

DATE: May 23, 2008

TO: NYSSCPA Chapter Executive Board Members

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RE: Legal Responsibilities of Executive Boards

Background

The Society's bylaws (Article V) empowers the NYSSCPA Board of Directors to establish and dissolve chapters. The Board used an unincorporated chapter model in creating the Society's chapter structure. This means that all authority and power of chapter leaders derives from the Society's Board of Directors and that chapters are not entities separate and apart from the Society itself. To date, the Society Board has established 17 chapters and dissolved one, so that currently there are 16 chapters.

The chapters operate within a framework outlined in NYSSCPA Board-defined chapter bylaws, reprinted in the Chapter Manual, which has been approved by the Executive Committee. According to the chapter bylaws, a great deal of responsibility for conducting chapter activities is delegated by the NYSSCPA Board to each chapter's Executive Board.

Per the chapter bylaws, each chapter is to be governed by a 13 or 14 person executive board comprised of the following:

- Four or five chapter officers, depending on whether the secretary and treasurer positions are combined, [Chapter officer positions include a President, President-Elect, Vice President, Secretary, and Treasurer (or if the chapter prefers, a combined Secretary/Treasurer).]
- The immediate past President, and
- 8 "elected" members.

Some chapters operate with less than fully populated executive boards due to a lack of volunteers.

Because the Society relies on an unincorporated chapter structure, all chapter assets belong to the Society and not to the chapter. The Society opens a chapter checking account for each chapter – most are with the Bank of America, the Society's bank – and authorizes certain Chapter officers and the Society's Executive Director to serve as authorized signatories.

Legal Responsibilities of Chapter Executive Board Members

The legal responsibilities of Chapter Executive Board Members are analogous to those of the Society's Board itself. Generally speaking, a member of the Society's Board has a fiduciary duty to the organization. In the case of Chapter Executive Boards, the "organization" is the Society as a whole, not only their respective chapters. This fiduciary duty has three aspects:

1. duty of care,
2. duty of loyalty, and
3. duty of obedience, that is, a duty to adhere to the organization's purpose.

Duty of Care

To meet the duty of care, a Chapter Executive Board member should

- Attend Chapter Executive Board meetings, at least by phone
- Participate in Chapter Executive Board deliberations and votes
- Show independent judgment when voting
- Be informed about organizational activities
- Rely on trustworthy sources of information (staff included)
- Delegate only to responsible persons
- Follow up regularly
- Fulfill these obligations honestly, in good faith, and with the care of an ordinarily prudent person in similar circumstances.

Being Informed; Reliance on Trustworthy Sources. In the ordinary course of business, a Board member may rely on information received from sources that the director reasonably regards as trustworthy. Generally speaking, Chapter Executive Board members may rely on information from the staff, but if a Chapter Executive Board member thinks such information is in any way inadequate, he or she should request additional information.

Chapter Executive Board Members' Personal Responsibility. Unlike the Society's Board, which does not manage the NYSSCPA's affairs on a day-to-day basis and must delegate the day-to-day management responsibilities to the staff, Chapter Executive Boards do manage most of the affairs of their chapters' day-to-day activities. This results in personal responsibility for some chapter volunteers. For instance, the Society Treasurer does not have access to the Society's checks though he or she does sign a number of checks. The chapter treasurer, on the other hand, has possession of the

chapter checkbook and must safeguard the checkbook.

Duty of Loyalty

The duty of loyalty requires that Board members give undivided allegiance to the organization. In other words, they must exercise their powers in the interest of the NYSSCPA and not in the chapter's interest alone, or their own interest or the interest of another entity or person. This duty primarily relates to

- Conflicts of Interest,
- Corporate Opportunity, and
- Confidentiality

The most common breach of duty of loyalty occurs when nonprofit board members use an organization's property, including intangible property such as the organization's good name or confidential information, for purposes not related to the organization.

