

**Office of the
Attorney General**

Service on an Idaho Nonprofit Board of Directors



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State of Idaho Office of Attorney General Lawrence Wasden

Idaho is a great place to live and charitable organizations make a significant contribution to Idaho's quality of life. Idahoans benefit greatly from the services and goods these organizations provide. Many charities are led by volunteers who give their time and talent to help organizations accomplish their charitable missions.

Charitable corporations and organizations vary in size, mission, and structure, but there are several principles and rules applicable to the people who serve on their boards of directors. This manual is provided to assist board members in fulfilling their duties. In short, board members need to understand the three "R's" of serving as a director: the Role they fulfill, the Rights they have, and the Responsibilities placed upon them.

This manual is not a substitute for the advice of a qualified attorney. The Attorney General encourages boards to consult with professional advisors, including attorneys and accountants, to help their organizations comply with the law. Attorneys within the Attorney General's Office cannot give legal advice to private persons or entities. Additionally, the Attorney General does not enforce the Idaho Nonprofit Corporation Act, the primary law that governs the internal organization and operations of nonprofits.

On behalf of all Idahoans, I thank the board members of Idaho's charities for their service. It is needed and respected. I hope this manual helps board members fulfill their duties.

I would also like to thank the Idaho Nonprofit Center for assisting my office in the preparation of this manual.

Sincerely,

LAWRENCE G. WASDEN
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SERVICE ON A CHARITABLE ORGANIZATION

This manual is intended to assist persons serving on a board of directors of an Idaho charitable corporation. The Idaho Nonprofit Corporation Act states that unless a nonprofit corporation's articles of incorporation place management of the corporation in its members or in a third person, the affairs of the nonprofit shall be managed by a board of directors. While it is true that not every charitable organization is a nonprofit corporation, it is common for organizations to be governed by a board of directors.

UNDERSTANDING A BOARD MEMBER'S ROLE

People serve on a charitable organization's board of directors for various reasons. Some may be skilled fundraisers. Others may have social standing. Still others may have special knowledge and expertise. Regardless of the reason for serving, each board member needs to understand that fundamentally his or her role is akin to one of a fiduciary.

In the law, a fiduciary is someone who holds a position of trust and from whom scrupulous good faith and candor is expected. This is certainly true for a board member, who is charged to act for the benefit of a charity and to manage the charitable assets for the use and benefit of the community.

This fiduciary role of the charity cannot be over-emphasized. Each board member is ultimately responsible for the charitable organization's mission, its charitable trust assets, and its place in the community.

Successful fulfillment of this role requires a clear understanding of the charitable organization and its purposes, assets, and mission. Board members must participate actively in the charity's governing and supporting activities. Those

who do not have the time to participate regularly should not serve on a board.

Perhaps the most important responsibility of a board member is ensuring that the organization is operated for its stated charitable purposes. It cannot be operated for any other purposes. A board member must ensure that the organization's assets are held "in trust" to be applied to its charitable mission. Allowing the charitable organization to be diverted from its mission or allowing its charitable trust assets to be used for purposes outside its stated mission violates that trust and is impermissible.

Keeping a charitable organization's resources and efforts focused on its mission requires the board member to understand the organization's programs, people, and available resources. As a starting point, every board member should be familiar with the charitable organization's articles of incorporation and bylaws.

The articles of incorporation include the general charitable purposes for which the organization was created. The bylaws are the rules by which the board agrees to govern itself.

If the charitable organization has received tax exempt status from the IRS, the board member should also be familiar with the information that the charitable organization submitted on its application to the IRS that qualified the charity for tax exemption. For a charitable organization that has been granted "501(c)(3)" status by the IRS, the application is on an IRS form called Form 1023. This form must be made available to the public. A charitable organization's tax exempt status is something of great value, and board members should be aware of what went into obtaining the exemption and what is necessary to maintain the status.

UNDERSTANDING A BOARD MEMBER'S RIGHTS

The board member must make informed decisions about important matters involving the organization's assets and operations in order to carry out his or her legal responsibilities and to serve properly as a fiduciary of the charitable organization. In making these decisions, a board member should understand that the law permits him or her to reasonably rely on information he or she receives from the charitable organization's staff, its lawyer, its accountant, its outside advisors, and its board committees.

A board member also has various rights to obtain information that relates to the charitable organization and its activities. For example, the board member has the right of reasonable access to:

- the organization's management (most likely the executive director or chief executive officer);
- internal information of the organization;
- the organization's principal advisors, such as its auditors and lawyers; and
- financial statements and records of the charity, including minutes of board meetings.

The board has the right, if necessary, to engage the services of outside advisors, at the charity's expense, to assist it with a particular matter. In short, board members have the right of access to and the obtaining of relevant information about the charity.

UNDERSTANDING A BOARD MEMBER'S RESPONSIBILITIES

A member of a charitable organization's board of directors has three basic responsibilities or duties. Each is a duty of trust.

The duties are that of care, loyalty, and obedience.

Duty of Care

The duty of care is the level of competence expected of a board member as he or she fulfills his or her responsibilities. In a nutshell, the most commonly used duty of care standard states that a board member must use the same care that an ordinarily prudent person would exercise in a like position and under similar circumstances. Acting with due care does not mean that the board member cannot take risks, cannot make mistakes, and can never be wrong. Rather, it means that the board member must act with common sense and with an informed judgment.

In order to act with due care, a board member needs to actively participate in the governance of the organization. This means attending board meetings regularly, reviewing relevant reports, and reading minutes of various meetings.

