

The Responsibilities of Service



A Guide for Directors of Nonprofit Organizations in Michigan

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Community leaders who serve as nonprofit board members assume special responsibilities - both to the organizations they serve and the public they represent. Nonprofit organization directors are charged with furthering the organization's mission and, in the process, improving civic life. They shape both organizations and communities as they fulfill the duties of board membership.

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Introduction

- o Boards of nonprofit organizations, unlike boards of business corporations, usually consist of a relatively large number of directors who are not compensated for their services. Directors of nonprofit organizations often serve uncontested and for long periods of time compared with directors of business corporations. Additionally, nonprofit boards face the continuing challenge of gathering resources in the form of donations and/or volunteers.

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- o Under Michigan law, a nonprofit organization may exist either as a corporation created under the Michigan Nonprofit Corporation Act or as an unincorporated association. In addition, private foundations are sometimes organized as trusts under state law. While unincorporated associations are not subject to the statutory requirements of the Nonprofit Corporation Act, in general, directors of corporations and of unincorporated associations are held to similar standards.

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- o My introductory comments have three purposes:
 - (1) to explain how nonprofit boards function;
 - (2) to describe the duties, responsibilities, and potential liabilities imposed upon nonprofit directors; and
 - (3) to suggest how a nonprofit organization can shield its directors from personal liability.

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Purpose of the Board of Directors

- o The overall purpose of the directors of a nonprofit organization is not to manage the day-to-day activities of the organization, but to monitor the results of day-to-day managers. Directors assume this responsibility by exercise of two general functions: taking action and gathering feedback.
- o The responsibilities of the directors can be separated into three major areas:
 - Defining the mission of the organization
 - Planning the budget and other financial aspects of the organization
 - Selecting and overseeing the organization's staff

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Mission

- o The board is responsible for the initiation, periodic review, and refinement of the mission statement and developing related strategies to accomplish the organization's goals.

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Financial Planning

- o The board of directors is also responsible for financial planning. A principal function of many nonprofit organizations is raising funds.
- o Fund-raising not only requires detailed financial planning, but also attention to fiscal integrity.

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Staffing

- o In selecting staff leadership, the board must seek individuals who are able to execute approved policies and maintain the organization's integrity. The board also must ensure that the administrative staff is capable of providing board members with the information necessary to monitor the organization's activities.

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Board Operation

Governance Structure

- There are essentially two governance structures available to Michigan nonprofit corporations: directorship and membership. The articles of incorporation must specify whether the corporation is organized on a membership or directorship basis.
- Most nonprofit corporations find that corporate governance can be streamlined by organizing as a directorship corporation with a single governing body. A directorship corporation may still have members, but they would be non-voting members.

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Meetings

- A board conducts the business of a nonprofit corporation in one of two ways: through formal action adopted at a board meeting, or by unanimous written consent.
- Michigan law provides a further incentive for directors to attend board meetings. In some circumstances, a director is assumed to have consented to action taken by the board during his or her absence.

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- Michigan law does not require that directors attend meetings in person. A member of the board or a committee may participate in meetings by conference telephone or other means of remote communication. Participation in a meeting constitutes presence in person at the meeting, whether the director is physically present or participating by conference telephone or other remote communication. Unlike members, however, directors do not have the option of voting by proxy or otherwise delegating their discretionary authority.

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- o When it is impractical for directors to hold a formal meeting, they take action instead by signing a consent in writing, including an electronic communication, which contains resolutions or other board action. To be effective, the written consent (or a duplicate) must be signed, which includes by electronic means, by all of the board members then in office. This is often referred to as taking action by "unanimous written consent."

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Officers

- o Michigan law requires that the officers consist of a president, secretary, and treasurer. If desired, the board may elect a chairperson of the board, one or more vice presidents, and any other officers as outlined in the bylaws or determined by the board to be necessary.
- o The president is generally the chief executive officer and has the responsibility of supervising and controlling the activities and affairs of the nonprofit corporation. The president may be a volunteer board member or may be an employee of the organization.
- o Nonprofit organizations sometimes give the chief operating officer the title "executive director." This title may indicate that the position is a staff position rather than one with policy-setting authority.

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Committees

- o While specific tasks of the board are often delegated to corporate officers, committees of the board are instrumental in developing and executing corporate strategy. Although Michigan law allows for the extensive use of committees, there are limits to the board's ability to delegate authority.
- o There are three major types of committees which may be designated by the board: standing committees, advisory committees, and ad hoc committees.

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Individual Director Duties

- o As individuals, directors of nonprofit corporations have several duties to the corporation. These duties are applicable to directors of both business corporations and nonprofit corporations. These duties are of care, of loyalty, and other fiduciary duties.