Conflicts of Interest. A major responsibility of Chapter Executive Board members is the obligation to avoid conflicts of interest. On October 2, 2003, the NYSSCPA Board of Directors adopted the NYSSCPA/FAE Conflict of Interest Policy, which is available on the web at http://www.nysscpa.org/governance/conflict_policy.htm. Under that policy, most of the members of a Chapter Executive Board are members of a "Group I" assembly and each Chapter Executive Board member is expected annually to complete the "Group I Disclosure Statement" and to notify the Society President if a conflict arises between disclosure statement filings. An exception to this general rule is the officers who are given authority to sign checks. These check-signing officers are required annually to complete the "Group II Disclosure Statement".

Chapter Executive Board members must provide undivided allegiance to the Society and its mission. The existence of occasional conflicts of interest is not a problem, but they need to be properly handled.

- Chapter Executive Board members should be sensitive to all the various interests they have in any decision to be made by the Chapter Executive Board.
- When a Chapter Executive Board member has an interest in a transaction, he or she should disclose it in advance of any Chapter Executive Board action. The Chapter President should consult either with the Society President, the Executive Director, or the General Counsel about how to handle the conflict or potential conflict of interest.
- If the Society deems the matter to be of sufficient concern, the Society will ask the Chapter President to have the Chapter Executive Board Member either completely recuse him- or herself, abstain from discussion of the matter, or refrain from participating in any vote related to the matter. The Society may also suggest that the chapter use an RFP process regarding the transaction.

- If the Chapter Executive Board member disagrees with the Society's decision as to the proper handling of the conflict, the matter may be appealed to the Society's Executive Committee or Board, the decision of which is final.

On rare occasion, a conflict of interest will be of such a nature that the Chapter Executive Board member cannot disclose details. In those instances, the Chapter Executive Board member should simply disclose that a conflict exists and then leave the meeting. If even this lower level of disclosure is impossible under the circumstances, the Chapter Executive Board member may need to resign from the Chapter Executive Board.

Corporate Opportunities. Your fiduciary duty also subjects you to the "corporate opportunities" doctrine. This precludes a Chapter Executive Board member who learns of a business opportunity through the director's service to the nonprofit organization from pursuing the opportunity outside the organization.

Confidential Information. Another important responsibility of Chapter Executive Board members relates to confidential information. A Chapter Executive Board member must maintain in confidence whatever information the Society desires to keep confidential and that it treats as confidential. A Chapter Executive Board member should not disclose information about the NYSSCPA's legitimate activities unless the information is already known to the public or is part of the public record. Similarly, from time-to-time Chapter Executive Board members receive information that is protectable under the attorney-client privilege. The protections available to preserve these confidential communications are lost if disclosed outside a proper venue.

Member Lists. One type of confidential Society information that Chapter Executive Board members occasionally come to possess is Society membership lists. The Society considers this information to be confidential. As a result, Chapter Executive Board members may not use or allow others to use these member lists for non-Society business.

Duty of Obedience

Nonprofit boards have a duty to ensure that their organization remains obedient to its stated purposes and does not act without authority granted in its governing documents or law. The Society's stated purpose includes the following activities, which it may, but is not required to, pursue:

1. to cultivate, promote and disseminate knowledge and information concerning accountancy and subjects related thereto;
2. to establish and maintain high standards of integrity, honor and character among certified public accountants;
3. to furnish information regarding accountancy and the practice and methods thereof to its members, and to other persons interested therein, and to the general public; to

protect the interests of its members and of the general public with respect to the practice of accountancy;

4. to promote reforms in the law;
5. to provide lectures and to cause the publication of articles, relating to accountancy and the practice and methods thereof;
6. to correspond and hold relations with other organizations of accountants, both within and without the United States of America;
7. to establish and maintain a library, and reading rooms, meeting rooms and social rooms for the use of its members;
8. to promote social intercourse among its own members and between its own members and the members of other organizations of accountants and other persons interested in accountancy or related subjects; and
9. to do any and all things which shall be lawful and appropriate in furtherance of any of the purposes hereinbefore expressed.

