the board to public and government scrutiny. In limited circumstances, a nonprofit may provide a loan or guarantee to a director or the director's family members if, in the judgment of the entire board, the transaction will benefit the nonprofit, as opposed to the loan or guarantee recipient. These decisions should be meticulously documented and tracked through means such as board meeting minutes, correspondence, ledgers, etc. to establish their propriety.
- 4. Corporate Opportunity.** Directors are under a fiduciary obligation not to divert a nonprofit's business opportunity for their personal gain. This means that a director may not engage in or benefit from a business opportunity that is available to and suitable for the nonprofit unless the organization decides not to engage in the business opportunity and the board follows the conflicts of interest procedures set forth in the Minnesota Nonprofit Corporation Act.
- 5. Internal Revenue Code.** There are additional prohibitions related to the duty of loyalty that are specified in the rules of the Internal Revenue Code regarding self-dealing. For more information, visit www.irs.gov/charities-non-profits.

IV. TO EXERCISE THE DUTY OF OBEDIENCE:

Directors have a duty to follow the nonprofit's governing documents, to carry out the organization's mission, and to ensure that funds are used for lawful purposes. Additionally, directors must comply with state and federal laws that relate to the organization and the way in which it conducts its business. This means:

- 1. State and Federal Statutes.** Directors should be familiar with state and federal laws relating to nonprofit organizations, charitable solicitations, sales and use taxes, FICA and income tax withholding, and unemployment and workers' compensation obligations. They should also be familiar with the requirements of the Internal Revenue Service. Directors should see to it that their organization's status with state and federal agencies is protected.
- 2. Filing Requirements.** Directors must comply with deadlines for tax and financial reporting with the Internal Revenue Service, for registering with the Attorney General's Office, for making social security payments, for income tax withholding, and so on. If an organization is incorporated under the Minnesota Nonprofit Corporation Act, directors also have a duty to maintain the organization's corporate status by submitting timely filings to the Secretary of State's Office.
- 3. Governing Documents.** Directors should be familiar with their organization's governing documents (including articles of incorporation, constitution, bylaws, codes of conduct, codes of ethics, and any other documents governing the organization) and should follow the provisions of those documents. Directors should ensure that proper notice is given for board meetings, that regular board meetings are held, that directors are properly appointed or elected, and that the organization's mission is being accomplished.
- 4. Board Training.** Directors should consider what training and education the board may need on a regular basis to ensure proper oversight of the corporation, and develop an orientation for new board members.
- 5. Outside Help.** When appropriate, directors should obtain opinions of legal counsel or accountants.

V. ENFORCEMENT OF THESE DUTIES:

If a director breaches his or her fiduciary duties, or fails to act in accordance with the standards described above, at least 50 members with voting rights or ten percent of members with voting rights, whichever is less, or the Attorney General's Office, may bring an action for equitable relief, including awarding attorney fees and disbursements to members.

VI. RESOURCES FOR NONPROFITS:

1. Attorney General's website

www.ag.state.mn.us

The Attorney General's website has a number of useful publications, reports, links to information, and all registration forms and instructions issued by the Charities Division available online for viewing or downloading.

2. Internal Revenue Service

www.irs.gov

The website of the Internal Revenue Service has useful information about required filings by nonprofit organizations and compliance to maintain tax-exempt status.

3. Guidestar

www.guidestar.org

Guidestar is a website which has free information on the programs and finances of more than 1.8 million charities and nonprofits.

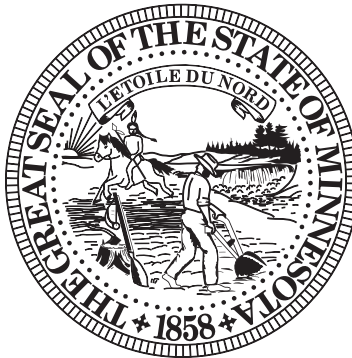
4. Propel Nonprofits

www.propelnonprofits.org

Propel Nonprofits states that its mission is to fuel the impact and effectiveness of nonprofits with guidance, expertise, and capital, including by providing nonprofit accounting assistance and financial management, board development, loans, and strategic consulting.

ENFORCEMENT
OF THESE
DUTIES

RESOURCES FOR
NONPROFITS



Charities, charitable trusts, and professional fundraisers with questions, or that wish to access registration and reporting forms, should visit the Attorney General's Office's website at www.ag.state.mn.us. The website has additional information on the topics discussed in this guide. Organizations may also call the Attorney General's Office with questions at (651) 296-3353 (Twin Cities Calling Area), (800) 657-3787 (Outside the Twin Cities), or through the Minnesota Relay Service at (800) 627-3529. Written inquiries and other submissions should be directed as follows:

Minnesota Attorney General's Office

Charities Division

445 Minnesota Street, Suite 1200

St. Paul, MN 55101

www.ag.state.mn.us/charity