

# UNDERSTAND YOUR RESPONSIBILITIES:

GUIDANCE FOR BOARD MEMBERS OF CHARITABLE  
NONPROFIT ORGANIZATIONS IN VERMONT

November 2015



Office of the Attorney General

WILLIAM H. SORRELL

**WILLIAM H. SORRELL**  
ATTORNEY GENERAL

**SUSANNE R. YOUNG**  
DEPUTY ATTORNEY GENERAL

**WILLIAM E. GRIFFIN**  
CHIEF ASST. ATTORNEY  
GENERAL



TEL: (802) 828-3171  
FAX: (802) 828-2154  
TTY: (802) 828-3665

[http:// www.ago.vermont.gov](http://www.ago.vermont.gov)

**STATE OF VERMONT  
OFFICE OF THE ATTORNEY GENERAL  
109 STATE STREET  
MONTPELIER  
05609-1001**

November 2015

Dear Friends,

Charitable nonprofit organizations play a vital role in our society, and their work touches all of our lives. Vermont's nonprofit community provides needed services to hungry and homeless Vermonters, delivers critical healthcare to patients in need, advocates for our environment, rescues and houses our animal friends, supports public art and civic engagement, and is involved in countless other activities besides. In short, it is an essential element to the way of life we hold dear.

Together with the dedicated staff and volunteers who bring its mission to life, a nonprofit's board of directors is essential to its success. A good board provides leadership, vision and wisdom to guide the nonprofit. But all boards have certain legal duties they must fulfill. The Attorney General is charged with ensuring nonprofits work for the public good, use charitable funds to further their missions, and act in accordance with Vermont law.

My office has developed this guide to provide today's nonprofit leaders with a general understanding of their duties as board members. I want to particularly thank Assistant Attorneys General Wendy Morgan and Todd Daloz, who developed these materials, with assistance from Linnea Myers. My hope is that you will find it useful whether you are a seasoned veteran of many boards, or someone interested in serving your community on a nonprofit board for the first time.

Sincerely,

A handwritten signature in blue ink, appearing to read "W. Sorrell".

William H. Sorrell  
Attorney General of Vermont

# UNDERSTAND YOUR RESPONSIBILITIES: GUIDANCE FOR BOARD MEMBERS OF CHARITABLE NONPROFIT ORGANIZATIONS IN VERMONT

## INTRODUCTION

The members of the board of directors of a charitable nonprofit organization perform an indispensable service both to the charity they govern and to the community at large. Along with their service, board members have critical responsibilities: they must actively govern the organization and ensure that charitable funds are used to advance the organization’s mission and serve the public. While boards must rely on the staff and volunteers of the organization to further its mission, ultimately, it is the board and the individual board members that are responsible for the financial health and integrity of the organization.

Along with the services they provide, nonprofits in Vermont are also an important sector in our economy. Statistics compiled by Common Good Vermont, an organization focused on Vermont’s nonprofit community, show nearly four thousand public charities operating in Vermont, accounting for \$4.1 billion in revenue annually: roughly 18.7% of the State’s economy.<sup>1</sup> Additionally, those statistics show that nonprofits hold nearly \$10 billion in assets and employ over 44,000 people, accounting for 14% of the Vermont work force. Almost all of this economic activity is managed by volunteer boards.

In broad strokes, this guide lays out the central legal duties of boards and board

members, and provides some practical details about how these duties can – and should – be carried out. Whether the charity has a budget of \$1000 or \$10 million, the board’s legal duties are the same. Along with presenting the legal baseline, this guide offers practical suggestions for boards seeking to adopt best practices. While some of the information and suggestions provided may not fit every size and type of organization, the bedrock principles of duty and legal responsibility remain for all board members.

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*Though this guide provides an overview of a board member’s role, it should not take the place of competent advice from a qualified lawyer, independent certified public accountant or other professional.*