Other salient points in the Society's Certificate of Incorporation as amended include that the Society's operations are to be principally conducted in New York State and the Society's offices are to be located in the Borough of Manhattan.

Chapter Executive Boards, since their authority derives from the Society Board's delegation, must also remain true to the Society's purpose, or they act outside their authority and violate this duty of obedience.

Illegal Activities. Nonprofit board members cannot ignore potentially illegal activities. If a Chapter Executive Board member believes some activity of his or her chapter or of the NYSSCPA generally may not be legal, he or she should bring the matter to the attention of the Society President and the Executive Director with a demand for an investigation. If ignored, the matter should be brought to the full Board. If not satisfied with the handling of the matter, the Chapter Executive Board member should consult his or her attorney to determine if disclosure outside the organization is required or if resignation is in order.

Liability of Chapter Executive Board Members

Nonprofit board members, even though they serve voluntarily and without pay, may be exposed to personal liability for acts they perform on behalf of the nonprofit. In general, as long as a Chapter Executive Board member exercises ordinary diligence and care, no personal liability will arise, even when actions and decisions are made in poor judgment, or cause damage or injury. Reasonableness and good faith are key aspects of ordinary diligence and care. Generally speaking, board members are not liable for actions taken by predecessors, but can be found liable for the consequences of those actions if continued into their terms and they do not disassociate themselves from the actions.

The Business Judgment Rule. Even where a corporate action has proven to be unwise or unsuccessful, a director will not be liable if he or she acted in good faith, in a manner reasonably believed to be in the organization's best interest, and with independent and informed judgment.

In general, directors may be held liable if they

- Perform or approve organization activities that are beyond the corporate power and authority of the organization (*ultra vires* activities).
- Intentionally cause injury or damage to others.
- Are fraudulent, act in bad faith or are grossly negligent.
- Commit or facilitate acts while representing the organization that violate anti-trust or other laws.

Directors' and Officers' Liability Insurance. One can never be immune from lawsuit; and nonprofit directors are exposed to suit from members and employees of their organization and government officials charged with regulation of nonprofit organizations. But directors can insulate themselves from liability by exercising ordinary diligence and care, and by purchasing directors' and officers' (D&O) insurance coverage. The Society has purchased \$10 million of D&O coverage: a \$5 million primary layer with Chubb and a \$5 million excess layer with Illinois National Insurance Company (AIG). This D&O coverage includes the Society's employment practices liability insurance (EPLI) coverage (unlike for-profit organizations where EPLI is generally carved out of the D&O coverage).

Resources

Jerald A. Jacobs, "Fiduciary Duty—Conflicts, Confidentiality, Opportunities" and "Personal Liability of Officers and Directors," Chapters 10 and 11, *Association Law Handbook: A Practical Guide for Associations, Societies, and Charities (4th Ed.)*, ASAE (2007).

Jacqueline C. Leifer and Michael B. Glomb, *The Legal Obligations of Nonprofit Boards: A Guidebook for Board Members*, BoardSource (1997).

Corporate Director's Guidebook (3rd Ed.), ABA Section of Business Law (2001).

Gregory V. Varallo and Daniel A Dreisbach, *Fundamentals of Corporate Governance*, ABA Section of Business Law (1996).

Guidebook for Directors of Nonprofit Corporations (2nd Ed.), ABA Section of Business Law (2002).

George Webster and Hugh K. Webster, "Responsibilities and Liabilities of Association Directors and Officers," Chapter 2A, *The Law of Associations*, Matthew Bender (1999).

Victor Futter, Editor-in-Chief, *Nonprofit Governance and Management*, ABA Section of Business Law (2002).

BoardSource, www.boardsource.org.

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American Society of Association Executives, www.asaecenter.org/.