CLEMENZA LAW GROUP

NEW YORK, NY · (212) 365-4875

THE PRIVATE BRIEF · HANDBOOK

The New York Nonprofit Board Handbook

Most people join a nonprofit board because someone they respect asked, and because they care about the cause. Almost nobody joins because they understand what a director is legally agreeing to, and almost nobody is told. You are handed a packet, welcomed at a meeting, and expected to work it out.

This handbook is what we wish every new director in New York were handed instead. It explains, in everyday language, what the role asks of you, how a board that actually governs is built and run, how to read the money, what has to be filed and when, how conflicts of interest are handled properly, and what to do when something goes wrong. It is written for a public charity, with a chapter on the extra rules that apply if your organization is a private foundation.

None of it is difficult. Nearly all of it is unfamiliar, and unfamiliar is where boards get into trouble. Read it once now, and come back to the chapter you need when the moment comes.

clemenzalaw.com/reference/nonprofit-board

Chapters

CHAPTER 1

Before you begin: what a board is for

A nonprofit belongs to no one. There are no shareholders, no owners, nobody who can sell it or take its profits home. In place of owners, the law puts a board: a group of people who hold the organization in trust for the public and for the mission it was formed to serve. That is what you are when you become a director. Not a helper, not an honored guest, not a donor with a title. A steward.

Stewardship has a job description, and in New York it comes down to three duties that every director owes. The duty of care means paying attention: reading the materials, coming to meetings, asking questions, and deciding things the way a reasonably careful person would in your position. The duty of loyalty means putting the organization ahead of yourself: no steering contracts to your company, no taking opportunities that belonged to the charity, and disclosing it when your interests and the organization's might diverge. The duty of obedience means keeping the organization faithful to its mission and within the law: the purposes in its founding document, the strings attached to its grants, the rules that come with being tax-exempt.

Every board failure we have seen fits inside one of those three duties. A board that did not read the financials failed the duty of care. A director who leased the charity his building at a price nobody checked failed the duty of loyalty. An organization that quietly drifted from the purpose its donors gave to failed the duty of obedience. Once you see the three, governance stops being a vague word and becomes a short list.

One more idea belongs here, because it shapes everything else. The board governs; it does not manage. Your job is to set direction, choose and support the person who runs the organization day to day, watch the money, and make sure the rules are followed. It is not to approve the newsletter or pick the caterer. Boards that manage exhaust themselves and their staff. Boards that govern get the important things right.

THE CHECKLIST

- [ ] **Learn the three duties by heart**

  Care (pay attention), loyalty (the organization first), obedience (stay inside the mission and the law). When a decision feels uncomfortable, ask which of the three is being tested. The answer usually tells you what to do.

- [ ] Know who the client is

The organization. Not the executive director, not the chair, not the founder, not you. When the board's lawyer gives advice, it is advice to the organization, and when a director's interests and the organization's part ways, the lawyer's duty is to the organization.

> This becomes real the day a founder or a long-serving executive director disagrees with the board. Boards that have never said out loud whom they serve find that conversation very hard.

- [ ] Govern, do not manage

Direction, the executive, the money, the rules: yours. Daily operations: staff. If the board is spending its meetings on operational detail, either the organization has no staff to do it (a real situation for a young charity, and a temporary one) or the board has lost its altitude.

CHAPTER 2

Saying yes: what you are agreeing to

Before you accept a board seat, or if you already have and nobody explained, here is what you are actually taking on.

Time. A working board meets four to six times a year, usually for two hours, with materials to read beforehand and a committee that meets in between. Count on a few hours a month. If the organization is going through something (a leadership change, a financial crisis, a building), count on more.

Money. Most boards expect every director to give personally, every year, at a level that is meaningful to them, and to help the organization raise money from others. Some set a specific figure. Ask. A board that cannot say "every director gives" to a funder is at a disadvantage, and you should know the expectation before you sit down.

Responsibility. Directors can, in principle, be personally liable for what the board does or fails to do. In practice New York gives an uncompensated director of a charity a defense against claims brought by someone other than the organization itself, for conduct in the role, unless the conduct was grossly negligent or intended to cause harm. The statute has its own exceptions, it does not cover everything, and it is not a substitute for insurance: a well-run organization carries directors' and officers' insurance for the defense costs and damages the statute leaves behind. Ask whether the organization has that insurance and when it was last renewed. If it does not, that is the first thing to fix.