Acting with due care also means the board member makes relevant, reasonable inquiries concerning the organization. A board member needs to obtain sufficient information so that he or she can carry out the responsibilities of the board member. When a problem exists or a report on its face does not make sense, a board member has a duty to inquire into the facts and circumstances.

A board member also has a duty to investigate and respond to warnings or reports of officer or employee theft, mismanagement, or malfeasance. The bottom line is that a board member acting with due care is informed about the organization's activities.

Duty of Loyalty

The duty of loyalty is the commitment a board member makes

to the organization. A board member is expected to give his or her undivided allegiance to the charitable organization. The board member cannot use for personal gain any information obtained from his or her position on the board and should not discuss confidential board business with outsiders.

Decisions regarding the organization's funds and activities must promote the organization's stated public purposes, rather than the board member's personal interests. However, although the board member must put the organization's interests ahead of the interests of family, friends, or business, a board member is permitted to have business dealings with the organization.

Part of the duty of loyalty deals with conflict of interest situations that can arise. Conflicts of interest can occur when the organization is considering a transaction with a board member, members of the organization or staff of the organization that may also benefit that person's personal, family or professional interests. Such actions should be carefully scrutinized because the public may be suspicious of such activities.

The board should establish a written policy for addressing conflicts of interest. The policy should include provisions for an interested board member's disclosure of financial interests, withdrawal from discussions where a conflict of interest is identified, and abstention from voting. Because of the sensitivity of conflicts of interest, it is recommended that a transaction that benefits one board member should proceed only if a super-majority of the board consents. The IRS provides a comprehensive sample conflicts of interest policy that can be found in appendix A of the instructions for IRS Form 1023.

Duty of Obedience

The duty of obedience refers to a board member's obligation to keep the charity focused on its mission, in compliance with the organization's organizing documents (normally the organization's articles of incorporation and bylaws) and tax exempt status, and lawfully using its funds. Board members must comply with state and federal laws applicable to the organization.

For example, board members should understand:

- **Federal Law.** Most charitable organizations must apply to the Internal Revenue Service for approval as a tax-exempt organization. Corporations that fail to obtain tax-exempt status are taxed at applicable corporate income tax rates, and contributors cannot take an income tax deduction for their donations. Most nonprofit corporations are required to file financial and other information with the IRS, using the appropriate version of IRS Form 990.
- **Idaho Law.** An Idaho nonprofit corporation must annually renew its status with the State by filing a form with the Idaho Secretary of State. The form requires a listing of the board of directors, but does not ask for financial information.
- **Laws of Other States.** If a charity is doing business outside of Idaho, a board member will want to ensure that the charity is in compliance with other states' charitable registration requirements.
- **Bylaws and Policies.** Board members should be familiar with bylaws and policies adopted by the board of directors to ensure that the organization follows their provisions. Board members are responsible for

updating these documents as the corporation's conditions or mission changes.

The board must give proper notice to members for meetings, hold regular meetings, appoint board members, and carry out the organization's mission. Minutes of board meetings and records of all actions taken by the corporation should be kept and maintained.

Boards may adopt a variety of policies useful for governing. These policies may address conflicts of interest, financial documentation, expenditures, personnel hiring and retention, fundraising, and executive and staff compensation.

- **Proper Financial Controls.** Board members must ensure that the organization's financial records are kept current and accurate. Effective financial controls are crucial to safeguarding an organization's assets from theft and financial impropriety. Connected to this responsibility, the board should review and approve the corporation's annual budget. The organization's treasurer should provide the board with current and thorough income and expense statements, balance sheets and budget status reports, preferably in advance of the board meeting.
- **Donations and Responsible Solicitation Activities.** All donations must be used to further the organization's stated mission. However, donors may designate that their gifts be used for a particular purpose. If the charity accepts such a gift, it must comply with the donor's instructions and use the donation for the designated purpose.

Some charities contract with professional fundraisers to solicit donations on the charity's behalf. To avoid legal complications and financial disaster, it is

important to hire a reputable, trustworthy fundraiser pursuant to a written contract that clearly sets forth the agreed-upon duties. The charity should review the fundraiser's references and investigate the fundraiser's past activities. Receiving angry complaints or undergoing a law enforcement investigation because of a third-party telemarketer's unlawful or annoying activities can destroy a charity's reputation.

Any contract with a professional fundraiser should be fair and reasonable, especially the terms of compensation. Most donors reasonably expect that most of their contributions will go to the charity and not to the fundraiser. It is generally considered unethical for a fundraiser to be paid a percentage of funds raised, though it is not illegal in Idaho to do so.

PERSONAL LIABILITY

Board members of a charitable corporation can become defendants in a lawsuit filed by someone who believes the organization caused the person an injury or financial loss. However, to encourage citizens to serve on boards, lawmakers enacted a "qualified immunity" law. This means volunteer members cannot be sued for their negligent acts. A member, however, is subject to suit based on the member's "gross" negligence or his or her willful or fraudulent acts.

Because some degree of litigation risk exists for board members, including the cost of defending a frivolous lawsuit, a charity should consider purchasing directors and officers (D&O) liability insurance. Including indemnification provisions in the organization's governing documents or in its agreements with the board members also helps minimize the board member's liability.

RESOURCES

Idaho Nonprofit Corporation Act, Title 30, Chapter 30,
Idaho Code

Available online at www.legislature.idaho.gov

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www.idahononprofits.org

Internal Revenue Service

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