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Duty of Care

- o Michigan law provides that a director of a nonprofit corporation must discharge the duties of that position in good faith and with the same degree of diligence, care, and skill which an ordinarily prudent person would exercise under similar circumstances in a like position. This obligation, which is set forth in a state statute, is commonly known as the "duty of care." The duty of care contains a number of elements.

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Duty of Good Faith

- o A director must act in good faith. In general, good faith can be defined as honesty of intention, openness, and fair dealing. Since this is a very subjective standard, courts must look for some objective evidence in assessing whether or not good faith was present in a director's actions.

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- o A director must act with the same degree of diligence, care and skill which an ordinarily prudent person would exercise. In this circumstance, "ordinarily" does not mean "mediocre." It simply means that the director is not expected to possess any technical expertise or specialization.
- o "Prudence" means that the director is expected to possess and exercise sound practical judgment and common sense, and reach informed conclusions. Prudence, however, does not require excessive caution.

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- o A director must exercise care. The concept of "care" incorporates both diligence and attention. Diligence requires an active interest - such as attending meetings, reading materials, and otherwise making an effort to learn about the corporation and its activities. Diligence is often viewed as an objective standard based on the amount of time dedicated to a task. Attention requires alertness and suggests anticipation of potential problems and issues.

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- o A director's satisfaction of the duty of care is measured in comparison to individuals in similar circumstances in like positions. Comparing the performance of a director to others in a like position allows for flexibility based upon the uniqueness of the specific nonprofit corporation for which the director serves. Circumstances surrounding a decision at the time it was made are also a consideration. By viewing a decision within the context of similar circumstances, the standard takes into account the specific factors that shape decisions.

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- o The statutory duty of care in Michigan allows for the director's reliance on experts both inside and outside of the nonprofit corporation, including accountants and attorneys.
- o Therefore, to the extent that nonprofit directors take rational actions in good faith, and without conflicts of interest, courts will be reluctant to question those decisions.

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Duty of Loyalty

- o Directors of both business and nonprofit corporations have the duty of loyalty. The duty of loyalty requires the director's undivided allegiance to the corporation. A director of a nonprofit corporation may possess a substantial amount of power and information with respect to the corporation and its property. The duty of loyalty prevents a director from using such power or information for personal gain.

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- o Duty of loyalty violations often are the result of a subversion of the nonprofit nature of the organization. Directors are required to put the interests of the organization ahead of their personal interests. A director who derives a personal benefit from an opportunity deprives the organization of the benefits of that opportunity. The most basic violations of the duty of loyalty result from conflicts of interest related to the personal financial interests of a director.

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- o Michigan law provides specific guidelines to prevent potential conflicts of interest from resulting in violations of the duty of loyalty. The Michigan Nonprofit Corporation Act states that a contract or transaction between a nonprofit corporation and one of its directors, or between a nonprofit corporation and another corporation in which one or more of the corporation's directors has an interest, is not void (i.e., revoked) or voidable (i.e., revocable at the option of the organization) solely because of the common interest if one of the following conditions is satisfied.

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Conflicts of interest can be avoided if:

- o Directors are financially disinterested from the organization to the greatest possible extent. Small, weak boards which are dominated by one or a few dominant directors are more likely to see conflicts of interest arising from the dominant director's or dominant group's ability to achieve personal gain.

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- o All directors have a working knowledge of applicable IRS rules in order to recognize situations which may endanger the tax-exempt status of the organization as a result of private benefit or self-dealing.
- o A formal conflict of interest policy should be established to address potential conflicts as they arise.
- o A conflict of interest policy should be in writing and encompass three key elements: awareness, disclosure, and disinterested review.

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Other Fiduciary Duties

- o A director of a nonprofit organization has a duty to maintain the confidentiality of the organization. Unless information has been released to the general public, a director should treat the information as private and confidential. A breach of this duty could jeopardize corporate opportunities and foster an environment of mistrust among the directors.

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Liabilities of Directors

- o Generally, the board of directors of a corporation cannot be held liable for the actions of management and staff. The corporate entity is responsible for acts committed by employees, and corporate liability is usually limited to the assets of the corporation. However, in some situations, individual board members may be held personally liable for their actions as directors.

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Trends in Nonprofit Activities and Regulation

- o Collaboration with for-profit organizations. Michigan law now provides for "low-profit" limited liability companies. The IRS still watches this carefully.
- o Increased government oversight. The new Form 990 return form requires much more information about procedures and activities. The Michigan solicitation act has been amended to require more financial information from large organizations.
- o Independence of governing board. Michigan law now requires at least three directors.
- o Electronic communications. The Michigan nonprofit corporation act has been amended to accommodate modern means of communication.

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Thank You

Questions?

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