Exposure. Your name will be on the organization's public tax return, on its state filings, and on its website. When the organization is praised, you share in it. When it is criticised, you do too. Join boards whose work you would be content to defend at a dinner party.

THE CHECKLIST

- [ ] Ask for the expectations in writing before you say yes

  How many meetings, how long, what preparation, which committee, what personal gift, what fundraising help. A board that cannot produce this page has not thought about what it is asking. You can still join; you should know what you are joining.

- [ ] Ask whether the organization carries directors' and officers' insurance

And when it renews. This is the policy that protects you personally. Its absence is not a reason to refuse a seat, but it is the first item on your agenda if you accept.

> General liability insurance is a different policy and does not cover directors for governance decisions. Do not accept "we have insurance" as an answer; ask which kind.

- [ ] Ask to see the last two years of financial statements and the last tax return

Not to audit them, but to see whether they exist, whether they were on time, and whether the numbers are moving in a direction you understand. The public tax return (the Form 990) is available online for any charity; read it before your first meeting.

- [ ] Ask when the bylaws and the conflict of interest policy were last reviewed

If the answer is "at founding," the organization has grown past its rules. That is common and fixable, and it is useful to know going in.

- [ ] Expect a real onboarding, and ask for one if none arrives

In your first month you should receive the certificate of incorporation and bylaws, the current budget and most recent financials, a year of board minutes, the conflict of interest policy with the disclosure form to sign, the strategic plan if there is one, and a conversation with the chair and the executive director. Most new directors get none of this and spend a year working out what the organization does.

CHAPTER 3

How a working board is built

Most boards begin as whoever said yes: a friend of the founder, a former colleague, someone's accountant. That is fine as a beginning. It stops being fine two or three years later, when the organization has grown and the board has not, and meetings are updates rather than decisions.

New York requires at least three directors. A working board is usually five to nine: large enough to divide the work and survive a resignation, small enough that everyone can speak at a meeting. Who they should be is best answered with a simple grid: the seats down one side, the things the organization needs across the top (someone who can read a balance sheet, someone with fundraising reach, someone with legal or compliance sense, someone who knows the field, someone from the community served), and honest ticks in the boxes. The gaps tell you whom to recruit next.

A few of New York's rules shape the board's structure. Directors serve terms of one to five years, set in the bylaws, and can be re-elected. An employee of the organization may serve as chair of the board only if the entire board approves by a two-thirds vote and writes down, at the time, why it did; without that, the answer is no. Even with it, the employee does not count as an independent director for the rules that require one. Certain roles, in particular oversight of the auditor at larger organizations, must be held by directors who are independent, meaning they are not employees, are not paid by the organization beyond their expenses, and have no significant financial relationship with it. And the board can create committees to do the detailed work between meetings, which is where most of the real work happens.

Two committees matter more than the rest. A finance committee (often doubling as the audit committee) reviews the monthly numbers, works with staff on the budget, oversees the annual audit or review, and brings the board a picture rather than a spreadsheet. A governance committee (sometimes called nominating) owns the board itself: recruiting against the grid, running onboarding, keeping the bylaws and policies current, running an annual self-assessment, and having the kind conversation with a director who has stopped showing up. Most young organizations lack the second one, and it is the one whose absence you feel most.

THE CHECKLIST

- [ ] **Build a skills grid and recruit toward the gaps**

  Seats down the side, needs across the top. Recruit for the board you will need in three years, not the one you needed at founding.

- [ ] Set terms with a limit on consecutive renewals

  Two three-year terms is a common pattern. Term limits are the kindest way to renew a board, because leaving becomes routine rather than a judgment.

- [ ] Keep the board independent of the staff it supervises

  Staff may sit on the board in limited numbers, but an employee may chair it only on a two-thirds vote of the entire board, documented at the time, and a board dominated by the people it is meant to oversee cannot oversee them.

- [ ] Stand up a finance committee and a governance committee

  Two or three directors each, meeting between board meetings, reporting to the full board. Other committees come and go as needed; these two should be permanent.