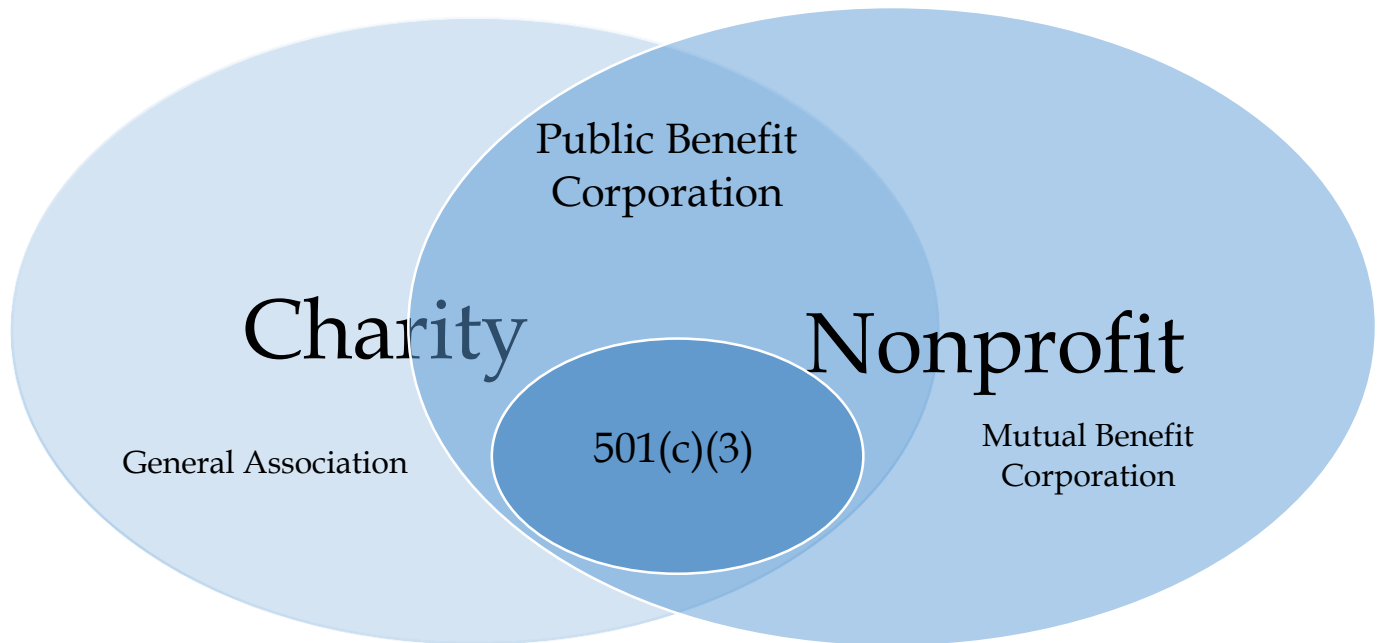
## Executive Summary

- This guide is directed at individuals currently serving, or contemplating serving, as a member of the board of directors of a charitable nonprofit organization in Vermont.
- Serving on a nonprofit board can be a wonderful and fulfilling experience, but before agreeing to join, it is important to understand the scope of the commitment and, more critically, the mission of the organization and its financial health.
- A nonprofit should endeavor to establish policies and practices that guide its structure, decision-making and operations to further its charitable mission and to promote consistency and transparency.
- Board members have a legal Duty of Care, which requires them to act with the care an ordinarily prudent person in a like position would [act] under similar circumstances. In simplest terms, this means a board member must act in a reasonable and informed manner when making decisions for the organization or overseeing its management.
- Likewise, board members also have a legal Duty of Loyalty, requiring them to exercise their authority in good faith and in a manner the director reasonably believes to be in the best interests of the corporation. Essentially this means a director has a duty to ensure that the nonprofit follows the law and, specifically, that a director cannot use her/his position for personal gain, including benefitting a family member or borrowing money.
- As a key component of their Duty of Loyalty, board members must disclose any potential conflicts of interest between them (including their family members) and the nonprofit they serve. When taking an action that raises actual or perceived conflict-of-interest concerns, a board should document decision-making procedures and rationale to provide transparency.

I. **Understand the Terms: What is a director of a charitable nonprofit organization, anyway?**

When discussing charities, we use lots of words interchangeably: charity or nonprofit or 501(c)(3); board member or director or trustee. But it is important to understand the distinctions among these terms because of the different requirements that may come into play with each one.

Below is a visual representation of the relationship among three key terms; it does not capture all the relational nuances.



- **Charity:** A charity is the general term used for an organization that works towards a charitable purpose. Under Vermont law, a charitable purpose can be very broad and includes any benevolent, educational, philanthropic, humane, patriotic, social welfare, advocacy, public health, environmental conservation, or civic objective.<sup>2</sup> Not all charities are incorporated under law; some are general associations – a group of people organizing for a charitable purpose without any formal legal structure, and, most notably, without a formal board of directors. Generally, the Attorney General is responsible for overseeing charities operating within the state, including those that are unincorporated.
- **Nonprofit or Not-for-Profit:** These terms describe how an organization is incorporated, or created, under Vermont law. The Vermont Nonprofit Corporation Act, in Title 11B of the Vermont Statutes, governs nonprofit organizations in Vermont. Not all nonprofits operate as charities or for a

charitable purpose.\* Only those nonprofit organizations created as “public benefit” corporations are considered charities because they are “organized for a public or charitable purpose.”<sup>3</sup> Both the Vermont Secretary of State and the Attorney General have regulatory authority over nonprofits.

- **501(c)(3) Organization:** Sometimes called a “public charity,” this is a federal tax-status designation that refers to the section of the Internal Revenue Code recognizing qualifying organizations as tax-exempt (meaning they do not have to pay federal income tax) and permitting donors to take a tax deduction for contributions to such organizations.<sup>4</sup> To attain tax-exempt status, an organization must apply to the Internal Revenue Service (IRS) and be organized and operated exclusively for charitable purposes set forth in section 501(c)(3), and none of its earnings may inure to any private shareholder or individual. The IRS regulates tax-status. As a general matter, only a charitable nonprofit corporation or recognized religious organization can receive tax-exempt status under section 501(c)(3) from the IRS.†
- **Director or Trustee or Board Member:** All three of these terms refer to the individuals who, together, control the functioning of the nonprofit organization. Under Vermont law, a “director” and “trustee” are identical and both serve on a board.<sup>5</sup> This guide will generally use the term “board member.”
- **Membership Organization:** This term refers to certain nonprofits that are incorporated with members. Generally, members have the right to elect<sup>6</sup> and remove<sup>7</sup> board members and amend the bylaws<sup>8</sup> and Articles of incorporation.<sup>9</sup> Membership organizations are required to have one annual meeting a year at which the President and chief financial officer of the organization should report on the organization’s activities and financial condition.<sup>10</sup>

**For the purposes of this guide, the broad terms “nonprofit” and “charity” will be used to mean a public benefit corporation incorporated for a charitable purpose whether or not it has 501(c)(3) status.**

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\* Vermont law also recognizes “mutual benefit” nonprofits, which can include fraternal organizations or industrial or trade associations. This guide focuses on public benefit organizations.

