Legal Duties and Obligations of NPO Board Members

What Does a Nonprofit Board of Directors Do?

**The board has legal and ethical duties that cannot be delegated to others.**These duties include:

**(1) Legal Oversight.**

* + - * The board generally ensures that it is operating in accordance with its mission and the purpose for which it was granted tax-exempt status.
			* As safeguards of the public trust, board members generally are responsible for protecting the organization’s assets.
			* The board should ensure legal and ethical integrity and maintain accountability.

**(2) Management Oversight.**

* + - * The board is responsible for ensuring that the nonprofit corporation is being run well.
			* The board selects the chief executive and decides his/her role. (The chief executive is often called the executive director.)
			* The board supports the chief executive and assesses his/her performance.
			* The board usually has the power to hire and remove the chief executive.

**(3) Financial Oversight.**

* + - * The board provides proper financial oversight, including setting and approving an annual budget.

**(4) Program Oversight.**

* + - * The board ensures that programs are in place to further the mission and goals of the organization.

Strong nonprofits have boards and staff with respectful working relationships. It is often the job of the executive director to keep the board informed on various legal, financial, planning, and policy, personnel issues. And since it is the board’s job to provide oversight of the executive director to ensure that the nonprofit is being run well, it is helpful for the two to find a healthy balance of guidance and supervision.

What are Nonprofit Directors’ Legal Duties and Obligations?

Directors are required to perform their duties **in good faith,** **with ordinary care**, and in the **best interest of the nonprofit.**

* + **In good faith**. Good faith is shown by honesty and faithfulness to duties and obligations.
	+ **With ordinary care**. Ordinary care is the use of good judgment and common sense. It means doing what an ordinarily prudent person in a similar position would do under similar circumstances. Ordinary care may differ from director to director based on their background and experience and the role they play in the organization.
	+ **In the best interest of the nonprofit**. A director acts in the best interest of the nonprofit if the director reasonably believes that the action will benefit the nonprofit. Doing what is in the best interest of the nonprofit means being *loyal* to the nonprofit – it means the nonprofit’s interest prevails over the director’s personal or business interest. Doing what is in the best interest of the nonprofit means that directors are *obedient* to the “laws” of that nonprofit, which include adhering to the Articles of Incorporation (or Certificate of Formation), bylaws, tax-exempt status, and faithfully following its mission and purpose. As always, it means that directors follow all laws applying to the nonprofit – federal, state, and local laws and regulations.

Are There Any Protections for Nonprofit Directors?

There are some protections for directors, including the following:

* + **Reliance on certain information prepared by others**. In some cases, a director may rely on information prepared by others. If the director is acting in good faith and with ordinary care, the director may rely on reports, financial statements, and information prepared by another director or by an employee, a board committee, legal counsel, accountants, or other professionals hired. However, the director is not protected from liability if she has knowledge that makes the information unreliable.
	+ **Delegation of Investment Authority**. If the board acted in good faith and with ordinary care in selecting a financial advisor for the nonprofit, the board may have no liability from any action taken or omitted by an investment advisor who invested the funds of the nonprofit.
	+ **Indemnity**. Occasionally a person is sued simply because he or she is or was a director of a nonprofit. In some situations the nonprofit may indemnify (pay the legal expenses for) the director; in other situations the nonprofit must must indemnify the director.
	+ **Insurance and other protections**.  A nonprofit may provide additional protection for directors by providing Director’s and Officer’s liability insurance.

What Directors Should Know About the Nonprofit & What Documents Directors Should Have in Files

Decision makers of nonprofit corporations that engage in ongoing operations should understand that their duty of care goes beyond financial or business decisions to reach all decisions made in the course or scope of their duties as directors.

**Board members should know details concerning the following matters:**

* + Legal form of the organization (is it a corporation or an unincorporated association?)
	+ Mission of the organization
	+ Provisions of the Articles of Incorporation (some states call this the Certificate of Formation)
	+ Provisions of Bylaws
	+ Any policies affecting decision makers (e.g. Conflict of Interest Policy)
	+ Financial Picture (budget and financials)
	+ Most recent IRS Form 990
	+ Existence/operations of related entities
	+ Where the organization is conducting activities
	+ Tax status and applicable legal requirements of the organization (is it a 501(c)(3)?)
	+ Activities being conducted by the organization
	+ Management structure
	+ Key employees
	+ Committee structure
	+ How directors and officers are selected

**Directors should keep the following in files:**

* + Articles of Incorporation/Certificate of Formation from the Secretary of State
	+ Most recently adopted bylaws
	+ Conflict of interest policy
	+ Minutes of the previous year
	+ Most recent audit/review
	+ Budget and most recent financials (Profit and Loss; Balance Sheet)