  > If your organization is large enough to need an audit, the directors overseeing the auditor must be independent ones. Check the definition in the bylaws against who is actually on the committee.

- [ ] Write the one-page expectations document for every seat

  Meetings, preparation, committee, giving, fundraising. Give it to every prospective director before they say yes. Boards that skip it get surprised directors, and surprised directors drift.

- [ ] Have the conversation with the director who has stopped contributing

  Privately and kindly, by the chair or the governance committee chair: is this still the right time for you? One disengaged director quietly lowers the standard for everyone. Most often the answer is relief on both sides.

CHAPTER 4

Meetings that decide things

A board exists in its meetings. Between them, individual directors have no authority; the board acts only when it meets, or when every director agrees in writing. So the quality of the meetings is the quality of the governance.

The mechanics that separate a board that decides from a board that listens are simple. Materials go out a week ahead, so the meeting is spent deciding rather than reading. The agenda leads with decisions and ends with updates, not the other way round. A quorum (by default a majority of the directors, though the bylaws can set it lower) has to be present to act. Directors can attend by video and count toward the quorum, as long as everyone can hear everyone. And there is a written record.

One New York rule about acting outside a meeting catches boards constantly. If the board wants to decide something without meeting, by email or by circulating a document, every single director must sign the written consent. Not a majority. Everyone. If one director has not signed, the decision has not been made, however clear the agreement on the thread. Boards that treat an email majority as a decision discover the gap later, when someone with a reason to challenge the decision reads the bylaws.

The minutes deserve their own paragraph, because they are the organization's memory and, in a dispute, its evidence. Good minutes record who was present, what was decided, the text of any resolution, who disclosed a conflict and left the room for which item, and what information the board relied on for significant decisions such as executive pay. They do not transcribe who said what. Minutes written within a week are minutes. Minutes reconstructed at year end are a reconstruction, and they read like one.

THE CHECKLIST

- [ ] **Send materials a week ahead and expect them to be read**

  The board packet: agenda, minutes of the last meeting, financials with a short narrative, the executive director's report, and any documents to be approved. A director who arrives unread has already failed the duty of care for that meeting.

- [ ] **Lead the agenda with decisions**

  Approvals, policies, the budget, the hire, first. Updates last, and briefly. If a meeting ends and nothing was decided, ask whether the meeting was needed.

- [ ] Never treat an email majority as a decision

Acting without a meeting requires every director's written consent. If unanimity is unlikely, call a meeting (video is fine) and vote with a quorum.

> This is the rule boards break most often without knowing it. A grant accepted, a contract signed, or an officer appointed on a majority email thread is vulnerable until it is ratified at a proper meeting.

- [ ] Keep minutes that record decisions, recusals and the basis for the big ones

Present and absent; each resolution as adopted; each conflict disclosed and who left the room; the comparison data relied on for pay decisions; the restriction on any significant gift accepted. Approved at the next meeting and filed where the whole board can find them.

- [ ] Hold an executive session when the board needs to speak without staff

Routinely, not only in a crisis, so that its use carries no signal. The executive director's performance and pay, a director's conflict, and legal matters are the usual subjects. Minute that the session happened and what was decided, not the discussion.

- [ ] Assess the board itself once a year

A short survey and a conversation: are we deciding the right things, is everyone contributing, what do we need that we lack? The governance committee runs it. It is where term limits, recruiting and the expectations document get their annual review.

CHAPTER 5

Conflicts of interest, handled properly

A conflict of interest is not wrongdoing. It is simply a situation where someone who decides things for the organization also has a personal stake in the outcome: owning the company that wants the contract, being related to the candidate for the job, sitting on the board of the organization across the table. The well-connected people who make good directors have conflicts all the time. The problem is never the conflict. The problem is a conflict nobody disclosed, that influenced a decision, and that came to light later.

New York requires every nonprofit to have a written conflict of interest policy with specific contents: a definition of conflict broad enough to include family members and businesses a director is involved with; a procedure for disclosing one in writing; a rule that the interested person is not present for the discussion or the vote; a rule against their improperly influencing the people who are; a requirement that the whole thing be recorded in the minutes; and procedures for disclosing, addressing and documenting deals with insiders, which the statute calls related-party transactions. That is six things the policy must say. The annual disclosure form is a seventh requirement, and a separate one: every director signs a statement before first taking the seat and every year after, listing the organizations they are involved with and any transactions in which they might have an interest. The interested director may give the board background before leaving the room, and it is the board or its committee, not the director, that decides whether a conflict exists.