† Along with charitable organizations, private foundations and private operating foundations are eligible for 501(c)(3) status. The IRS has more restrictive rules governing tax deductions and business relationships for these types of organizations, and any prospective board member should review these rules.

*This guide is directed at individuals currently serving, or contemplating serving, as a member of the board of directors of a charitable nonprofit organization in Vermont.*

## II. Understand the Commitment: Before You Say “Yes.”

Board members are chosen because of their connection to the charitable purpose of the organization, the skills and experience they bring to the board, the personal and professional connections they may have, and countless other reasons. Beyond being honored by the invitation, there are some important aspects of the charity you should understand before you commit to serving.

- **Charitable Mission:** Make sure you understand the charitable purpose of the nonprofit. Review its annual report, IRS filings and any other public filings to ensure you appreciate its stated purpose. Look at its published materials, fundraising appeals and website to get a sense of its programs and outreach efforts. Certain nonprofits suffer “mission creep” whereby opportunities for additional funding or programming pull the organization’s focus away from its core mission.
  - Is the organization’s mission something you can publicly support and fully engage with?
  - Can current members of the board or the organization’s staff articulate the mission?
  - Is the organization’s work and reputation in the community directly related to its stated mission?
- **Financial Health:** Ensure that you understand the nonprofit’s financial picture currently and over the past several years. Review its recent board minutes, any end-of-the-year financial statements, the latest audit report and recent filings with the IRS. Engage with the board or staff members who oversee the organization’s finances to gain a clearer picture. Organizations that are overly reliant on one or two sources of funding have less flexibility if a funder reduces funding of the organization, which could then result in sudden, significant financial strain.
  - Does the board review and approve an annual budget for the organization?
  - Do board minutes reflect that the board treasurer or board finance committee is actively involved and the board is regularly given a clear picture of the organization’s finances?

- Does the organization generally operate within its means? Is this confirmed through monthly financial statements, a regular outside audit or financial review?
- Are there any significant financial stresses on the organization? Do its recent financial documents show an upward or downward trend?
- How diverse is the organization's fundraising or income base? Does it receive revenue from various sources or is it reliant on one or two major funders or grants?
- ***Expectations for Board Membership:*** Bringing expertise, connections or skills is part of why a nonprofit may have asked you to join its board, but be certain you understand the full scope of the expectations. Find out what fundraising duties are required of board members. Ask current board members about their weekly or monthly time commitment; many of the problems that plague nonprofit boards stem from an overworked or under-committed board.
  - Will you be able to regularly attend meetings and have adequate time to prepare for the meetings?
  - Is there a board-wide expectation to make an annual gift to the organization? At what level?
  - Are you expected to assist with or attend any of the organization's public events?
  - Does the organization have a job description for its board members? Can other board members describe the work they do for the board and organization?
- ***Board Structure and Role:*** Given the diversity of nonprofits in Vermont, be sure you understand how the board operates and its role in the organization. All boards are responsible for overseeing the organization – and must do so independently – but some boards in smaller nonprofits also perform day-to-day operational tasks; boards of larger nonprofits generally operate at a more abstract level, providing strategic planning and vision. Some boards directly supervise staff; others interact mainly with executive leadership. A well-functioning nonprofit will have written policies and bylaws about the structure and function of its board.
  - How large is the board? How many officers does the board have?
  - What committees operate within the board? What do they oversee?
  - What is the relationship between the board and the staff? Does the board have direct oversight of multiple staff members, or one or two senior managers, or just the executive director? Does the board make decisions independently of the staff?



- How does the board make decisions between regular meetings? Is there an executive committee? What is its authority and who are its members? Does the board review and affirm decisions made by the executive committee?
- How does the board train new members? Does it have a mentorship program to encourage new board members to learn and engage?

*Serving on a nonprofit board can be a wonderful and fulfilling experience, but before agreeing to join, it is important to understand the scope of the commitment and, more critically, the mission of the organization and its financial health.*

### III. **Understand the Board: Characteristics of a legal and sound nonprofit board.**

A properly established board is critical to the success of a nonprofit; it is also the law.<sup>11</sup> Under Vermont law, the board exercises the corporate powers and manages the affairs of the nonprofit, either directly or by authorizing another entity to do so.<sup>12</sup> Though Vermont law does allow significant flexibility in how the board is formed and operates, there are a few important requirements.<sup>13</sup>

