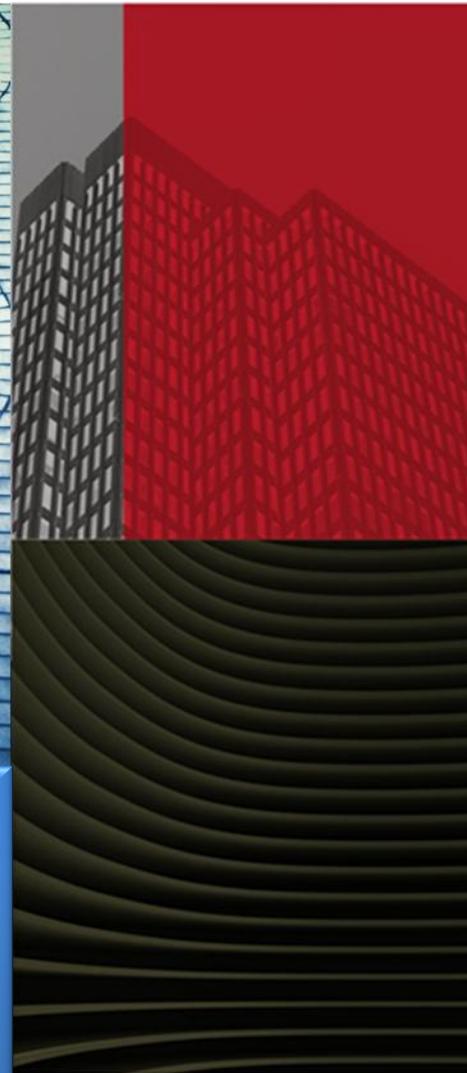




# NEW YORK NON-PROFITS: WHAT YOU NEED TO KNOW ABOUT THE NEW YORK NON-PROFIT REVITALIZATION ACT

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# NON-PROFIT REVITALIZATION ACT OF 2013 NEED FOR REFORM

- > The Act is the most comprehensive revision of the New York Not-for-Profit Corporation Law (“NPCL”) in over 40 years.
- > Prior to the Act, non-profits have faced:
  - > Antiquated requirements
  - > Unnecessary costs and delays
  - > Insufficient guidance on fiduciary responsibility

# NON-PROFIT REVITALIZATION ACT OF 2013 CHAPTER 549 OF THE LAWS OF 2013

- > Passed by the NY Legislature on June 21, 2013
- > Signed by Gov. Cuomo on December 18, 2013
- > Technical and other changes made on May 20, 2014
- > Delay of effective date of certain provisions approved on June 30, 2014

# EFFECTIVE DATE

Most provisions took effect July 1, 2014, but some have a later effective date.

# WHO IS SUBJECT TO THE NEW LAW?

- > The law applies to New York not-for-profit corporations, including New York education corporations and New York religious corporations.
- > Certain provisions also apply to New York charitable trusts.
- > Certain provisions also apply specifically to non-New York corporations and trusts registered with the AG to solicit charitable contributions in New York.

# PURPOSES

## **The purposes of the Non-Profit Revitalization Act are:**

- > to reduce unnecessary and outdated burdens on non-profits; and
- > to enhance non-profit governance and oversight to prevent fraud and improve public trust.
- > The Act was based on recommendations by a committee convened by Attorney General Schneiderman. They issued a report on February 16, 2012. [www.ag.ny.gov](http://www.ag.ny.gov)

# BOARD GOVERNANCE HIGHLIGHTS

## Highlights of the Act relating to Board Governance practices include:

- Independent director rules
- Related Party Transaction rules
- Conflict of Interest policy
- Whistleblower policy
- Audit oversight rules
- Board governance provisions

***“Best practices are now mandatory”***

# INDEPENDENT DIRECTORS

The act requires non-profits to assign certain votes and responsibilities to “independent directors”

- > conflict of interest matters
- > whistleblower policy matters
- > certain audit matters

An **“INDEPENDENT DIRECTOR”** is defined as a director who:

- (i) is not, and has not been within the last three years, an employee of the corporation or an affiliate, and does not have a **relative** who is, or has been within the last three years, a key employee of the corporation or an affiliate;
- (ii) has not received, and does not have a relative who has received, in any of the last three fiscal years, more than \$10,000 in direct compensation from the corporation or an affiliate (other than reimbursement for expenses reasonably incurred as a director or reasonable compensation for service as a director); and
- (iii) is not a current employee of or does not have a **substantial financial interest** in, and does not have a relative who is a current officer of or has a substantial financial interest in, any entity that has made payments to, or received payments from, the corporation or an affiliate for property or services in an amount which, in any of the last three fiscal years, exceeds the lesser of \$25,000 or 2% of such entity's consolidated gross revenues. (In terms of “payments,” membership dues count, but charitable contributions do not.)