The category that carries real risk is the related-party transaction: any deal between the organization and a director, officer, key employee, or their family or business. Leasing space from a board member. Hiring the executive director's spouse. Buying services from a director's company. New York does not forbid these. It requires the board to decide, before the deal is done and with the interested person out of the room, that it is fair, reasonable and in the organization's best interest; where the organization is a charity and the insider has a substantial financial stake, to consider alternatives and approve by at least a majority of the directors present; and to record in the minutes both the basis for the approval and the alternatives considered. The Attorney General can unwind a deal that was not handled this way and recover the money.

In a board with good habits, a conflict is undramatic. A director says, at the start of the item, "I should note that my firm has a relationship with this vendor." The chair thanks them and asks them to step out. The board discusses, considers whether another vendor could do the job, votes. The minutes record all of it. The director returns for the next item. Four minutes added, and an undocumented conflict is the thing you no longer have.

THE CHECKLIST

- [ ] Check your policy against the six required elements

Definition, disclosure procedure, exclusion from discussion and vote, no improper influence, documentation in the minutes, related-party procedures. Most downloaded policies have the first two and are vague on the rest.

- [ ] Collect a signed disclosure statement from every director, every year, and read them

Before a new director's first meeting and annually after that. The secretary or governance committee reviews them and flags anything that touches upcoming board business. Signed statements in a drawer nobody opens are decoration.

- [ ] Put a standing invitation to disclose at the top of every agenda

The annual form catches conflicts that existed in January. It does nothing about the one that arose in June. Make raising a conflict at the moment it appears normal and unembarrassing.

- [ ] Run every insider deal through the procedure, in advance, and know which ones need more

Every related-party transaction needs disclosure, the interested person out of the room, a board determination that it is fair, reasonable and in the corporation's best interest, and a record of all of it in the minutes. Two further steps attach only where a charitable corporation is dealing with a related party who has a substantial financial interest in the transaction: the board must consider alternatives to the extent available, and approve by a majority of the directors with no interest in it. Work out which kind you have before you decide how much procedure the deal needs. The deal can be identical either way; what matters is whether the board did the work and wrote it down.

> A generous deal is still a related-party transaction. A director offering space at a bargain rent, or a loan at no interest, needs exactly the same procedure as one charging full price, and if the organization is a private foundation the rules are stricter still (see the chapter on private foundations).

- [ ] Name who does what when a conflict arises

Who decides whether it rises to recusal, who asks the director to step out, who writes it down. If the policy does not say, the moment arrives and everyone looks at each other.

- [ ] Treat a director who discloses as someone doing their job

Not as someone under suspicion. The tone the chair sets the first time it happens decides whether it ever happens voluntarily again.

CHAPTER 6

Reading the money

You do not need to be an accountant to sit on a board. You do need to be able to look at the financial report and know whether the organization is healthy, and to notice when it is not. Every director owes this, not only the treasurer.

Three documents do most of the work. The budget, approved by the board before the year begins, is the plan. The regular financial statement (monthly or quarterly) compares what has actually happened to the plan: income against budget, expenses against budget, and cash in the bank. The annual financial statements, prepared or examined by an outside accountant, are the year's final account. The question to ask of each is the same: is anything moving in a direction I do not understand, and has someone explained it?

Nonprofit money has one feature that has no equivalent in business, and boards must understand it: restriction. When a donor gives for a specific purpose (the scholarship fund, the new roof, the program in the Bronx), the organization may spend that money only on that purpose. Restricted gifts are enforceable obligations that outlast the people who accepted them. The financial statements should show restricted funds separately, and the board should be able to say, at any moment, that restricted money has not quietly become general revenue. Spending it as such, even in a cash crunch, is one of the fastest routes to an Attorney General inquiry.

Depending on size, New York requires the annual statements to be looked at by an independent accountant. The test runs on gross revenue and support. As of this writing, an organization above $1 million needs a full audit, one between $250,000 and $1 million needs a review (a lighter examination), and one below that needs neither. Needing neither is not the same as having nothing to file: the annual report to the Charities Bureau is due either way. The thresholds move from time to time, and crossing one is a legal event: an organization that lands a large grant and passes the million-dollar line owes an audit for that year, which is a different engagement, at a different cost, that needs to be arranged early.