**Articles of Incorporation and Bylaws:** All nonprofits operate based on their articles of incorporation and bylaws – both are required under Vermont law. The articles of incorporation set forth the organization’s name, whether it is a public or mutual benefit corporation, its address, and other essential details about its corporate identity.<sup>14</sup> A public benefit corporation’s articles should also contain its mission statement. Beyond requiring adoption of bylaws, the law does not set specific terms for a nonprofit’s bylaws,<sup>15</sup> but the bylaws generally prescribe how the organization regulates and manages its affairs, and how the board operates.<sup>16</sup> Additionally, the bylaws should dictate what will happen to the organization’s assets upon dissolution. An organization can amend its articles and bylaws through a vote by the board and, if applicable, the members.<sup>17</sup>

- *A sound nonprofit has clear and accessible bylaws that accurately describe how the board can – and does – function.*

**Size and Composition of Board:** A board can be no smaller than three individuals<sup>18</sup> but should have at least seven members. For a charity, no more than 49% of the board can have a financial interest in the organization’s work.<sup>19</sup> This means more than half the members of a board (as well as those individual’s close family members) do not receive payment or compensation directly or indirectly from the organization and have not received such compensation in the year prior to joining the board.

- *A sound nonprofit has a board with diverse experience and at least seven members, none of whom have a direct or familial financial interest in the organization.*

**Qualifications for Directors:** The boards of most nonprofits are self-perpetuating, meaning the board – often through a specific governance or membership committee – selects and approves its own members.<sup>20</sup> Membership organizations generally elect directors by a vote of the membership at their annual meeting.<sup>21</sup> The bylaws and articles should set forth additional qualifications of the directors,<sup>22</sup> but at a minimum they must state the terms of the directors, which cannot exceed six years; directors may be elected for successive terms.<sup>23</sup>

- *A sound nonprofit has a board with staggered terms and term limits so that the board has a regular mixture of experienced and new members.*

**Officers:** A board must have, at minimum, a president, a secretary and a treasurer.<sup>24</sup> The same individual may hold more than one office, except that a person cannot act as both president and secretary.<sup>25</sup> One of the officers must be responsible for preparing minutes of the directors' meetings.<sup>26</sup> Though the articles or bylaws can dictate otherwise, generally, the president is responsible for overseeing the work of the board and facilitating board meetings. The treasurer oversees the financial aspects of the organization and may operate as its chief financial officer. The secretary takes custody of the organization's meeting minutes and other records and is often responsible for preparing the meeting minutes.

- *A sound nonprofit has a full slate of officers, none with overlapping positions, and structures its board with an eye to training new board members to fill leadership roles.*

**Making Decisions:** To act, a majority of the total number of board members required in the articles or bylaws (a quorum) must be present at the vote, and a majority of those members present must affirm the action. If the bylaws do not prescribe a fixed number of board members, a majority of the total number of board members in office immediately before the meeting begins constitutes a quorum.<sup>27</sup> Importantly, any director present at a meeting is deemed to have agreed to the corporate action taken unless her/his dissent or abstention (to holding the meeting or taking the specific action) is noted in the minutes.<sup>28</sup>

- *A sound nonprofit holds regular meetings that are well attended, with an agenda and supporting materials distributed sufficiently in advance of the meeting to enable board members to be adequately informed about the issues to be discussed and decided.*

**Meetings and Committees:** A board must meet, although if permitted by the articles and bylaws, directors need not all meet in person\* (they can use electronic means so long as they can “simultaneously communicate”<sup>29</sup>), and under certain

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\* Depending on how the organization was founded or funded, certain nonprofit boards may operate as a “public body” and be subject to the requirements of Vermont’s Public Meeting Law. See 1 V.S.A. § 310(3) (defining “public body”); see generally 1 V.S.A. §§ 311-314 (requirements of public meeting law).

circumstances, they can take action without a formal meeting.<sup>30</sup> Likewise, the board can act through an appointed committee – with a minimum of two members – and the committee can act as the full board within its designated authority, so long as it follows the meeting and decision-making requirements that apply to the board as a whole.<sup>31</sup>

- *A sound nonprofit maximizes its resources by developing structures that enable directors to attend and fully participate in meetings and engage more deeply through work outside the board meetings on topics of interest or specific to the director's skills and experience.*

**Minutes and Records:** A board must record minutes at all meetings and must have a record for any actions taken without a meeting or by a committee of the board.<sup>32</sup> A board must also maintain appropriate accounting records.<sup>33</sup> These records should be stored at the organization's principal place of business along with a copy of the articles of incorporation and the bylaws. In general, board members have a right to inspect and copy these records at a reasonable time and place.<sup>34</sup>

- *A sound nonprofit establishes a transparent system to ensure that decisions and current financial position are appropriately documented, approved, and available for later review.*

*A nonprofit should endeavor to establish policies and practices that guide its structure, decision-making and operations to further its charitable mission and to promote consistency and transparency.*

#### IV. **Understand Your Duties: What are your legal responsibilities and rights as a board member?**

A board member's core duty is to govern the organization. But as a board member, your obligations go beyond this broad mandate; you have legal duties regarding the management and oversight of the organization and its assets. In legal terms, as a board member, you have a fiduciary relationship with the organization – an obligation to act as a steward of the charity. Vermont law imposes two specific duties on all board members: the duty of care and the duty of loyalty. The Attorney General is responsible for ensuring that these duties are fulfilled and that the interests of those who benefit from the charity's work are protected.