# INDEPENDENT DIRECTORS, CONT.

## TAKEAWAY LESSON

Non-profits should:

- > determine and continuously monitor which directors are “independent”
- > consider using an “independent director” questionnaire form
- > Ensure the non-profit has enough independent directors and that they handle the appropriate matters

# RELATED PARTY TRANSACTIONS

A “**Related Party Transaction**” is defined as any transaction, agreement or any other arrangement in which a related party has a financial interest and in which the non-profit corporation or charitable trust or any affiliate thereof is a participant.

# RELATED PARTY TRANSACTIONS, CONT.

A “**Related Party**” is:

- > any **director, trustee, officer, or key employee** of the non-profit corporation or charitable trust (**or any affiliate**);
- > any of their respective relatives; or
- > any entity in which any individual described above has a 35% or greater **ownership or beneficial interest**, or, in the case of a partnership or professional corporation, a direct or indirect ownership interest in excess of 5%.

## RELATED PARTY TRANSACTIONS, CONT.

No non-profit corporation or charitable trust shall enter into any related party transaction unless the transaction is determined by the Board to be **fair, reasonable and in the corporation's (or charitable trust's) best interest** at the time of such determination. Any director, officer or key employee who has an interest in a related party transaction shall disclose in good faith to the Board or Board committee the material facts concerning such interest.

# RELATED PARTY TRANSACTIONS, CONT.

Enhanced review is required of charitable corporations and trusts if a related party has a **substantial financial interest** in the transaction. The Board or Board committee must:

- > consider alternatives to the extent available;
- > approve the transaction by at least a majority vote; and
- > contemporaneously document in writing the basis for its approval including consideration of alternative transactions

“***Substantial financial interest***” is not defined.

# RELATED PARTY TRANSACTIONS, CONT.

**Related Parties are not permitted to participate in deliberations or voting on Related Party Transaction matters.**

- > BUT, any director, officer, or key employee who has an interest in a Related Party Transaction **must disclose the material facts** concerning such interest in good faith to the Board or committee.
- > A Related Party **may provide information** concerning a Related Party Transaction prior to the commencement of deliberations or voting on the Related Party Transaction upon request.

# RELATED PARTY TRANSACTIONS, CONT. *AUTHORITY OF THE ATTORNEY GENERAL*

The Act clarifies that the AG may begin an action to enjoin, void or rescind any related party transaction or proposed related party transaction that:

- > **violates any provision of the NPCL;** or
- > was otherwise **not reasonable or in the best interests** of the non-profit corporation or charitable trust at the time the transaction was approved.

# RELATED PARTY TRANSACTIONS, CONT. *AUTHORITY OF THE ATTORNEY GENERAL*

- > The AG may also seek other relief, including, for example, restitution, removal of directors, trustees, or officers, or, in the case of willful and intentional conduct, payment of an amount up to double the amount of any benefit improperly obtained.

# RELATED PARTY TRANSACTIONS, CONT.

## TAKEAWAY LESSON

**All New York non-profits, including charitable trusts, need to:**

- > Approve all related party transactions and document that each is determined to be fair, reasonable and in the corporation's best interest; and
- > if there is a substantial financial interest, document the consideration of alternatives.

# CONFLICT OF INTEREST POLICY

The Act requires all non-profits to adopt a written conflict of interest policy

- > The policy must cover directors, officers, and “key employees.”
- > A “**KEY EMPLOYEE**” means any person who is in a position to exercise substantial influence over the affairs of the corporation, as referenced in the IRS rules on excess benefit transactions with disqualified persons. *It includes a CFO, for example, but not a low level employee.*

## CONFLICT OF INTEREST POLICY, CONT.

**Is there a distinction between a related party transaction and a conflict of interest?**

# CONFLICT OF INTEREST POLICY, CONT.

**While the Act defines the circumstances that constitute a related party transaction, the Act does not define the circumstances that constitute a conflict of interest.**

- > Under the Act, a non-profit must define “conflict of interest,” which must at least include related party transactions and can include more.
- > According to the IRS, “A conflict of interest arises when a person in a position of authority over an organization, such as a director, officer, or manager, may benefit personally from a decision he or she could make.”

# CONFLICT OF INTEREST POLICY, CONT.

## **The new Conflict of Interest Policy must:**

- > Define circumstances constituting a conflict of interest (COI)
- > Establish procedures for disclosing, addressing and documenting COI and Related Party Transactions
- > Prohibit the conflicted person from being present at, participating in, or improperly influencing the vote
- > Require documentation of existence and resolution of COI
- > Require compliance with related party rules
- > Require annual COI statement be signed by all Directors

# CONFLICT OF INTEREST POLICY, CONT.

## PRE-ELECTION & ANNUAL COI STATEMENT

### **Required Conflict of Interest Statement:**

- > Must be signed by all directors (1) before initial election, and (2) annually.
- > Must identify entities with which the director is affiliated and the non-profit has a relationship
- > Must identify transactions the director is involved in that might present a conflict
- > Secretary must give copy to Audit Committee or Board.

