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### **A Practical Guide to Legal Risk Management: Governance**

*This publication is the first in series of guides to legal risk management. Future topics include contracts, programmatic risks, personnel, general operational, and financial. Lawyers Alliance staff attorneys are available for a more focused assessment of your nonprofit organization's specific legal risk management activities, and our network of pro bono attorneys are ready to assist with legal projects that will reduce your organization's unnecessary exposure to legal risk.*

#### **Why it Matters:**

- A city agency deemed a small community-based organization that began as a food bank ineligible for City funding for its youth services programs because the organization failed to amend its certificate of incorporation to reflect its expanded scope.
- A well-respected arts institution was forced to defend publicly its decisions regarding a transaction involving a company with financial ties to a Board member.<sup>1</sup>
- Board members of a nonprofit organization providing housing for New York City college students were held personally financially liable in connection with their approval of a detrimental contract with a company owned by the executive director.<sup>2</sup>

These problems were all preventable if the Boards and managers involved had paid attention to the risks that can result from inadequate legal compliance in the governance of organizations. These lapses are common and quite understandable. Governance forms the foundation of thoughtful legal risk management analysis, but even the most efficient nonprofit managers need to make decisions on where to focus their attention.

Governance issues, including up-to-date bylaws, conflicts of interest policies, and whistleblower policies, have a tendency to fall by the wayside in the face of pressing programmatic or financial challenges. Beyond the comfort of knowing your organization is in compliance with applicable regulations, there are many reasons to make good governance a priority.

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<sup>1</sup> See <http://www.wsj.com/articles/an-award-takes-center-stage-in-controversy-at-carnegie-hall-1442616294>.

<sup>2</sup> See <https://ag.ny.gov/press-release/ag-schneiderman-obtains-55-million-settlement-self-dealing-leading-not-profit-provider>.

- Governance policies that accurately reflect the way an organization is operating and comply with best practices *preemptively address legal and reputational risks* to the organization. For example, an organization seeking to lease space from a Board member, even if the lease terms are more favorable than available on the market, needs to comply with an up-to-date conflict of interest policy. Failure to comply with a conflict of interest policy may result in the need to make embarrassing disclosures on publicly available documents, financial penalties to those involved, or open up the organization to accusations of impermissible private inurement.
- Up-to-date *governance policies are one of the hallmarks of a healthy organization, and your stakeholders know this*. Private foundations, savvy Board members, and government agencies with whom you make seek to contract all care about the state of your governance documents and how the organization complies with ongoing governance procedures. Failure to keep governance documents current could result in lost opportunities for the organization.

### **Risk Identification Guideline: Governance Risk**

The following list of governance issues highlights some of the most common, but the specific governance issues your organization should address may be different. For example, organizations running Head Start programs, umbrella organizations, and those delegating significant fiduciary responsibilities to committees may have additional governance concerns with which an attorney can assist.

1. **Governance Documents:** Review your organization's certificate of incorporation and bylaws, including committee charters, to confirm that they reflect both current operations and governance best practices.
  - a. Does the purpose statement in your certificate of incorporation accurately reflect the organization's current activities?
  - b. Have your bylaws been updated to reflect amendments to the Not-for-Profit Corporation Law (NPCL), and do they accurately reflect how your organization operates?
  - c. Are the organization's committees formed and operated as required by the NPCL and your bylaws or committee charters, including membership, authority, and recording keeping?
2. **Governance Practices:** Ensure your organization's procedures are consistent with your governance documents and best practices.
  - a. Are you holding meetings at which a quorum is present, as required in your bylaws?
  - b. Are minutes for board meetings and committee meetings recorded and maintained?
  - c. Does the organization's management provide regular information regarding the finances, programs, and operational challenges and opportunities to the Board?

- d. Does your Board engage with management in regular and meaningful discussions and analysis of risks and opportunities?
  - e. If the organization is a membership corporation, do you have adequate records of membership, and do you hold membership meetings as required?
3. **Conflicts of Interest:** Do you have an up-to-date conflict of interest policy to prevent self-dealing by Board members and management staff?
- a. Has your conflict of interest policy been updated to reflect recent changes to the NPCL, including updating the definition of a conflict, who is covered by the policy, and how to review conflicts of interest? Do you collect and maintain annual conflict of interest disclosure forms from Board members, officers, or key persons as defined by the NPCL?
  - b. Does your organization document review of conflicted transactions at the time a decision regarding such a transaction is made, including documenting consideration of comparable alternatives to the transaction under review?
  - c. Has your Board defined what would represent transactions that are “de minimis” and “in the ordinary course” based on your organization’s mission and activities, so that you will review required conflict transactions?
4. **Corporate Policies:**
- a. Do you have a document retention policy that complies with statutory retention requirements such as employment related documentation as well as contractual and funding requirements?
  - b. Do you have a whistleblower policy that complies with the NPCL? Is it distributed as required?
5. **Affiliate Organizations:** Do you have affiliate organizations? If so:
- a. Are governance documents (certificate of incorporation, bylaws, conflict of interest policies) up to date?
  - b. Do you maintain appropriate control of affiliate organizations?
  - c. Do you follow your conflict of interest policy when considering transactions between related entities?

### **Next Steps:**

To follow up on any issue raised by the items described above, or for a consultation on governance and other legal risk management issues, please contact Elizabeth Perez at [eperez@lawyersalliance.org](mailto:eperez@lawyersalliance.org) or 212-219-1800 ext. 232. Please note that we will request the involvement of a Board member or Board committee for all governance matters.

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