

COMPLIANCE AND THE BOARD OF DIRECTORS



Role of the Board

The board's role is to oversee the management and governance of the organization and to monitor senior management's performance.

The board is responsible for assuring that the organization's work is consistent with its mission and that it complies with applicable laws.

Areas of Responsibility

Nonprofit board members have three fundamental areas of legal and fiduciary responsibility:

1. the duty of care
2. the duty of loyalty, and
3. the duty of obedience.

Duty of Care

The duty of care requires that a nonprofit board member participate actively in governance and oversight of an organization's activities.

This includes:

- ▶ attending board and committee meetings,
- ▶ reviewing and understanding the organization's financial documents,
- ▶ helping to frame strategic plans,
- ▶ identifying and managing risks as well as opportunities, and
- ▶ taking prudent steps to advance the organization's mission and goals.

Duty of Loyalty

- ▶ The duty of loyalty requires that a nonprofit board member act in the best interest of the organization at all times.
- ▶ This includes identifying and disclosing potential conflicts of interest before joining the board, and when they arise.
- ▶ When a potential conflict exists, board members must follow conflict of interest management steps as mandated by law and recommended in good governance guidelines. (Note: New York State law requires that all nonprofits have a written Conflict of Interest Policy.)

Duty of Obedience

- ▶ The duty of obedience requires that a nonprofit board member work to ensure that the organization complies with applicable laws and regulations, acts in accordance with its own policies, and carries out its mission appropriately.
- ▶ Board members should ensure that their organization carries out its purpose and does not engage in unauthorized activities.

Board's Policy Role

In its role as an oversight body, the nonprofit board sets and confirms policies that govern how the organization will be managed.

Policies for consideration include the following:

- ▶ The Nonprofit Revitalization Act of 2013 established requirements for nonprofit board policies. All nonprofits soliciting donations in New York State, whether or not they are incorporated or located in the state, are required to have a board-approved **Conflict of Interest policy**.
- ▶ If a nonprofit has over \$1 million in annual income and 20 or more employees, New York State law requires that such an organization have a **Whistleblower policy** and related procedures.



Tone from the Top

- ▶ The tone from the top is critical to providing a clear directive for the organization and employees on the importance of compliance with applicable laws, rules and regulations as well as policies established by the organization.
- ▶ The board of directors plays a critical role in setting the right tone.
- ▶ Chapter 8 of the Sentencing Guidelines Manual of the U.S. Sentencing Commission states: ***“The organization’s governing authority shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program.”***

Tone from the Top (continued)

Section 9-28.800 of the U.S. Attorneys' Manual, which addresses the role of corporate compliance programs when considering whether to charge company officers, directors and employees for criminal misconduct: “**[D]o the corporation's directors exercise independent review over proposed corporate actions rather than unquestioningly ratifying officers' recommendations; ...and have the directors established an information and reporting system in the organization reasonably designed to provide management and directors with timely and accurate information sufficient to allow them to reach an informed decision regarding the organization's compliance with the law. See, e.g., In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 968-70 (Del. Ch. 1996).**”

Tone from the Top (continued)

- ▶ The *Caremark* decision held that directors could, in certain circumstances, be determined to have breached their fiduciary duty and, therefore, be liable for compliance program failures if they knew or should have known about violations and did nothing to prevent – or did not make sure that the company's systems were reasonably designed to prevent – compliance breaches.
- ▶ The 2006 Delaware Supreme Court decision held in *Stone v. Ritter* that a director's failure to implement and oversee aspects of a compliance program could constitute an indemnifiable breach of the duty of loyalty.

Tone from the Top (continued)

In *re Lemington Home for the Aged*, Official Committee Of Unsecured Creditors, 777 F.3d 620 (3rd Cir. 2015), the court held that:

- ▶ Personal liability may result from breach of fiduciary duties.
- ▶ Directors breached duty of care by failing to exercise reasonable diligence and prudence over the institution and its poorly performing management team.
- ▶ The CEO was allowed to work on part-time basis in violation of state law

Compliance Oversight

Consider both the quantity and quality of time the board actually spends in compliance oversight:

- ▶ Can each director name the organization's Chief Compliance Officer (CCO)?
- ▶ Does the CCO have direct access to the board and utilize that access regularly?
- ▶ Does the board understand how the compliance function is structured and operates?

Compliance Oversight (continued)

- ▶ Is the board satisfied that the company's compliance function matches up with the company's strategic plan and risk appetite?
- ▶ Does the board understand its responsibilities in the event of a compliance breach?
- ▶ Does the board periodically review the company's compliance training program and itself participate in regular compliance training?

Compliance Oversight (continued)

It is not enough for the board to simply assume without knowing that management has established a proper compliance culture that permeates the entire company. Rather, the board must affirmatively confirm and reconfirm that to be the case.

**“If you think
compliance is
expensive –
try non-compliance.”**

Former U.S. Deputy Attorney General Paul McNulty