**Duty of Care:** The law requires that a director act “with the care an ordinarily prudent person in a like position would [act] under similar circumstances.”<sup>35</sup> In simplest terms, this means a board member must act in a reasonable and informed manner when making decisions for the organization or overseeing its management. To fulfill this duty, board members should:

- **Be informed:** Read and review the board minutes, financial statements and other materials. Evaluate staff performance and the quality of work being done by the organization. Monitor the organization's finances.
- **Participate:** Attend meetings and actively join in the discussion and decision-making process. Ask questions of staff and other board members. Provide guidance and offer opinions on organizational direction.
- **Engage:** Use independent judgment when making decisions on behalf of the organization. Ensure that decisions of the board are made only by members without a financial stake in the outcome.

**Best Practice:**

- ✓ Have a regular meeting schedule, meeting in person at least four times per year.
- ✓ Create a clear and consistent agenda and meeting format, including reviewing previous meeting minutes and current financial reports.
- ✓ Foster a culture of critical inquiry, encouraging board members to ask questions of staff and advisors prior to making decisions.
- ✓ Establish a standard format for taking, reviewing and approving meeting minutes, clearly identifying board votes and decisions.
- ✓ Ensure regular oversight of finances through internal controls, a dedicated finance or audit committee, and an external audit or review.
- ✓ Track gifts to ensure they are used in a manner consistent with the donor or grantor's intent.
- ✓ Manage invested assets using reasonable judgment.
- ✓ Evaluate senior staff and staff compensation on a regular basis.
- ✓ Encourage diversity among board members in order to provide a range of appropriate skills, interests and perspectives.
- ✓ Design board member orientation and training for new directors.
- ✓ Consider adopting a committee structure to increase board capacity and expertise, and better access board member skills.

**Duty of Loyalty:** The law requires that a board member exercise her/his authority “in good faith” and “in a manner the director reasonably believes to be in the best interests of the corporation.”<sup>36</sup> Essentially this means a director has a duty to ensure that the nonprofit follows the law and, specifically, that a director cannot use her/his position for personal gain, including benefitting a family member or borrowing money. To fulfill this duty board members should:

- ***Avoid conflicts of interest:*** Establish a written conflict of interest policy, consistent with Vermont law,<sup>37</sup> for determining when a board member should not participate in a decision or discussion – the existence of a conflict of interest does not necessarily prevent the board from approving such an action. Ensure that all board members annually disclose any potential areas of financial interest that they or their family members have that may involve the organization’s work. When taking an action that raises conflict-of-interest concerns, document procedures and rationale, including recording which members have conflicts and whether they participated in the discussion or decision. Even where there only appears to be a conflict of interest, boards should take steps to protect the public reputation of the charity. Transparency is paramount.
- ***Adhere to the charitable mission:*** Act in a manner consistent with, and in support of, the mission and purpose of the organization.
- ***Prevent loans to directors or officers:*** A nonprofit cannot make a loan of money or property to any director or officer of the board – it is against the law.<sup>38</sup>

#### **What is a Conflict of Interest?**

A conflict of interest exists *when a board member may benefit financially from a decision she makes in her capacity as a board member*. For example, if the organization is considering making a grant to another nonprofit run by a current board member, that board member has a conflict of interest. Likewise, if the board is considering entering into a contract with a company in which a board member (or a member of his/her family) is employed or has a material interest, that board member has a conflict.

**Example 1:** A board member of Organization A suggests making a grant to Organization B, where his wife is a board member. This is an actual conflict. The board member should disclose his interest and recuse himself from discussion and voting.

**Example 2:** A board member of Organization A suggests purchasing land from Organization B, where she works. This is a potential conflict, depending on the board member’s position in Organization B. Regardless, she should disclose her interest and recuse herself from discussion and voting.

**Example 3:** A board member of Organization A is an executive of another local charity. When the board of Organization A votes on its executive’s salary, the board member votes against it because it is out of line with his salary. This is a potential conflict because the board member is voting based on interests unrelated to the best interests of Organization A.

- **Keep confidential:** Maintain control and confidentiality of information that is private within the organization. This may include individual donor identities and information.
- **Put the organization's interests before your own:** Make sure the organization is aware and has the option to act on any business opportunity (e.g., purchasing property) you learn about because of your position in the organization before personally acting on that opportunity.
- **Know the law:** Understand and follow applicable laws and legal obligations, including those of an employer or property owner.

**Best Practice:**

- ✓ Require board members to report all areas of financial interest (businesses, properties, employment, etc.) that they or their families have that may come into conflict with the decisions the board makes.
- ✓ Disclose specific conflicts of interest that arise during the course of board business.
- ✓ Establish a written policy for identifying conflicts of interest and addressing them in the decision-making process.
- ✓ Document all conflict of interest transactions in official meeting minutes.
- ✓ Develop confidentiality protocols and document control mechanisms, as appropriate.
- ✓ Ensure the organization's activities and actions are in line with the charitable mission and purpose of the organization.
- ✓ Confirm the organization is in compliance with applicable legal requirements.
- ✓ Report activities or actions of the board or organization that threaten its mission or conflict with applicable laws.