*NOTE: COI statement need not be submitted by officers or key employees*

# CONFLICT OF INTEREST POLICY, CONT.

- > Many non-profit corporations have the standard conflict of interest policy suggested by the IRS. Sometimes the policy is part of a Corporation's By-Laws. Other non-profits have a stand-alone policy.
- > Non-profits need not adopt a new COI policy if its existing policy is “substantially consistent” with new law.
  - > Unclear if IRS policy would be acceptable, but we recommend updating COI policies

# CONFLICT OF INTEREST POLICY, CONT.

## TAKEAWAY LESSON

All New York non-profits, including charitable trusts, need to:

1. Review and update conflict of interest policies
2. Start using a pre-election and annual conflict of interest statement form
3. Have independent directors handle conflict of interest matters

# WHISTLEBLOWER POLICY

The new law requires non-profit corporations and charitable trusts with **20 or more employees** AND annual revenue **exceeding \$1 million** to adopt a Whistleblower Policy.

- > Whistleblower policy can be made part of the By-Laws or adopted as a standalone policy.
- > Those organizations that have adopted a whistleblower policy pursuant to federal, state or local law that is substantially consistent with the requirements of the Act will be deemed to be in compliance.

## WHISTLEBLOWER POLICY, CONT.

The purpose of a whistleblower policy is to **protect from intimidation, harassment, discrimination or other retaliation** persons who **in good faith** report improper conduct. The policy must protect directors, officers, employees and volunteers who in good faith report action or suspected action taken by or within the corporation or charitable trust that is **illegal, fraudulent or in violation of any policy** of the corporation or charitable trust.

# WHISTLEBLOWER POLICY, CONT.

## **The Whistleblower Policy must:**

- > set forth procedures for reporting violations
- > designate an employee, officer or director to administer the policy and report to the Board or Board committee
- > provide that a copy of the policy will be distributed to all directors, officers, employees and to volunteers who provide “**substantial services**” (*not defined*)

# WHISTLEBLOWER POLICY, CONT.

## TAKEAWAY LESSON

Certain New York non-profits and charitable trusts must:

1. adopt a Whistleblower Policy;
2. have independent directors handle whistleblower matters;  
and
3. distribute Whistleblower Policy to directors, officers, employees and volunteers who provide “substantial services”

*Distribute when? Not clear, but we recommend immediately, if not already distributed and thereafter a copy to all new directors, officers, employees and volunteers.*

# NEW AUDIT REQUIREMENTS

- > New audit oversight requirements apply to New York (and possibly foreign) non-profits **that solicit contributions in New York State AND** which are required to file an independent CPA **audit report** with the New York State Charities Bureau.
- > Only **independent directors** may deliberate or vote on audit matters.

# NEW AUDIT REQUIREMENTS, CONT.

**Which entities are required to file an independent CPA audit report with the Charities Bureau?**

In general, **charities that solicit contributions in New York State** are required by the Executive Law to register with the NYS Charities Bureau and file annual reports. Only charities meeting certain gross revenue thresholds are required to submit an independent CPA's review or audit with their annual report.

*Good news for smaller charities.*

# NEW AUDIT REQUIREMENTS, CONT.

## NEW REVENUE THRESHOLDS FOR FINANCIAL REPORTING

Annual Gross Revenue and Support Levels	Unaudited Financial Report on Form Prescribed by the AG	File Annual Financial Report with Independent <u>CPA Review Report</u>	File Annual Financial Report with Independent <u>CPA Audit Report</u>
<b>Current</b>	Less than \$100,000	At least \$100,000, but not more than \$250,000	<b>Greater than \$250,000</b>
<b>Effective July 1, 2014</b>	Less than \$250,000	At least \$250,000, but not more than \$500,000	<b>Greater than \$500,000</b>
<b>Effective July 1, 2017</b>	Less than \$250,000	At least \$250,000, but not more than \$750,000	<b>Greater than \$750,000</b>
<b>Effective July 1, 2021</b>	Less than \$250,000	At least \$250,000, but not more than \$1,000,000	<b>Greater than \$1,000,000</b>

# NEW AUDIT REQUIREMENTS, CONT.

The Act requires charities to use **independent directors** or an Audit Committee (comprised of all independent directors) to:

- > Oversee accounting and financial reporting processes
- > Oversee audit of non-profit's financial statements
- > Retain an auditor annually
- > Review audit results with auditor