Two more things belong to the board on the money side. Pay for the executive director and any other insider should be approved by independent directors, in advance, based on what comparable organizations pay, with the reasoning written down; do this and the IRS presumes the pay is reasonable, skip it and the burden is on you. And once the organization has twenty or more employees and more than $1 million in revenue in the prior fiscal year, New York requires a whistleblower policy that lets staff report wrongdoing without fear of reprisal.

THE CHECKLIST

- [ ] Approve a budget before the year starts, and compare to it every meeting

A one-page summary with a short narrative from the treasurer or finance committee is enough for the full board. The detail lives in committee.

- [ ] Learn to find four numbers

Cash in the bank, income against budget, expenses against budget, and the balance of restricted funds. If you can find those four in the packet and ask about any that surprise you, you are meeting the duty of care.

- [ ] Track restricted gifts separately and reconcile them every year

Record the restriction where finance will see it, not only in the thank-you letter. Report to the donor as promised. Never borrow from restricted funds to cover operations, even briefly, without legal advice.

> The most common restricted-fund problem is not theft. It is a tired executive director in a cash crunch, moving money "just until the grant arrives." The board's job is to have made clear in advance that this is not an option.

- [ ] Know which accountant tier you are in, and watch the line

Audit above the higher threshold, review between the two, neither below. When a budget crosses a line, engage the accountant in the first months of the year, not the last.

- [ ] Set insider pay properly

Independent directors, in advance, with comparison data from similar organizations, the interested person absent, the reasoning in the minutes. Once a year, and before any renewal.

- [ ] Insist on basic controls

Two signatures or approvals above a set amount, someone other than the bookkeeper opening bank statements, expense reimbursements approved by someone other than the person claiming them, and the treasurer seeing the bank statements directly. Most nonprofit fraud is small, long-running, and possible only because nobody was looking.

- [ ] Adopt a whistleblower policy once you reach the threshold, and consider one before

Required at twenty employees and a million dollars in revenue. Sensible earlier. It names a person, not the executive director, to whom concerns can be brought, and forbids retaliation.

- [ ] **Read the Form 990 before it is filed**

  It is public, it is what funders and journalists read first, and it asks the board questions about its own governance. Directors should see it before a donor asks about something in it.

CHAPTER 7

The filings and the calendar

When a nonprofit loses its tax exemption, or receives a letter from the Attorney General, or fails a funder's due diligence, the cause is almost never a scandal. It is a deadline: a return not filed, a registration that lapsed, a policy adopted years ago and never looked at. These are not failures of good faith. They are failures of calendar, and the fix is a written list, owned by one named person, reviewed briefly at every board meeting.

Two filings matter most, and they fall on the same day. The federal annual return (a version of the Form 990: the postcard for the smallest organizations, the short form for mid-sized ones, the full form above that) is due four and a half months after the fiscal year ends, with an easy six-month extension. Miss a required filing three years running and the IRS revokes the organization's exemption automatically, without a hearing. Getting it back means applying to the IRS again: organizations that qualify can use a streamlined procedure, others file a full application with a reasonable-cause explanation, and either way there is a gap to explain to every funder. The New York annual report to the Attorney General's Charities Bureau is due on the same schedule, with the federal return attached and, above the thresholds in the previous chapter, the accountant's review or audit.

Registration comes before any of it. Most New York charities must be registered with the Charities Bureau before asking anyone in the state for money, and most organizations that hold charitable assets must register within six months of doing so even if they never solicit. Some categories are exempt from one or both, so check the Bureau's current exemption list against your own facts. Founders assume that once they have incorporated and applied to the IRS they can start fundraising. Under New York law, the Charities Bureau registration comes first, and the Bureau has become noticeably more attentive to organizations that solicit without it.

Beyond those, a handful of obligations recur: tax forms for staff and contractors early each year, the annual harassment prevention training New York requires of every employer, insurance renewals, registration in any other state where the organization actively fundraises, a license before any raffle or game of chance, registration with the state ethics commission if lobbying spending passes a modest threshold, and filing the contract of any outside fundraiser with the Charities Bureau before the work begins. The board does not do these. The board makes sure someone does, and asks at every meeting what is due before the next one.