**Director's Rights:** Along with your duties as a nonprofit board member, you also have rights. These include:

- **Right to information:** You have the right to receive or access all information that is necessary and relevant to help you act as a board member. This includes reasonable access to the organization's management and principal advisors (e.g., auditors or attorneys), as well as financial information, including tax filings, and other documents.
- **Right to rely:** You have the right to rely on information provided by the organization's staff, board committees, or other outside experts when making

decisions. However you cannot unreasonably rely on such information, especially if it contradicts your personal knowledge.

- ***Right to notice:*** You have the right to reasonable notice in advance of all board and committee meetings, including notice of the agenda and important topics for discussion or actions to be taken.
- ***Right to dissent:*** You have the right to disagree with an action the board takes or the manner in which the board acts and to have your disagreement noted in the minutes of the meeting. Unless you voted to approve the action, you can provide the board secretary with a written dissent to be included in the official minutes. Once the board has reached a decision, any dissenting board member should stand behind the board's decision or resign.
- ***Immunity from Liability:*** If you serve as a director or officer of a nonprofit, qualified as tax-exempt under § 501(c), and do not receive compensation, you cannot be held personally liable for damages resulting from: (1) acts taken within the scope of your official functions, other than intentional torts or acts of gross negligence, if undertaken in good faith; (2) acts of an employee of the organization; and (3) the act of another director or officer.<sup>39</sup> Importantly, this immunity may not apply for acts undertaken on behalf of the nonprofit that are not part of your board duties – e.g., volunteering to serve food at a function.

#### V. **Understand Operations: The board's role in organizational oversight.**

Board members also operate as managers and employers for the organization. While many boards directly supervise only the executive director or senior management of the nonprofit, delegating responsibility for day-to-day affairs, all have responsibilities for ensuring that the organization runs properly. This includes making sure that the organization follows its mission and makes decisions in line with its stated purpose and goals, operates in accordance with applicable laws, and has sufficient internal structures to protect its assets and employees.

**Internal Financial Controls:** Oversight of charitable assets is one of the core responsibilities of a board. Beyond regular review of financial information during meetings and periodic outside audits of the organization, the board should establish internal controls over finances. Among other things,<sup>40</sup> these should include a limit on individual signing authority (i.e., the size of expenditure that a single employee can approve) and requiring that multiple people (staff or board members) regularly review spending and accounts. The board should additionally review the existing financial controls annually.

**Regulatory Filings:** The board should also confirm that the organization has fulfilled its regulatory obligations. All Vermont nonprofits must file a biannual report with the Vermont Secretary of State.<sup>41</sup> Failure to do so could result in a revocation of the nonprofit's corporate status. With the exception of most faith-based organizations, all charities recognized as 501(c)(3) tax-exempt organizations must file an annual informational return with the IRS, called a Form 990; the specific filing requirements may vary based on the size of the organization.<sup>42</sup> Though tax-exempt organizations do not have to pay income tax,<sup>43</sup> a failure to file the 990 can result in significant penalties. Legally, both of these documents must be made available to members of the public.<sup>44</sup> Vermont law does not require charities to register with the Attorney General, however, organization's operating in other states, including New Hampshire, New York and Massachusetts, should research applicable filing requirements.

**Gifts, Bequests and Charitable Trusts:** Funds given to a nonprofit to be used for a charitable purpose are charitable trust funds. When a nonprofit accepts such funds, even when they are not expressly dedicated as a "trust," it acts as trustee for the funds and board members may have a higher duty of care than when they act as directors of the charity.<sup>45</sup> This duty includes administering the funds in accordance with the terms and purposes for which they were given, and in the interests of the beneficiaries of the trust.<sup>46</sup> Additionally, trustees with special skills (e.g., financial acumen) must use those skills when administering the trust.<sup>47</sup> Board members should endeavor to be aware of any substantial gifts or bequests (gifts made through a will) to the organization and the terms of such gifts. For some nonprofits, over time the restrictions on such funds can become a burden or impossible to carry out. If a nonprofit cannot comply with the terms of the gift, it should seek to modify the terms through the court.<sup>48</sup>

**Other Legal Compliance:** Board members should also ensure that the organization complies with the law, including legal obligations to employees. This includes adherence to applicable state and federal non-discrimination statutes, and payment of pay-roll taxes, unemployment insurance and workers' compensation insurance, as applicable. Likewise, receipt of state or federal funds can bring additional legal requirements.<sup>49</sup> Organizations can face stiff penalties and liability for failure to adhere to the law.

**Insurance:** As part of protecting an organization's charitable assets, boards should consider insurance coverage to protect the organization's assets. Additionally, boards should investigate the value of a directors and officers liability policy to protect their own assets from possible claims arising from their service as board members.

## VI. Understand Fundraising: Ensuring accuracy and accountability.



Fundraising is one of the core activities of most nonprofits. Individual organizations and boards have different funding models and responsibilities for generating income. Beyond remaining aware of how an organization generates revenue and ensuring diversity of funding sources to keep the organization healthy, board members should engage in some level of active oversight of fundraising activities. With any model, there are a four important points to keep in mind.