*NOTE: Corporations and trusts with less \$10 million in revenues in last fiscal year have a grace period until January 1, 2015 to comply with the new audit committee requirements.*

# NEW AUDIT REQUIREMENTS, CONT.

**For charities with more than \$1 million revenue, there are additional steps and procedures:**

- > Review scope and planning with auditor prior to audit
- > Following audit, review material weaknesses, restrictions on scope, significant disagreements, and adequacy of audit processes
- > Annually consider auditor's performance and independence

# NEW AUDIT REQUIREMENTS, CONT.

## TAKEAWAY LESSON

New York (and possibly foreign) charities required to register with the Charities Bureau to solicit contributions and which meet the gross revenue thresholds should:

- > be aware of the new financial reporting thresholds
- > where an audit is required, follow the new audit oversight rules and procedures
- > have independent directors handle audit issues through an audit committee

# BOARD MANAGEMENT

**Starting January 1, 2016**, no employee can serve as Chair of the Board or hold any other title with similar responsibilities.

# COMPENSATION

- > **Starting July 1, 2014**, no person may be present at or participate in any Board or committee deliberation or vote concerning his or her compensation; provided such person may present information as background or answer questions at a committee or Board meeting prior to the commencement of deliberations or voting on such compensation.

# BOARD MANAGEMENT AND COMPENSATION, CONT.

## TAKEAWAY LESSON

- > Prior to January 1, 2016, figure out any necessary changes so that the Chair of the Board is not an employee.

# MODERNIZATION HIGHLIGHTS

## **Highlights of the Act relating to streamlined and modernized procedures include:**

- Electronic Communications
- Modernized and simplified procedures
- Board Committees

# ELECTRONIC COMMUNICATIONS

The Act allows **fax and email communications** for:

- > notices of Board and member meetings
- > waivers of notice
- > Board and member unanimous written consents
- > authorizing member proxies

**Also, directors may participate in Board and committee meetings by “electronic video screen communication”** (e.g., Skype) as long as all persons participating can hear each other at the same time and each director can participate in all matters before the Board or committee.

# OTHER MODERNIZATIONS

- > Easier to incorporate and amend the certificate of incorporation
- > Easier to merge, dissolve or sell “all or substantially all” assets – now need only one-step approval process (either Supreme Court or AG approval) instead of the more burdensome two-step process under old law
- > Easier for Board to approve real estate transactions
- > Easier for religious corporations and education corporations to merge – old law permitted only consolidation
- > Minimize NYS Department of Education signoff – speed up incorporation and amendment process

# BOARD COMMITTEES

- > No more distinction between standing committees and special committees of the Board
- > Effective as of July 1, 2014, there will be only **committees of the Board** and **committees of the corporation**.
  - > All members of committees of the Board must be board members.
  - > Committees of the corporation may consist of non-Board members; however, they cannot bind the Board.

# MODERNIZATION HIGHLIGHTS, CONT...

## TAKEAWAY LESSON

- > Update By-Laws (and the Certificate of Incorporation if necessary) to follow the modernized provisions.

# SUMMARY OF TAKEAWAY LESSONS

1. Determine and continuously monitor which directors are “independent”
2. Consider using an “independent director” questionnaire form
3. Starting July 1, 2014, ensure the non-profit has enough independent directors and that they handle the appropriate matters
4. Beginning on July 1, all New York non-profits, including charitable trusts, need to:
  - > Approve all related party transactions and document that each is determined to be fair, reasonable and in the corporation’s best interest; and
  - > if there is a substantial financial interest, document the consideration of alternatives
5. Review and update conflict of interest policy
6. Use a pre-election and annual conflict of interest statement form.
7. Have independent directors handle conflict of interest, audit oversight and whistleblower matters
8. Document that any approved related party transaction was determined to be fair, reasonable and in the corporation’s best interest, and if there is a substantial financial interest, document the consideration of alternatives
9. By July 1, 2014, certain New York non-profits, including charitable trusts, need to
  - > Adopt a Whistleblower Policy, and
  - > Have independent directors handle whistleblower matters
  - > Distribute to all directors, officers, employees and to volunteers who provide “substantial services”.

# SUMMARY OF TAKEAWAY LESSONS, CONTINUED

10. New York (and possibly foreign) charities required to register with the Charities Bureau to solicit contributions and which meet the gross revenue thresholds should:
  - > be aware of the new thresholds
  - > where an audit is required, follow the new audit oversight rules and procedures.
  - > have independent directors (or an audit committee comprised of independent D's) handle audit oversight issues
11. Prior to January 1, 2016, figure out the necessary changes so that the Chair is not an employee.
12. Update By-Laws (and the Certificate of Incorporation if necessary) to follow the modernized provisions.

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