THE CHECKLIST

- [ ] Register with the Charities Bureau before the first ask

Before the donate button, the gala invitation, the email appeal. Registration is done online with the formation documents, bylaws and the IRS letter (or a note that it is pending). Once registered, the annual report follows every year.

- [ ] Put the two big filings on the calendar with a name next to them

Federal return and New York annual report, both due four and a half months after your fiscal year ends. Request the extension early if it is needed; never let the date pass in silence.

> Three consecutive missed required federal returns means automatic revocation. This is the single most common way a nonprofit loses its exemption, and it happens to organizations that were simply small and disorganized, not dishonest.

- [ ] Confirm the audit or review is engaged in the first quarter of the year it is due

The tier depends on revenue and the thresholds change. The finance committee checks each year and engages the accountant early, especially the year the organization crosses a line.

- [ ] Register in other states before actively fundraising there

Most states require it, an email campaign reaches every state, and the renewal dates do not line up. If the organization fundraises seriously beyond New York, this belongs on the calendar or with a service that manages it.

- [ ] Get the license before the raffle

Raffles, auctions with games of chance and similar fundraisers are regulated in New York and usually require a municipal license in advance. The gala committee tends to find this out late.

- [ ] Watch the lobbying threshold

Advocacy is allowed within limits for a charity, but once spending on lobbying in New York passes a modest annual figure, the organization must register with the state ethics commission and report periodically. Service organizations that occasionally call their assembly member sometimes cross it without noticing.

- [ ] Keep the employer obligations on the same calendar

Tax forms for contractors and staff early each year, the annual harassment prevention training for every employee, the state-required insurance coverages, and the written notices New York requires at hiring.

- [ ] Keep every filed document in one folder the whole board can reach

  Returns, annual reports, the IRS determination letter, the Charities Bureau registration, signed disclosure statements, minutes, policies. When a funder asks for three years of returns, the answer should take four minutes.

The firm publishes a standing version of this calendar, stated as rules rather than dates so it stays right whatever your fiscal year, on the reference shelf alongside this handbook.

CHAPTER 8

Fundraising rules a board should know

Fundraising is where a nonprofit meets the public, and the law around it is mostly about honesty: registering so the state knows who is asking, telling donors the truth, thanking them in the form the tax rules require, and keeping the promises that came with the money.

Two acknowledgement rules matter for every gift. A donor who gives two hundred and fifty dollars or more in a single gift cannot deduct it without a written acknowledgement from the organization that states the amount and says whether anything was given in return. And when a donor pays more than seventy-five dollars for something that is partly a purchase and partly a gift (the gala ticket, the auction item), the organization must tell them in writing how much of the payment is deductible. Most organizations send these as gifts arrive; the board's interest is that nobody is missed, because donors start asking in February and the penalties for the second rule fall on the organization.

Restricted gifts were covered in the money chapter and bear repeating here from the fundraising side: the moment the organization accepts money for a stated purpose, it has made a promise it must keep. A gift acceptance policy, adopted by the board, lets staff decline a gift whose strings the organization cannot honor, and gives them the language to redirect a generous donor toward a restriction the organization can live with.

Finally, if the organization hires an outside firm or consultant to raise money, New York regulates the relationship: the fundraiser must be registered, the fundraiser must file the contract with the Charities Bureau within ten days of signing it, a professional fundraiser cannot start work until the Bureau acknowledges it or it has been on file for fifteen days, and the organization remains responsible for what is said in its name.

THE CHECKLIST

- [ ] **Send written acknowledgements for every gift at the threshold, and audit for misses each January**

  Amount, date, whether goods or services were provided in return and their value. A template letter does it. The check in the new year is what catches the gift that arrived over the holidays.

- [ ] **Disclose the deductible portion of any payment that is partly a purchase**

  Event tickets, auction purchases, memberships with benefits. The invitation or receipt states what the donor received and what part of the payment is a gift.

- [ ] Adopt a gift acceptance policy

What the organization will and will not accept (real estate, closely held stock, gifts with unusual restrictions, gifts from certain sources), who decides, and how restrictions are recorded. It protects staff from having to refuse a donor on the spot and the organization from promises it cannot keep.