- ***Truthful and accurate solicitations, applications and materials:*** Ensure statements made in any solicitation or application for funding are accurate and the organization has documents to support any claim made in such materials, including the amount of money raised, the current status of a project or the number of individuals participating in a specific program. Deceptive or misleading solicitations violate Vermont law.<sup>50</sup>
- ***Use contributions in a manner consistent with the donor's intent:*** A specific gift, given for a specific purpose must be used for that purpose.<sup>51</sup> This includes funds solicited for a specific purpose, as represented in the solicitation materials, such as funds donated to a capital campaign or for a particular program – these are restricted gifts. A nonprofit must make certain that its development and accounting systems track restricted gifts and can demonstrate that the terms of a gift were honored when the funds were expended. If carrying out the donor's intent is not practicable or possible, the organization must take the appropriate steps, including contacting the donor and, when necessary, the Attorney General.<sup>52</sup> The Attorney General has authority to ensure that funds donated for a charitable purpose are used for such a purpose.<sup>53</sup>
- ***Ensure compliance with grant terms:*** Similar to ensuring a donor's intent is honored, nonprofits need to comply with the requirements of any grant they receive. This includes using the grant funds as described in the grant application or approval and providing complete, accurate and timely reports, as determined by the granting entity. If a nonprofit has been (or will be) unable to comply with the terms of a grant, the first step should be to contact the granting entity to determine what alterations in the terms are possible. When compliance and alteration are not possible, the funds need to be returned to the granting entity in their entirety. Otherwise the organization should contact the Attorney General.
- ***Carefully consider fundraising costs and benefits:*** As part of a board's fiduciary duty of care, it must review how the organization raises its funds. Different models – direct donor solicitation, event-based funding, grants, or paid fundraisers – all present various opportunities and costs, which a board should weigh. In determining the value of a particular model, the board should examine the overall cost of each dollar raised and the likely reaction of the donor-base to the method chosen. If a nonprofit chooses to employ a paid fundraiser, it should compare the structure of fees charged by fundraisers. The

Attorney General has information available regarding individual fundraisers operating in Vermont, including copies of contracts between fundraisers and various charities.<sup>54</sup>

## CONCLUSION

Service on nonprofit boards is vital to keeping Vermont charities strong. To best perform in this role, board members need to understand the function of the board alongside their legal duties, rights and obligations as board members. Informed and empowered board members remain actively engaged in governing their organizations and bring the wealth of experience and knowledge that is critical to the success of a charity in carrying out its mission and fulfilling its public good.

## RESOURCES

- Print Resources:

A. Blackwood, N. Dietz & T. Pollack, *The State of Nonprofit Governance* (Urban Institute, Sept. 2014).

*Guidebook for Directors of Nonprofit Corporations*, Third Edition, American Bar Association Nonprofit Organizations Committee (Willard L. Boyd III & Jeannie Carmedelle Frey eds., 2012).

Michael W. Peregrine & James R. Schwartz, *Fiduciary Liability of Non-Profit Directors: The Fundamentals*, Governance Institute White Paper (Spring 2010).

*Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations*, 2015 Edition, Independent Sector's Panel on the Nonprofit Sector (2015), available at [https://www.independentsector.org/uploads/PrincipleResources/The\\_33\\_Principles.pdf](https://www.independentsector.org/uploads/PrincipleResources/The_33_Principles.pdf).

- Internet Resources:

**Board Source**, <https://www.boardsource.org/eweb/> (resources on bylaws, board governance and a host of other topics)

**Common Good Vermont**, <http://commongoodvt.org/learning-center/> and <https://blog.commongoodvt.org/2015/10/leading-with-intent-improving-board-leadership-governance/> (Vermont resource for board trainings, networking and other valuable materials)

**Vermont Attorney General's Office**, <http://ago.vermont.gov/focus/consumer-info/charities.php> (general information on regulating nonprofits, paid fundraisers and charitable trusts)

**Vermont Secretary of State's Office**, <https://www.sec.state.vt.us/corporationsbusiness-services/start-or-register-a-business/nonprofit-corporation.aspx> (gateway to multiple resources on incorporating a nonprofit, filing official documents, and additional guidance materials)

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**END NOTES:**

<sup>1</sup> Common Good Vermont, "Vermont's Nonprofit Sector: An Economic Driver & Vital Community Partner," (Sept. 2015), available at: <http://data.commongoodvt.org/>. The figures cited refer only to nonprofits designated by the Internal Revenue Service as tax-exempt under section 501(c)(3) that filed an IRS Form 990, and do not include private foundations.

<sup>2</sup> See 9 V.S.A. § 2471(3); 14 V.S.A. § 3412(a); 14A V.S.A. § 405(a).

<sup>3</sup> 11B V.S.A. § 17.05(3); see 11B V.S.A. § 3.01 (listing lawful purposes of nonprofits).

<sup>4</sup> A donor is technically permitted to take a tax deduction under 26 U.S.C. § 170, which references § 501(c)(3).

<sup>5</sup> 11B V.S.A. § 1.40(9).

<sup>6</sup> 11B V.S.A. § 8.04(a).

<sup>7</sup> 11B V.S.A. § 8.08(a).

<sup>8</sup> 11B V.S.A. § 10.21.

<sup>9</sup> 11B V.S.A. § 10.03.

<sup>10</sup> 11B V.S.A. § 7.01.

<sup>11</sup> 11B V.S.A. § 8.01(a).

