

CHARITABLE LAW SECTION

GUIDE FOR BOARD MEMBERS

**FIDUCIARY DUTIES OF
TRUSTEES AND DIRECTORS
OF CHARITABLE ORGANIZATIONS**

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TRUSTEE/DIRECTOR: THEY ARE NOT HONORARY TITLES

Charities depend greatly on volunteers for their governance. Volunteers donate their time for a variety of reasons: Some are interested in the charity's programs, while others may feel that the position brings them some level of prestige. Most often, the motivation is a sense of civic duty and the satisfaction that comes from making a contribution to the community.

Charities often seek prominent members of the community to serve on their boards, perhaps because of that individual's business and management reputation. This could also be a means of honoring that individual and boosting the image and credibility of the charity by having well-known names listed among its trustees. Whatever the motivation of the individual or the charity, joining a board of trustees is a decision not to be taken lightly.

Prospective board members should investigate what such a commitment will entail, and understand the role, function, and responsibilities of a charity's governing body. This guide is intended to assist in that endeavor.

THE LEGAL DUTIES

Trustees and directors of a charitable organization, whether or not the organization is formally incorporated as a nonprofit corporation, have specific legal duties owed to the organization. The primary duties are:

The duty of care.

The duty of loyalty.

The duty to maintain accounts.

The duty of compliance.

THE DUTY OF CARE

The duty of care requires that a trustee be active in the charity's affairs by attending board meetings and meetings of committees on which the trustee serves. A board member must keep himself or herself informed to determine if the policies established by the board are being followed and should understand how the charity is functioning.

This duty must be discharged diligently and in good faith. Board members must act with knowledge and after adequate deliberation. They should carefully establish organizational policy and regularly oversee its administration by a competent staff.

Board members who are regularly absent from meetings, are inactive, or who fail to conduct adequate research prior to making decisions are not fulfilling their duties of care. Board members should conduct themselves with the level of care, skill, and diligence exercised by prudent persons in the handling of their own affairs. Generally, a board member who knows the facts, analyzes the probable result

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of an action, exercises sound judgment, and keeps reasonable records acts prudently and fulfills his or her duty of care. Some ways you can meet your duty of care include:

- Understand the charity's mission by familiarizing yourself with the charity's articles of incorporation, constitution, by-laws, or other governing documents.
- Attend board and committee meetings and be prepared for those meetings by reading and reviewing reports, minutes, and other materials distributed for the meeting.
- Be prepared to ask questions and obtain the information needed for you to make informed decisions in approving and disapproving proposals. Included in your responsibilities is the oversight and review of the performance of the charity's executive director or chief executive officer. You should exercise your independent judgment and not merely acquiesce to the staff's requests.

THE DUTY OF LOYALTY

Many problems can be avoided if board members keep the duty of loyalty foremost in their thoughts. The duty of loyalty requires that the interest of the charity, and, as a consequence, the interest of the public, take precedence over the board member's personal interests. A trustee must, loyally and **without self-interest**, further the charitable objectives of the organization by acting fairly and in the best interest of the charity.

Trustees may breach the duty of loyalty when they engage, directly or indirectly, in transactions between themselves as trustees and themselves as individuals. They may also violate this duty by being involved in transactions with family members or businesses in which they hold an interest. Board members should not engage in any transaction that is adverse to the charity, engage in any competing enterprise to the detriment of the charity, divert an organizational opportunity for personal gain, or derive any kind of secret profit or other advantage in dealing with or on behalf of the charity. **Caution should be exercised in entering into any business relationship between the organization and a board member.** This should be avoided entirely unless the board determines that the transaction is clearly in the charity's best interest. Ways to avoid trouble:

- Ensure that the interest of the charity is always first.
- Establish a written policy for dealing with conflict of interest situations, which should include procedures for written disclosures from board members concerning business dealings with the charity or those seeking to do business with the charity.
- Disclose your financial interest whenever the charity proposes to enter into a business relationship with you, a member of your family, or a business in which you hold an interest. Don't vote on the transaction or participate in any debate or decision on the merits of the transaction.
- Don't divert an opportunity available to the charity for your own gain.
- Avoid transactions involving potential conflicts of interest, appearance of impropriety, and self-dealing situations.

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THE DUTY TO MANAGE ACCOUNTS

Board members are responsible for assuring the financial accountability of the charity. Procedures should be established to keep the organization fiscally sound and ensure that it operates in a fiscally responsible manner. Care must be taken for the proper use of any restricted funds. Trustees should oversee the executive director and determine that the charity's purposes are fulfilled without waste. Preparation of a budget is important for providing clear directions for spending and translating program and management goals of the board into financial projections.

The organization should be able to demonstrate the wise use of its funds. Accurate records of all income, expenditures, transactions, and activities must be maintained. Accurate minutes of board meetings should be taken in order to demonstrate board approval of certain expenditures and investments and to show that informed decisions were made with regard to these transactions.

- Keep accurate records of income, investments, expenditures, and transactions, and accurate minutes of board meetings.
- Develop annual budgets that provide clear direction for spending at all levels of activities. The budget should be a blueprint of the board's program plans.
- Establish appropriate internal accounting systems, including a system of checks and balances. No one person should retain total control over finances.
- Prudently invest and reinvest assets.
- Assist the organization in acquiring resources for its programs. Develop fund-raising goals and policies. Make certain that fundraising appeals are presented honestly and fairly, and monitor the performance of fund-raising professionals.
- Shop around for the best values in goods and services through comparisons and informed bidding processes. This process should also be applied to contracts entered into with fund-raising professionals.

THE DUTY OF COMPLIANCE

Board members have a duty to be faithful to the organization's purposes and comply with the charity's governing documents. They are also under a duty to be familiar with the laws that apply to the charity and to comply with those state and federal laws that relate to the charity and its business operations.

- Be familiar with and follow the provisions of the charity's articles of incorporation, constitution, by-laws, or other governing documents.
- Familiarize yourself with state and federal laws relating to nonprofit entities, fund-raising, and tax-related issues.
- Comply with state and federal registration and reporting requirements, which may include filings with the Ohio Attorney General, the Ohio Secretary of State, and the Internal Revenue Service.

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KEEPING THE BOARD VIGOROUS

To ensure the continuing vitality of the charity and its awareness and responsiveness to community needs, board members should look for ways to continue to breathe new life into the board. Choose board members who have an interest in the charity's mission and represent diverse viewpoints. Actively recruit individuals whose skills and commitment will enhance the charity. Consider term limits and rotation off the board to other assignments as a means of avoiding stagnation, tunnel vision, and the perception that the board is merely an insider's club.

CONSEQUENCES

There can be severe consequences to trustees for breaches of fiduciary duty. Trustees can be held individually responsible to charities for breaches of fiduciary standards. For example, if charitable assets are sold at less than their fair market value, trustees may be held accountable for any shortfalls.

IS IT WORTH IT?

Serving the community and its needs is a worthy act of stewardship. However, a board member who feels that his or her position as trustee is merely honorary is in for a shock. Service on a charity's board requires your acceptance of responsibility for the funds donors have contributed. Donors are placing their trust in you; the public that benefits from the charity's services is depending on you; and regulators are watching you.

These responsibilities need not deter any prospective board member. You need only to be active and involved, use sound judgment, act responsibly and in fairness to the charity, and always have the charity's best interests foremost in all actions. For board members who take their responsibilities seriously, the rewards of voluntary service are immeasurable.