- [ ] Make sure every solicitation says who you are and is truthful

Registered name, what the money is for, and nothing that overstates results. Charitable solicitation is regulated speech, and the Attorney General reads appeals.

- [ ] File any outside fundraiser's contract before the campaign starts

And confirm the fundraiser is registered with the state. The organization answers for what its fundraisers say.

- [ ] Report to institutional funders exactly as promised

A missed grant report is the most common reason a foundation declines to renew, and it is entirely avoidable. Put every reporting date on the same calendar as the filings.

CHAPTER 9

If you are a private foundation: the extra rules

Most nonprofits are public charities: they raise money from the public and spend it on programs. A private foundation is different. It is typically funded by one family or one company, it usually makes grants rather than running programs, and because it is controlled by a small group with no public accountability, federal law surrounds it with rules that public charities do not face. If your organization is a private foundation, everything in this handbook still applies, and this chapter applies on top.

The most important of the extra rules concerns self-dealing. Federal law taxes almost any financial transaction between a private foundation and the people closest to it (the donors, the directors and officers, their families, and the businesses they control, together called disqualified persons), and here is the part that surprises every new family board: the fairness of the deal is generally not a defense. A director who sells the foundation a building at an appraised price, lends it money at no interest, or rents it office space at half the market rate has done something generous, and in most cases something the law treats as self-dealing anyway. The rule is structural. It exists so that nobody has to litigate whether an insider deal was fair.

The acts the rule reaches are broad: selling, exchanging or leasing property between the foundation and an insider; lending money in either direction; providing goods, services or facilities; paying an insider compensation (with a narrow exception for reasonable pay for necessary personal services, set and documented in advance); and using foundation assets or income for an insider's benefit, which includes a grant that pays off a donor's personal pledge or an event held mainly to raise a family member's profile. The tax falls on the individual, not the foundation, it runs every year until the transaction is undone, and it escalates sharply if it is not corrected.

The shape of most self-dealing problems is that there is a lawful way to do the generous thing, and it is rarely the way the family would have papered it. A founder who wants the foundation to have an office in her building cannot lease it to the foundation, even for a dollar a year. She can simply let the foundation use the space, free, with no lease and no obligation. The economics are nearly identical. The legal character is not. This is why a family foundation routes any transaction involving an insider to counsel before it is agreed, not after.

Two other rules round out the picture. A private foundation must distribute a minimum amount for charitable purposes every year or face a tax on the shortfall. The commonly quoted five percent is a useful sense of scale, not the calculation: the real figure starts from the value of the assets not used for charitable purposes and is then adjusted for debt, cash held for operations, certain taxes, and distributions carried over from earlier years. Have the accountant run it rather than estimating. And it files a different, more detailed annual return (the Form 990-PF) that lists every grant and every insider, and is public.

THE CHECKLIST

- [ ] **Keep a written, current list of disqualified persons**

  Substantial donors, directors and officers, their spouses, parents, children and grandchildren and those spouses, and any business or trust in which those people together hold more than a third of the interest. Update it when a child marries or a new entity is formed. Circulate it before every meeting.

- [ ] **Route any proposed transaction with a person on that list to counsel first**

  Before it is agreed, not after. Most can be restructured into a lawful form. Almost none can be cured by good intentions or a fair price.

  > The three traps family boards actually fall into are paying a family member without setting the compensation properly in advance, using foundation assets in a way that benefits the family, and loans in either direction. A generous loan from a director to the foundation is the one people are most sure must be fine.

- [ ] **Meet the annual minimum distribution**

  Roughly five percent of the average value of investment assets, in qualifying grants and expenses, each year. The finance committee calculates it early and the board approves grants against it.

- [ ] **Set any insider compensation with comparison data, in advance, in the minutes**

  The exception for reasonable pay for necessary personal services is real and widely relied on. Its edges are where the trouble lives: personal services only, reasonable in amount, documented before payment rather than justified afterwards.

- [ ] **Register with the Charities Bureau on the right basis**

  A family foundation that never asks the public for money still registers because it holds charitable assets, and files the annual report on that basis. If it later seeks grants from other foundations or the government, it picks up the fundraising registration too, at that moment.

