



*This article presents general guidelines for Georgia nonprofit organizations and should not be construed as legal advice. Always consult an attorney to address your particular situation.*

## **FIDUCIARY DUTIES OF GEORGIA NONPROFIT DIRECTORS**

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When serving on the board of directors of a Georgia nonprofit corporation, a director must fulfill certain legal responsibilities to the organization. These obligations include the fiduciary duties of care, loyalty, and obedience. These duties are described below along with practical suggestions that may assist a director in carrying out these duties.

**1. Duty of Care.** In managing and overseeing a nonprofit organization, a director must act with the care that an ordinary, prudent person in a like position would exercise under similar circumstances. In discharging this duty, the director should participate actively in the management of the organization and inquire reasonably into fundamental matters involving the operations of the organization. Active participation will typically include attending periodic meetings of the board, evaluating reports, reading minutes, and reviewing the performance of the chief executive officer. Reasonable inquiry may also include requesting and reviewing information from the organization's management or agents (e.g., accountants, lawyers and consultants).

**2. Duty of Loyalty.** Directors also have a duty to give their undivided loyalty to the organization. Decisions regarding the organization's assets and activities must promote the organization's nonprofit purpose and not promote any private or individual interests. The board should scrutinize closely any potential conflict-of-interest transactions with the expectation that the public will be skeptical of any such arrangements. Under certain circumstances, a contract or transaction between a nonprofit organization and its director, or between a nonprofit organization and an organization in which the nonprofit's director has a material financial interest, may be not only be acceptable but in the nonprofit organization's interest. However, if the transaction is challenged, the director will have the burden of establishing that the contract or transaction is fair and reasonable, that there was full disclosure of the conflict and that the contract or transaction was approved by disinterested board members in good faith.

Federal tax rules also may bear on the director's duty of loyalty. In 1996, Congress imposed intermediate sanctions – a tax on “excess benefit transactions” – on individuals involved in transactions with tax-exempt public charities that result in private benefit. The legislation gave the IRS a way to penalize the persons engaged in the transaction (rather than the nonprofit alone) and provided an alternative to the revocation of the nonprofit's tax-exempt status. Under the intermediate sanction rules, the persons who benefit from the transaction (and in some cases the board and committee members who approve the transaction) may be penalized for excess benefit transactions. Examples of excess benefit transactions may include payment of excessive compensation and the sale of property or assets, leases, loans, provision of goods, services, and facilities on other than fair market value terms. The excess benefit doctrine does not prohibit transactions between the nonprofit and individuals who control or are otherwise close to it (except in the case of private foundations), but requires instead that the transactions satisfy a test of reasonableness. The reasonableness test compares the transaction to a similar one engaged in by like organizations, acting with prudence in similar

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circumstances, and may include an analysis of the arm's-length nature of the transaction, the costs, and similar elements.

**3. Duty of Obedience.** A third obligation of a director is the duty of obedience. Directors have a duty to follow the organization's governing documents (such as the articles of incorporation and the bylaws), to carry out the organization's mission, and to ensure that resources are used for lawful purposes consistent with the organization's mission.

## **MINIMIZING THE POTENTIAL FOR DIRECTOR LIABILITY**

1. **Analyze.** The standard for liability in most cases is what the director knew or should have known. Therefore, a director should critically analyze reports, financial data and other available information about the management and operation of the organization.
2. **Attend.** A director should regularly attend board meetings and meetings of committees on which he or she sits. If a director cannot attend a significant percentage of the meetings, he or she should consider whether continued service as a director is appropriate.
3. **Review Bylaws.** A director should review the nonprofit's bylaws to ensure the charity is acting within the scope of its mission and that the director individually is fulfilling his or her responsibilities.
4. **Notify.** Insist on proper notice requirements being fulfilled for any meetings in which major items of business are to be discussed. If adequate notice is not given, then the board might lack the authority to undertake proposed actions. This is particularly important for sensitive issues such as removing a fellow board member. In addition, make sure there is sufficient opportunity to review written materials in advance of board meetings so that directors will be educated on the matters to be addressed.
5. **Read.** Read all meeting minutes, financial statements, budget proposals, and other reports.
6. **Question and Investigate.** Question reports when obvious inconsistencies appear. Take steps to investigate and rectify problems. If a director suspects improprieties, he or she should pursue the information. Potential problems should not be ignored.
7. **Communicate.** The board should have open communication with more than one staff member. It is very important that staff or a subgroup of the board not control information flow. If all information filters through one person, then the board might not get key information, particularly on issues regarding that staff member.
8. **Seek Advice.** When dealing with complex matters, seek expert advice. The board can rely generally on conclusions of reputable experts.
9. **Ensure Accuracy.** Ensure that accurate minutes are made, discussions and votes are recorded. This is particularly important on controversial or divisive topics, so that it is clear that the process leading to the decision was proper.
10. **Abide by Policies.** Abide by the corporate policies, particularly conflict-of-interest policies. Make sure that potential conflicts are exposed before any action is taken. Make sure a transaction in which a conflict exists is fair to the organization before authorizing the corporation to enter into the transaction.

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