<sup>12</sup> 11B V.S.A. § 8.01(b).

<sup>13</sup> The Vermont Secretary of State's Office has additional resources for individuals interested in establishing their own nonprofit at: <https://www.sec.state.vt.us/corporationsbusiness-services/start-or-register-a-business/nonprofit-corporation.aspx>.

<sup>14</sup> 11B V.S.A. § 2.02.

<sup>15</sup> 11B V.S.A. § 2.06.

<sup>16</sup> The Vermont Secretary of State's Office provides basic resources for drafting bylaws: <https://www.sec.state.vt.us/corporationsbusiness-services/start-or-register-a-business/nonprofit-corporation/nonprofit-bylaws.aspx>.

<sup>17</sup> See generally, Title 11B, chapter 10, Vermont Statutes Annotated.

<sup>18</sup> 11B V.S.A. § 8.03(a).

<sup>19</sup> 11B V.S.A. § 8.13.

<sup>20</sup> 11B V.S.A. § 8.04.

<sup>21</sup> 11B V.S.A. § 8.04(a).

<sup>22</sup> 11B V.S.A. § 8.02.

<sup>23</sup> 11B V.S.A. § 8.05(a).

<sup>24</sup> 11B V.S.A. § 8.40(a). The law permits an organization's bylaws or Articles to dictate an different number of officers, but it is not recommended to have fewer than the three noted here.

<sup>25</sup> 11B V.S.A. § 8.40(c).

<sup>26</sup> 11B V.S.A. § 8.40(b).

<sup>27</sup> 11B V.S.A. § 8.24. An organization's bylaws can require a larger quorum (i.e., more than a majority of the board), but it cannot be smaller than a majority of current board members.

<sup>28</sup> 11B V.S.A. § 8.24(c).

<sup>29</sup> 11B V.S.A. § 8.20(c).

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<sup>30</sup> 11B V.S.A. § 8.21 (requiring all members of the board to consent in writing to an action taken without a meeting).

<sup>31</sup> 11B V.S.A. § 8.25.

<sup>32</sup> 11B V.S.A. § 16.01(a).

<sup>33</sup> 11B V.S.A. § 16.01(b).

<sup>34</sup> 11B V.S.A. § 16.02(a).

<sup>35</sup> 11B V.S.A. § 8.30(a)(2).

<sup>36</sup> 11B V.S.A. § 8.30(a)(1), (3).

<sup>37</sup> 11B V.S.A. § 8.31.

<sup>38</sup> 11B V.S.A. § 8.32.

<sup>39</sup> 12 V.S.A. § 5781.

<sup>40</sup> The Vermont State Auditor has additional resources on internal financial controls. Visit: <http://auditor.vermont.gov/localgovernment> for more information.

<sup>41</sup> 11B V.S.A. § 16.22.

<sup>42</sup> 26 U.S.C. § 6033(b).

<sup>43</sup> In certain circumstances, nonprofits are required to pay tax on unrelated business income. See IRS, Publication 598, “Tax on Unrelated Business Income of Exempt Organizations” (Jan. 2015), available at: <https://www.irs.gov/pub/irs-pdf/p598.pdf>.

<sup>44</sup> 26 U.S.C. § 6104(a)(1)(A).

<sup>45</sup> See 14A V.S.A. §§ 801-817.

<sup>46</sup> 14A V.S.A. § 801.

<sup>47</sup> 14A V.S.A. § 806.

<sup>48</sup> Depending on the nature of the gift in question, Vermont law provides a number of different options for modifying the restrictions. See 14 V.S.A. § 3411-20 (Uniform Prudent Management of Institutional Funds Act); 14A V.S.A. § 412 (modification or termination because of unanticipated circumstances or inability to administer the trust effectively); 14A V.S.A. § 413 (cy pres – modification or termination of a charitable trust when its purpose has become unlawful, impracticable, impossible to achieve, or wasteful).

<sup>49</sup> See Office of Management and Budget, Circular A-133, “Audits of States, Local Governments, and Non-Profit Organizations,” (June 1997), 2014 supplement available at:

[https://www.whitehouse.gov/omb/circulars/a133\\_compliance\\_supplement\\_2014](https://www.whitehouse.gov/omb/circulars/a133_compliance_supplement_2014); Vermont Agency of Administration, Bulletin No. 5, “Policy for Grant Issuance and Monitoring,” (Dec. 2014), available at: [http://finance.vermont.gov/policies\\_procedures/subrecipient\\_monitoring](http://finance.vermont.gov/policies_procedures/subrecipient_monitoring)

<sup>50</sup> 9 V.S.A. § 2475(b), see generally 9 V.S.A. § 2453.

<sup>51</sup> See 14A V.S.A. §§ 405, 413; *Wilbur v. University of Vermont*, 129 Vt. 33, 44 (1970); *President & Fellows of Middlebury Coll. v. Cent. Power Corp. of Vt.*, 101 Vt. 325, 343 (1928).

<sup>52</sup> See 14 V.S.A. § 3416; 14A V.S.A. §§ 110(d), 405, 413, 813.

<sup>53</sup> 14A V.S.A. § 405(c).

<sup>54</sup> See <http://ago.vermont.gov/focus/consumer-info/charities.php>.