- [ ] Adopt a conflict of interest policy written for a family board

A policy drafted for an ordinary charity is not enough. The one a foundation needs produces the disqualified-persons list, the advance review and the minute-book record as a matter of routine.

CHAPTER 10

When something goes wrong, and how to use a lawyer

Every board eventually faces a difficult moment. The executive director is not performing. A director has a conflict they did not disclose. A staff member raises a concern about money. A letter arrives from the Attorney General. A filing was missed and nobody noticed for two years. The founder does not agree with the board. None of these is rare, and none is fatal to an organization that handles it well.

The pattern for handling them is the same. Slow down. Find out what actually happened before deciding anything. Make sure the right people are in the room and the wrong ones are out of it (a director with an interest in the matter recuses; the executive director leaves for a discussion of the executive director). Get advice early rather than late. Write down what the board decided and why. And remember who the client is: the organization, whose interests may not be the same as those of the person who brought the problem.

Some decisions are too large for the board alone. Under New York law, selling or transferring all or substantially all of the organization's assets, merging with another organization, or dissolving requires the approval of the Attorney General or a court, and often both. These are processes that take months and must be started early, not filings to make at the end. Real estate transactions and any significant change of purpose deserve the same caution.

A word on lawyers, because boards use them badly in both directions. Some call for nothing, and discover the missed filing from a letter. Others call for everything, and spend money they did not have. The useful middle is standing counsel who owns the compliance calendar, reviews the minutes, is in the room for the conflict and the pay decision, and can say plainly what is outside the engagement (litigation, an investigation, a property transaction needing state approval, a tax dispute) so that the board is not surprised in a crisis. The measure of that relationship is boring: the filings are made, the minutes are current, the policy is followed rather than filed, and nobody on the board is learning about an obligation from a letter.

THE CHECKLIST

- [ ] **When a concern is raised about money or conduct, follow the whistleblower policy and do not investigate it yourself**

  The person named in the policy receives it, the board (or a committee of independent directors) oversees a proper look, usually with outside help, and the person who raised it is protected from reprisal. A director who starts phoning staff to find out what happened compromises the process.

- [ ] **When a director's undisclosed conflict comes to light, unwind first and judge second**

  Establish the facts, have the director recuse from anything related, decide whether the transaction must be reversed, record everything, and only then decide what it means for the director's seat. The Attorney General will ask what the board did once it knew.

- [ ] **When a filing was missed, fix it before the letter arrives**

  File late rather than not at all; a late return is a penalty, three missing returns is revocation. If exemption has already been revoked, reinstatement is a process with its own forms and it is far easier with counsel.

- [ ] **When a letter arrives from the Attorney General or the IRS, do not answer it alone**

  Note the deadline, tell the chair and counsel the same day, gather the documents requested, and respond completely and on time. Most inquiries end well for organizations that respond well. Almost none end well for organizations that ignore them.

- [ ] **When the executive director must go, do it as a board, properly**

  A documented performance process where there is time for one, a decision by the board in executive session, a separation agreement drafted by counsel, a communications plan, and an interim arrangement decided before the announcement. The relationship between the board and its executive is the most important one in the organization, and its ending is watched by staff, funders and the public.

- [ ] **Start early on any transaction that needs state approval**

  Sale of substantially all assets, merger, dissolution, and certain real estate transactions require Attorney General or court approval in New York. Months, not weeks. Counsel scopes the process before the board commits to the deal.

- [ ] **Expect standing counsel to own the calendar, review the minutes, and name their limits**

  And to answer, at the first meeting, the question of who the client is. Counsel who cannot say "the organization" then will not be able to say it in the meeting where it matters.

That is the whole of it. A board that knows its three duties, meets to decide, handles conflicts in the open, reads the money, keeps the calendar and asks for help early is a board that can be looked at by anyone, at any moment, without worry. That is what stewardship looks like from the outside, and it is within reach of any board willing to spend a few hours a year on it.

If your board would like to talk any of this through, the conversation usually begins with the packet you were handed when you joined and the question of what was missing from it.

Clemenza Law Group, New York, NY. (212) 365-4875.

The current edition of this handbook, and the essays behind it, are at clemenzalaw.com/reference/nonprofit-board.